

MONGOLIA UPGRADES ITS CAPITAL MARKETS

BY JOHN VIVERITO AND MYLES HANKIN

After more than six years of consideration, the Mongolian parliament is expected to adopt a new securities markets law later this year to replace the existing law, which will be a major step in Mongolia's recent efforts to bring its capital markets up to world-class standards. The need for a new law is driven primarily by the rapid development of the Mongolian economy over the past few years and the desire to capture a larger share of the benefits of that development domestically, which is predicated on a strong and robust legal and regulatory regime that gives comfort to investors as being on par with more developed jurisdictions.

Without a doubt, Mongolia's recent economic growth has been nothing short of phenomenal: real gross domestic product grew by 17.3% in 2011, according to preliminary estimates from the National Statistical Office of Mongolia, following 6.1% growth in 2010 (driven in large part by the mining sector, which generated more than 20% of Mongolia's 2010 GDP). Looking forward, this growth is widely expected to show no signs of slowing, with The Economist estimating that Mongolia's GDP will expand by nearly 15% in 2012. Foreign investors have most assuredly taken notice of these developments, and indeed foreign direct investment in Mongolia increased by 120% in 2011, according to The Economist.

Before delving into the key improvements advanced in the draft of the new law, it is worth briefly mentioning a parallel project with a similar goal of raising the caliber of Mongolia's capital markets in order to retain a larger share of Mongolia's economic growth domestically. In April 2011, Mongolian Stock Exchange, known as the MSE, entered into a strategic partnership with London Stock Exchange plc, an initiative that was spearheaded by Sükhbaataryn Batbold, the prime minister of Mongolia. The goal of the strategic partnership is to leverage LSE's experience and resources with the aim of modernizing the MSE and transforming it into a first-class market. Under their partnership arrangements:

- LSE has nominated some of the members of the MSE's board of directors and mobilized a management team to supplement the MSE's own management and to provide knowledge, experience and expertise on managing and operating exchanges in accordance with international standards.
- LSE is providing market technology such as software licensing, training, maintenance and configuration services in order to enhance the MSE's operational capabilities.
- LSE is holding training programs for MSE staff, regulatory authorities and other market actors in subjects such as global capital markets, corporate governance, initial public offerings and post-trade development.
- LSE is offering advice and assistance on how to develop and

eventually privatize the MSE, including structuring and organization, legal and regulatory reform, market surveillance and public education.

In line with the anticipated benefits to be realized from the LSE partnership, the draft of the new securities law affords a number of improvements over the existing law and more fully reflects prevailing international standards. Key upgrades of the new law over the existing law include the following:

- The existing law requires a company issuing securities in Mongolia to be registered in Mongolia, which would require the company to observe all Mongolian laws. This is an obvious deterrent to secondary listings in Mongolia by foreign companies with Mongolian assets or operations that are already listed overseas, as those companies will already be subject to the legal and regulatory regimes of their jurisdictions of incorporation (and the jurisdictions where they are listed, if different), and compliance with both the Mongolian and the foreign regimes would likely be excessively onerous if not impossible due to overlapping, inconsistent or conflicting requirements.

By contrast, the new law does not require companies issuing securities in Mongolia actually to be registered there, and expressly permits a company whose securities are listed abroad to list and trade its securities on a Mongolian exchange as well. The new law allows for the legal and regulatory framework governing such companies in Mongolia to differ from the framework applicable to Mongolian companies in order to avoid compulsory dual compliance, and further states as a general rule that a person registered abroad will not be considered as having operations in Mongolia simply because it issues securities there.

- The existing law does not recognize the concept of depository receipts, which are issued by a custodian or similar entity holding securities issued by another entity and carry rights in those other underlying securities. By comparison, the draft of the new law explicitly contemplates the domestic issuance of depository receipts whose underlying securities are traded on a foreign exchange (and introduces a legal-versus-beneficial ownership distinction as discussed below, which is a necessary precursor to any depository receipts regime). Combined with its loosening of the requirement for companies seeking a secondary MSE listing to comply with the Mongolian legal regime in its entirety, the net effect of the draft law is to make secondary MSE listings much more attractive and feasible.
- The existing law fails to make a distinction between legal-versus-beneficial ownership, and as such does not recognize arrange-

ments whereby the person actually entitled to the benefits of ownership of securities (the beneficial owner) is different from the person registered as the owner of the securities (the legal owner). Similarly, the existing law does not recognize custodial, trustee or similar types of arrangements that are underpinned by a split of legal and beneficial ownership. As a result, only registered holders of securities are legally recognized, which means that the law does not consider clients or beneficiaries to have any ownership interest in securities that are held for them by brokers, nominees or custodians. The new law remedies this deficiency by introducing a clear legal-versus-beneficial ownership distinction and by permitting trustee and custodial services to be provided to beneficial owners, thereby laying the groundwork for the types of broker, trustee and custodial services that are commonplace in more developed jurisdictions and making the Mongolian capital markets much more appealing to foreign investors.

Other enhancements incorporated into the new law include the following:

- It more explicitly defines various securities market terms and prospectus requirements.
- It more specifically sets out broker, dealer and underwriter responsibilities.
- It strengthens disclosure and transparency requirements.
- It incorporates parts of the official listing rules from the U.K. Financial Services Act to provide a legislative framework for listing and for operation of listed companies.
- It lays out the framework for settling trades in clear terms based on a "T+3" system whereby securities trades are settled via delivery and payment within three business days after the trade is initiated,

which is consistent with general international practice (as opposed to the current system whereby all trades must be prefunded).

Once the MSE modernization process is completed and the new securities markets law is adopted, hopes are that Mongolia will become even more enticing as a location for foreign investors and for Mongolian companies and foreign-listed companies with a Mongolia nexus considering an IPO or a dual listing. To be sure, a number of foreign-listed companies have assets or operations in Mongolia and would thus appear as suitable candidates for a secondary or tertiary listing in Mongolia, including Mongolian Mining Corp. and Mongolia Energy Corp. Ltd. (both listed in Hong Kong), Prophecy Coal Corp. (listed in Toronto), SouthGobi Resources Ltd. (listed in Hong Kong and Toronto), Aspire Mining Ltd. and Xanadu Mines Ltd. (both listed in Australia), and Petro Matad Ltd. (listed on the LSE).

The scheduled MSE listing later this year of Erdenes Tavan Tolgoi, the owner of the world's largest untapped coking coal deposit, worth an estimated \$10 billion, as part of a global IPO that also includes the London and Hong Kong exchanges should set a high-profile and compelling precedent for local IPOs, which could encourage other companies to list locally as well, particularly if the MSE and securities markets law upgrades are fully implemented by then as currently planned. Together, these events should put the Mongolian capital markets on a firm path toward modernization, which will undoubtedly benefit the country as a whole and further enhance Mongolia's profile in the eyes of investors.

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