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Competitiveness Project*

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ABBREVIATION AND ACRONYMS

ACCA	Association of Chartered Certified Accountants
AIMR	Association of Investment Management Research
ADB	Asian Development Bank
BoM	Bank of Mongolia
CFA	Chartered Financial Analyst
CGRI	Corporate Governance Rating Index
EPRC	Economic Policy Reform and Competitiveness Project
EBRD	European Bank for Reconstruction and Development
FEAS	Federation of Eurasian Stock Exchanges
FRC	Financial Regulatory Commission
GDP	Gross Domestic Product
GoM	Government of Mongolia
IFAC	International Federation of Accountants
IFC	International Finance Corporation
IMF	International Monetary Fund
IOSCO	International Organization for Securities Commission
IPOs	Initial Public Offerings
MBA	Master of Business Administration
MoF	Ministry of Finance
MONEF	Mongolian Employers' Federation
MNCCI	Mongolian National Chamber of Commerce and Industry
MSE	Mongolian Stock Exchange
NBFI	Non-Bank Financial Institutions
OECD	Organization for Economic Co-operation and Development
SOE	State Owned Enterprises
SLC	Mongolian Savings and Loan Cooperatives
SME	Small and medium enterprises
SRO	Self Regulatory Organization
ROSC	Report on the Observance of Standards and Codes
USAID	United States Agency for International Development

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EXECUTIVE SUMMARY

An effective corporate governance system provides an overview of the mechanisms that mediate the use of capital and discipline business entities with public or private ownership, whether their shares are traded in the stock markets or held privately. In that system, investors must be assured a fair rate of return for their investment, commensurate with the risk they have assumed.

A good corporate governance environment is, thus, one in which the interests of the managers are aligned very closely with those of the owners of the firm, or, the shareholders. The four values of good corporate governance; transparency, accountability, responsibility and fairness, in addition to ethical conduct in the management of the privately or publicly owned companies characterize the main pillars of good corporate governance practices. In this mechanism, “*disclosure*” plays a major role.

A good corporate governance framework and sound corporate practices are key prerequisites for companies as well as countries that wish to attract and retain the capital they need for investment and economic growth.

In Mongolia, the legal framework and ownership structures are still evolving. This provides an important opportunity to develop good corporate governance and to change the present situation where foreign and domestic investors are often reluctant to invest unless the expected rates of return in investment is higher than might be expected in a similar risk class country.

This report provides a review and an analysis of the main elements of the corporate governance environment, framework and practices, and specific issues of relevance to the economy of Mongolia. While recognizing that Mongolia needs to build on the existing systems, there is a fair amount of the environment for ownership structures and governance institutions that currently exist.

Bank financing still is the main source of financing for Mongolian corporations. In most cases, firms rely much more on internally generated funds and on banks than they do on capital markets. The Mongolian GDP has shown a steady increase over the last ten years. Private sector credit is growing, supported by deposit growth. Bank lending to SMEs and micro enterprises are largely driven by international donor funds, which ought to change. Nominal interest rates have declined in 2008 but inflation is rising. The mortgage market is expanding rapidly, however, so are banks' exposure to risks. Overall banking sector has shown significant growth during the last decade.

The Mongolian banking sector is still small and comprises 16 private banks in which top 5 banks account for over 60 % of the banking activities in terms of total assets, loans, deposits, and equity. While the BoM has stepped up its efforts to ensure stability and liquidity of the banking sector, weak governance of banks may lead to implications throughout the economy with negative ramifications for economic development. Bank loans to private sector are characterized by maturities that range between 0-1 year (43 percent of all credit in the first half of 2008); followed by 1-4 years (48 percent) and over 4 years a very small ratio (9 percent of all loans). There has been a significant growth in credits, reflecting the improved confidence in banks. But due to increases and the volatility of the inflation rate more recently, there have been issues regarding the sustainability of the credit markets.

Evidence shows that creditor protection is critical in improving financial discipline and in promoting sound lending practices. Therefore, national insolvency system must develop in order to provide effective protection and enforcement of creditors' rights as well as to ensure

efficient liquidation of debtors, which cannot be expeditiously re-structured into commercially viable enterprises.

Moreover, banks have a responsibility for the effectiveness and integrity with which the enterprises they are financing are being directed and controlled. As a result, bank credits should flow to companies with high corporate governance standards. Legal, regulatory, and supervisory policies, which ensure sound bank governance, need to be firmly established and maintained. Special attention needs also to be paid to the ability and incentives of bank shareholders to exert governance over banks, while not engaging in abusive related party lending. Overall, the banking sector has vast potential for diversification and sustained growth.

In terms of securities markets, the Mongolian Stock Exchange remains underdeveloped, with low capitalization and liquidity levels. The market capitalization to GDP ratio at the end of August 2008 stood at 16 percent, meaning there are challenges ahead, but there are also a lot of opportunities to gain further depth and breadth – only if proper policies are followed.

The Mongolian Stock Exchange (MSE) was created as privatization device and still remains largely a secondary market dedicated to this function. There are currently 380 listed shares. However, during the early part of 2008, the FRC has suspended trading on 166 listed companies for lack of trading, non-compliance with regulations, and minority shareholder abuses. A series of new share offerings through initial public offerings (IPO's) during the past five years has not been adequate to improve the illiquidity of the markets. Financial sector continues to be dominated by banks. The development of the capital markets in Mongolia would depend on a number of internal and external factors.

Appropriate policies need to be developed and put in place in order to support the development of Mongolian Stock Exchange and other non-bank financial markets. Financial sector in general does not yet perform the key functions of providing an alternative to bank funds for debt and equity finance to the private sector and of offering a secondary market in ownership. For this reason, capital markets are thin and underdeveloped, but showing positive signs of growth.

Non-Bank Financial Institutions (NBFIs) currently constitute a very small percentage of the financial sector. There are currently 137 NBFIs licensed in Mongolia. The majority of NBFIs traditionally provide lending facilities to SME and households in currency exchange, and money transfers. NBFIs involvement in the financial market development is crucial for increased access to credit, especially in rural areas. However, NBFIs are slowly taking shape. With the introduction of the Insurance Law in 2004, a nascent but growing sector is forming. The industry is yet to realize its potential as a main member of the NBF community. In 2007, there were about 15 insurance companies with significant growth. This growth has not yet translated into an accumulation that would create a significant demand for investment in the capital markets. There are others in financial leasing, investment and financial advisory services.

Professional capital market intermediaries and securities firms are emerging but there are concerns over their competence. There are 36 such companies at this point, however, only two top firms account for 52 percent of all the brokerage activity. The SLC crisis in 2006 has severely damaged public confidence in NBFIs.

Government should actively facilitate the development of the institutional sector in Mongolian capital markets such as the pension funds (as part of the reform of the public pension system), insurance companies (including in health insurance) and investment funds. Until this occurs, significant concerns remain regarding potential systemic problems

Mongolian economy faces a set of corporate governance policy challenges and key priority areas for reform. Including corporate governance, Mongolia has made considerable progress in the wide-scale legal and institutional reforms over the last decade. Since 1990s, Mongolia passed many laws that will constitute the backbone of an effective corporate governance environment. Over the last two decades, Mongolia has introduced or substantially amended its laws, regulations and other formal corporate governance normative acts in its jurisdiction.

These include the Civil Law, Company Law, Securities Market Law, NBFIL Law, Taxation Law, Bankruptcy and Insolvency Law, Competition Law, Banking Law, FRC Law, Insurance Law. These are significant contributions to the improvement of the corporate governance environment.

The Mongolian Corporate Governance Code has been introduced in December 2007. With the introduction of the Code, the important foundations for establishing sound corporate governance systems have been formed. The Code is, in some areas a mandatory regulation, and in some other areas it is voluntary, subject to the “*comply or explain*” regime. However the magnitude of challenges ahead is still significant. The Mongolian Corporate Governance Code reflects solid content and an excellent effort to adapt the OECD Principles to the domestic Mongolian context. The most difficult task facing regulators is the challenge of presenting the code’s contents to ensure clarity of understanding and its accessibility to all.

The legislative and regulatory efforts in Mongolia should be matched by progress in its implementation and enforcement. The credibility of the corporate governance framework depends on its enforceability.

Many of the necessary new laws have been drafted, and the government should move quickly to pass them. These laws include: (i) a revised banking law; (ii) a revised securities market law; (iii) a draft law on mortgage collateral; (iv) a draft mortgage securitization law; and, (v) revised company law. It is our understanding that these are forthcoming.

The capacity of the regulators should be significantly improved in terms of financial and human resources, including through adequate capacity development training and skills upgrade programs as part of a career enhancement initiative. The criteria for selection and appointment of members of the regulatory bodies need to be based on professional merit and integrity.

Regulators must strengthen their role in ensuring that the Mongolian Stock Exchange and other relevant self-regulatory bodies observe high ethical and professional standards.

Improved shareholder rights are an important prerequisite for the emergence of effective owners, capable to engage in corporate restructuring and development. With effective ownership and strengthened shareholder rights, company management will have incentives to restructure the companies, improve operations, and look for profitable opportunities to take the company forward and attract new investors. Until recently, it has not been feasible for most small shareholders to sell their shares to controlling owners. These issues must be resolved by facilitating the emergence of a strong private sector with an effective ownership and control structure.

A central element of such an effort is accelerated privatization, which includes a program for improved corporate governance of large enterprises in which the state is likely to retain a stake in the foreseeable future. It is also important that public policy priorities are clearly defined in legislation and exercised through regulation rather than ownership.

Improved corporate governance and continued capital market development will require converting the ownership structures of many smaller joint stock companies into LLCs. This will mean de-listing of these shares and having the controlling shareholder buy-out of the

minority shares. This process, if done in an orderly fashion, will lead to a stronger stock market with a few shares. The securities market will be more appealing to the investing public as it will now include the more viable enterprises.

Turning controlling shareholders into effective owners is important, provided adequate safeguards for minority shareholders are in place. In the absence of well functioning or enforced laws, managers with or without shares can effectively expropriate minority owners, who acquired their stakes by default through mass-privatization or employee ownership schemes. Important steps in this respect should include strengthening disclosure requirements of decision making mechanisms and related party transactions, as well as forbidding self-dealing, and insider trading.

The legal framework in Mongolia does not make a distinction between the rights of the state as a shareholder and the rights of other shareholders. However, evidence shows that the state does not act as an efficient owner in Mongolia and there is a vast scope for improvement in this area.

The unfinished business of privatization is the main culprit in most of the corporate governance problems and the deficient price discovery mechanism at the MSE. The continued state ownership in half privatized firms has significant implications on the functioning of the State Owned Enterprises (SOEs) as well. Increasing the transparency, accountability, responsibility and the fair and equitable treatment of all shareholders in the SOEs as with all others is crucial.

These challenges for SOEs would need to be addressed at the levels of (i) the government; (ii) the board; and, (iii) the management. These arguments lend credence to the conclusion that without the proper corporate governance structure, SOEs can not be expected to perform at their potential. In order to improve corporate governance practices SOEs must be given: (1) Clear mandate with clear performance objectives; (2) Performance based pay and performance tied to real consequences for failure; (3) High level of disclosure and good communications with stakeholders. In order to expedite this process, we recommend that the introduction of (1) Corporate Governance Code for SOEs only is encouraged; and, (2) Corporate Governance Rating Index to measure the compliance with the code and management performance would be useful.

In most listed Mongolian corporations, the fiduciary duty of directors to act in the interest of the company and all its shareholders needs to be clarified and strengthened. Shareholders who have suffered abuse of their rights and incurred financial losses need to be provided with private and collective rights of action against controlling shareholders and directors.

Educational and public awareness programs need to be implemented to allow for a better understanding of corporate governance issues by the numerous disenfranchised individual minority shareholders of Mongolia. The however slowly emerging, institutional investors, including foreign ones should also be encouraged to formulate and publicize their ownership policies.

Mongolian authorities and the corporate sector should pay special attention to increasing transparency and disclosure as this area is the most important deficiency towards achieving improvements in corporate governance. Improving transparency and disclosure would lead to an overall improvement in corporate governance practices in all private sector firms by example. In this regard, the legislators and the regulators need to ensure that ownership structures are transparent. The accounting and audit profession must be licensed and more closely regulated in order to increase its credibility and efficiency.

The role of banks as the main source for corporate finance is an opportunity for them to play a major role in improving corporate governance. Further, companies with employee ownership could play a constructive role in the evolution of good corporate governance practices. Employee owners have been facing significant challenges as owners—such as restrictions on their participation in shareholders’ meetings, using their votes, or have their shares voted for them by management.

Corporate governance will provide a structure of public and private rules that specify the distribution of rights and responsibilities among the different counterparts of an economic entity such as its management, shareholders, the board, and other stakeholders. Corporate governance is thus an important part of the economic and social development that will directly support corporate restructuring and socio-economic development programs in a transition country. Effective corporate governance contributes to the efficiency of the rule of law, anti-corruption efforts and building the well-functioning institutions in a market economy. In a way, corporate governance can be thought of the antidote to corruption!

It must be recognized that corporate governance is a public policy concern that is critical to economic growth. Operationalizing the emerging international principles and standards of business conduct, including the OECD Principles of Corporate Governance (2004) and the Mongolian Code of Corporate Governance (2007) must be the targeted objective in this initiative.

The challenges of establishing a strong corporate governance culture in Mongolia would require close cooperation among the donor community. In order to accomplish these goals, it is recommended that USAID/EPRC technical assistance engage in the following activities:

1. **Capacity Building**: Improve and enhance the directors’ education. In addition, enhancement of management education and training in Mongolia is necessary;
2. **Institution Building**: Build and strengthen effective legal and regulatory institutions, civil society organizations such as the Mongolian Corporate Governance Forum as a permanent institution, investor NGOs, SROs, and regulatory oversight capacity for enforcement, and the creation of a business friendly environment. Performance metrics needs to be developed through a “corporate governance rating index” (CGRI) to rate corporate governance compliance of listed firms as well as the SOEs.
3. **Public education** activities to increase awareness of the public in general towards implementation of good corporate governance practices. Public education programs may include forums, round tables and TV and internet based awareness programs that are held on a periodic basis.

SECTION I: BACKGROUND

An effective corporate governance system provides an overview of the mechanisms that mediate the use of capital and discipline business entities with public or private ownership, whether their shares are traded in the stock markets or held privately. In that system, investors must be assured a fair rate of return for their investment, commensurate with the risk they have assumed.

The main objective of the firm is to maximize the wealth of its shareholders—this is accomplished by the managers who act as agents on behalf of the shareholders to achieve this objective. A critical issue in a corporate governance system is the resolution of the principal-agent conflict, which emanates from the separation of powers between the shareholder/owners and the managers who control the entity in effect. A good corporate governance environment is, thus, one in which the interests of the managers are aligned very closely with those of the owners of the firm, or, the shareholders.

Safety and stability are of paramount importance as the foundation of any viable financial system for building investor trust and confidence in the financial markets. The four values of good corporate governance; transparency, accountability, responsibility and fairness, in addition to ethical conduct in the management of the privately or publicly owned companies characterize the main pillars of good corporate governance practices.

In this mechanism, “*disclosure*” plays a major role. Disclosure is the transfer of necessary information to the investors or shareholders that enables the price discovery mechanism to function in a stock market, allowing for better access of finance into companies.

A good corporate governance framework and sound corporate practices are key prerequisites for companies as well as countries that wish to attract and retain the capital they need for investment and economic growth. The corporate governance environment must demonstrate that such frameworks and practices are sustainable before positive results will be seen. This is true not only for developed countries but for emerging economies as well. Investors must have confidence both in the legal system and corporate governance practices if they are to put their money at risk.

In Mongolia, the legal framework and ownership structures are still evolving. This provides an important opportunity to develop good corporate governance and to change the present situation where foreign and domestic investors are often reluctant to invest unless the expected rates of return in investment is higher than might be expected in a similar risk class country.

This report provides a review of the current state of corporate governance in Mongolia, and includes concrete recommendations on how the government, regulators and business associations may contribute to improved corporate governance, as well as an opportunity for USAID intervention to develop the grounds for good corporate governance in cooperation with the responsible local institutions mentioned.

The recommendations in this report mainly flow from face-to-face interviews held with leading bankers, policy makers, regulators, corporate leaders, academicians, and leading member of the parliament. Also, the proceedings of the Mongolian Corporate Governance Workshop held on September 25th, 2008 in Ulaanbaatar, which brought together 21 senior policy-makers, regulators and high level representatives of business and civil society provided major inputs, and recommended strategies in order to improve the regulatory framework and corporate governance practices in Mongolia. List of people interviewed, and offices visited are attached in **ANNEX A**.

The face to face interviews included a questionnaire that inquired about (i) transparency and disclosure, (ii) shareholders rights and equitable treatment and (iii) boards and (iv) stakeholders; (v) legal and regulatory environment for corporate governance in Mongolia. In preparing the questionnaire, The OECD Corporate Governance Principles and The Mongolian Corporate Governance Code were used as benchmarks. Detailed findings from conducting the corporate governance survey are provided in **ANNEX B**.

This report provides a review and an analysis of the main elements of the corporate governance environment, framework and practices, and specific corporate governance issues of relevance to the economy of Mongolia.

While recognizing that Mongolia needs to build on the existing systems, there is a fair amount of the environment for ownership structures and governance institutions that currently exist. We reach a set of conclusions identifying the main corporate governance reform priorities for Mongolia as well as offering a concluding set of recommendations for USAID intervention.

The recommendations call for a three phased strategy to be implemented, in order to ensure the sustainability of corporate governance reforms undertaken. The intervention program ought to include (i) Institution building; (ii) Capacity building; and, (iii) Public education activities.

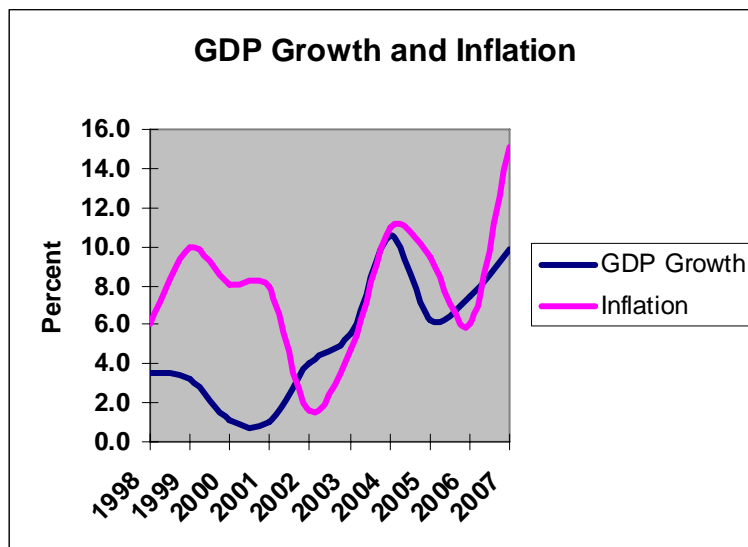
We recommend implementing international standards for accounting and auditing, strengthening the capacity of regulators and the judiciary, ensuring the basic rights of shareholders, especially minority shareholders, increasing the capacity of board members through Directors Training, licensing and certification programs, improving business school curricula, and encouraging both banks and the emerging institutional investors play a more constructive governance role in Mongolian business environment as some of the priority interventions. Additionally, public education programs such as forums, round tables and TV and internet based awareness programs are held on a periodic basis.

SECTION II: THE FINANCIAL SECTOR HIGHLIGHTS

A. Corporate finance in Mongolia and the role of banks

Bank financing is the main source of financing for Mongolian corporations. In most cases, firms rely much more on internally generated funds and on banks than they do on capital markets. Mongolian banking sector can be described as growing, however, with some important caveats: The Mongolian GDP has shown a steady increase over the last ten years. Private sector credit is growing, supported by deposit growth. Bank lending to SMEs and micro enterprises are largely driven by international donor funds, which ought to change. Nominal interest rates have declined in 2008 but inflation is rising. The mortgage market is

expanding rapidly, however, so are banks' exposure to risks.



The Mongolian banking sector comprises 16 private banks. However, the top 5 banks account for over 60 % of the banking activities (total assets, loans, deposits, and equity) in the country.

According to a World Bank study (2007) there are high levels of cross-ownership between banks and non-financial conglomerates which may lead to “extensive self dealings” to the exclusion of

potentially bankable outside businesses, which coupled with weak controls on related party lending, may increase systemic risks.

While the BoM has stepped up its efforts to ensure stability and liquidity of the banking sector, weak governance of banks may lead to implications throughout the economy with negative ramifications for economic development.

Bank loans to private sector are characterized by maturities that range between 0-1 year (43 percent of all credit in the first half of 2008); followed by 1-4 years (48 percent) and over 4 years a very small ratio (9 percent of all loans). There has been a significant growth in credits, reflecting the improved confidence in banks. But due to increases and the volatility of the inflation rate more recently, there have been issues regarding the sustainability of the credit markets.

In the short-term, debt financing is likely to prevail as a source of external finance in Mongolia. When banks efficiently mobilize and allocate funds, this lowers the cost of capital to firms, boosts capital formation, and stimulates productivity growth.

However, an important feature of the financial development is the potential for weaknesses of the banking sector, the prevalence of the short term nature of the credit market may in the near term pose liquidity risks and a mismatch between supply and the demand requirements, exacerbating the risk problem. On the other hand, the existence of a great number of large formerly state-owned enterprises has prompted governments, on many occasions, to refinance loss-making entities.

Evidence shows that creditor protection is critical in improving financial discipline and in promoting sound lending practices. Therefore, national insolvency system must develop in order to provide effective protection and enforcement of creditors' rights as well as to ensure efficient liquidation of debtors, which cannot be expeditiously re-structured into commercially viable enterprises.

In addition, lending mostly to short and medium term borrowers (90 percent of the loans are short to medium term loans not surpassing 4 years maturities) which accounts for 57 percent of all credit, unusually high collateral and high real interest rates are the norm in most cases. Instead of simply monitoring compliance with prudential rules and avoiding risks, the banks could shift to more pro-active credit risk policies and management.

Moreover, banks have a responsibility for the effectiveness and integrity with which the enterprises they are financing are being directed and controlled. As a result, bank credits should flow to companies with high corporate governance standards.

Legal, regulatory, and supervisory policies, which ensure sound bank governance, need to be firmly established and maintained. Special attention needs also to be paid to the ability and incentives of bank shareholders to exert governance over banks, while not engaging in abusive related lending.

Overall, the banking sector has vast potential for diversification and sustained growth. In addition, consolidation among Mongolian banks is likely with Ulaanbaatar being the primary market. Regulatory and internal constraints to the banking sector growth are numerous. The under-development of inter-bank, money, and foreign exchange and capital markets limits banks' options. Banks and other lender need new bankruptcy, foreclosure, securitization and mortgage laws—which are currently being developed.

B. Securities markets

The majority of Mongolian firms would be considered small by global standards. As shown in the table below, 87 percent of employment in Mongolia is generated by SMEs with up to 10 employees, and this is growing.

Private Sector Entities In Mongolia				
Number of Employees	2006	2007	YoY Change	Pct of Tot Employment in 2007
1 - 9 employees	42204	48655	15.29%	87.04%
10 - 19 employees	3083	3300	7.04%	5.90%
20 - 49 employees	2369	2617	10.47%	4.68%
50 + employees	1223	1329	8.67%	2.38%
Total	48879	55901	14.37%	

Source: Mongolian Statistical Yearbook 2007, National Statistical Office of Mongolia.

The availability of international sources of finance for most Mongolian firms is also very minimal. This reason creates uncertainties for the future growth of the capital markets.

Mongolian Stock Exchange remains underdeveloped, with low capitalization and liquidity levels. The market capitalization to GDP ratio at the end of August 2008 stood at 16 percent, meaning there are challenges ahead, but there are also a lot of opportunities to gain further depth and breadth – only if proper policies are followed.

The Mongolian Stock Exchange (MSE) was created as a privatization device and still remains largely a secondary market dedicated to this function. As the table below shows, there are currently 380 listed shares. However, during the early part of 2008, the FRC has suspended trading on 166 of these companies for lack of trading, non-compliance with regulations, and minority shareholder abuses.

Even though there have been a series of new share offerings through initial public offerings (IPO's) during the past five years, the market remains illiquid. Financial sector continues to be dominated by banks.

The development of the capital markets in Mongolia would depend on a number of internal and external factors, including the following: (i) The availability of international funds looking for investment opportunities in Mongolian capital markets; (ii) the creation of a mortgage backed securities market; (iii) perhaps the introduction of Mongolian Depository Receipts listed in international markets; (iv) the development of a life insurance industry that will eventually accumulate investable funds seeking long term placements; (v) domestic private equity funds; (vi) laws to increase banks' incentives to play a greater role in capital market development through new financial products; (vii) Mongolian IPO's in international markets, and the last but not the least, (vii) final completion of privatization through which the state removes itself from direct intervention into the economy. One way or another, these financial activities will provide benefits to all aspects of Mongolian capital markets.

The introduction of modern technological advancements and sound legal frameworks is only one step in the development of sound capital markets. More needs to be done in order to

MONGOLIAN STOCK EXCHANGE 5 YEAR STATISTICAL COMPARISON

* in millions	2004	2005	2006	2007	YTD 2008
Number of Listed Companies	395	392	387	384	380
Market Capitalization (US\$*)	24.7861	45.6191	112.6001	613.3157	627.4324
Total Vol.-Stocks (US\$*)	0.5496	2.1188	10.689	52.8691	46.9635
Total Vol.-Stocks (# Shares*)	9.0658	25.9482	74.5317	116.1037	152.7086
Avg. Daily Vol.-Stocks (US\$*)	0.0022	0.0084	0.0424	0.209	0.2746
Avg. Daily Vol.-Stocks (# Shares*)	0.0356	0.1026	0.2958	0.4589	0.893
Total Vol.-Bonds (US\$*)	12.9598	2.2261	1.6344	34.484	1.7282
Total Vol.-Bonds (# Shares*)	0.1991	0.3054	0.1093	0.5428	0.0663
Avg. Daily Vol.-Bonds (US\$*)	0.2592	0.0184	0.0192	0.5305	0.3456
Avg. Daily Vol.-Bonds (# Shares*)	0.004	0.0025	0.0013	0.0084	0.0133
Monthly Avg. Turnover Ratio	0.0018	0.0039	0.0079	0.0072	0.0094
Index	590.68	995.29	1867.99	10014.03	9026.38
Currency/US\$	1209	1221	1165	1169.97	1150.91

Source: Federation of Stock Exchanges Member Information, September 30, 2008

transform the MSE into a vibrant market. The implementation of the existing legal framework by the Stock Exchange and strengthened supervisory authority is the key in this respect.

Liquid and vibrant capital markets can have a strong positive impact on corporate governance.

Further, research has shown that improving corporate governance

at the firm level will have a direct positive impact on increasing the market value of the firm. Either way, corporate governance will help the Mongolian investors and issuers alike.

Appropriate policies need to be formulated and put in place in order to support the further deepening of Mongolian Stock Exchange and other non-bank financial markets. Financial sector in general does not yet perform the key functions of providing an alternative to bank funds for debt and equity finance to the private sector and of offering a secondary market in ownership. For this reason, capital markets are thin and underdeveloped, but showing positive signs of growth.

Over the last few years, IPO's and trading activity on the MSE raised hopes. However, the bond market relies mostly on government issues, as corporate bond market activity has largely fizzled out. During 2008, there were only four government bond offerings, with a maximum of one year maturity each, with yields ranging between 9.2 to 11 percent.

One important contribution towards the further development of the capital markets would be to have a vibrant government bond market that would allow for the development of a yield curve to serve as a benchmark. It is likely that the planned introduction of the mortgage backed securities might provide this benchmark. Increasing the capacity of the Depository, Clearing and Settlement Company would be a major plus. Most importantly, the capacity of the FRC enforcement capacity and the legal and regulatory frameworks would increase investor confidence.

C. Non-Bank Financial Institutions (NBFIs)

NBFIs currently constitute a small percentage of the financial sector. However, NBFIs are slowly taking shape. With the introduction of the Insurance Law in 2004, a nascent but growing sector is forming. The industry is yet to realize its potential as a main member of the NBFIs community. In 2007, about 15 companies had a total of 220 types of insurance products, with 635 million MNT in profits, and about 4.3 billion MNT worth of re-insurance agreements signed. This growth has not yet translated into an accumulation that would create a significant demand for investment in the capital markets. The asset structure of the sector is indicated in the table below.

NBFIS currently constitute a very small percentage of the financial sector, but their involvement in the financial market development is crucial for increased access to credit, especially in rural areas. There are currently 137 NBFIs licensed in Mongolia. The majority of NBFIs traditionally provide lending facilities to SME and households in currency exchange, and money transfers. There are others in financial leasing, investment and financial advisory services.

Total Assets of Banks and NBFIs	Number of Institutions	Assets (Bn. Tug)	% of Tot. assets	Total Assets as % of GDP
Commercial Banks	16	3,279	95.7%	87
Securities Market Intermediaries	36	16	0.5%	0.6
Insurance Companies	15	28	0.8%	6
NBFIs	137	66	1.9%	6
Savings and Credit Coops	168	36	1.1%	0.6
Source: IMF Mongolia Financial Sector 2008		3,425	100.0%	100.2

Professional capital market intermediaries and securities firms are emerging but there are concerns over their competence. There are 36 such companies at this point, however, only two top firms account for 52 percent of all the brokerage activity.

The Savings and Loan Coops (SLC) crisis in 2006 has severely damaged public confidence in NBFIs. However, due to the public pressure, the government intervened during the SLC failure. Mongolia's first SLCs were established in 1996 and early 1997 through an ADB project. A national network of SLCs was established in 2002. SLCs were unregulated until 2006 when a number of them began to fail. By mid-2006 FRC reported that 57 billion MNTs or 1.5 percent of the GDP was lost with the failing SLCs. These institutions are regulated under the FRC. However, they have lost their appeal to the depositors at this time. Their current asset to GDP ratio is a very small 0.8 percent of GDP at this time. The crisis in SLCs has shown that deficiencies in the legal and regulatory frameworks may lead to systemic failures.

Government should also actively facilitate the development of the institutional sector in Mongolian capital markets such as the pension funds (as part of the reform of the public pension system), insurance companies (including in health insurance) and investment funds. Until this occurs, significant concerns remain regarding potential systemic problems

The above observations and discussions lead to three important lessons for Mongolia:

1. Creating an active securities markets means getting active interaction between the issuers, investors and intermediaries. It is thus not the same as creating the market infrastructure, even though that would help as the critical foundation for the market. Creating good corporate governance practices is an important element in this equilibrium.
2. Market participants will participate in the market activities if there is an economic/business opportunity, or the investors are willing and capable to transact, in addition to having the proper structure to transact. There are more factors that contribute to this than are observable within the market environment. The other factors may be attributable to lack of confidence, capacity of market participants, existing legal and regulatory environment protecting the rights of all participants, in a fair and equitable way.
3. Regulatory oversight agencies often play a crucial role in creating the prudentially regulated, enabling environment, in reference to the existing legal and regulatory frameworks.

A well functioning, prudentially regulated, efficient securities market within an enabling investment environment is much harder to create in any place, let alone Mongolia. Getting the issuers, investors and intermediaries to transact takes much effort, and can only be encouraged through the enabling environment.

Within this enabling environment good corporate governance practices implemented by the securities issuing companies is an enormously important requirement. It is key in this process, to ensure that an effective regulatory and supervisory framework and good governance mechanisms are in place for all these types of investment vehicles.

ANNEX C provides a further detailed discussion of observations in the securities markets and provides a critical perspective at the underlying factors in Mongolia. The factors underlying the further development of securities markets will lead to active participation of the three relevant parties crucial in a securities transaction; *the issuers, the investors and the intermediaries*. Each of these three important market players will interact due to three main elements: (i) an economic incentive structure for them to transact; (ii) adequate capacity and skills to transact; and (iii) the structure to support the transaction.

We next review the corporate governance phenomenon in light of the OECD Principles of Corporate Governance (2004) that is the basis of the Mongolian Corporate Governance Code, and how improvements in corporate governance will generate a better investment environment.

SECTION III: THE CORPORATE GOVERNANCE ENVIRONMENT

A. Current issues

Mongolian economy faces a set of corporate governance policy challenges and key priority areas for reform. Including corporate governance, Mongolia has made considerable progress in the wide-scale legal and institutional reforms over the last decade.

Since 1990s, Mongolia passed many laws that will constitute the backbone of an effective corporate governance environment. Over the last two decades, Mongolia has introduced or substantially amended its laws, regulations and other formal corporate governance normative acts in its jurisdiction.

These include the Civil Law, Company Law, Securities Market Law, NBFIL Law, Taxation Law, Bankruptcy and Insolvency Law, Competition Law, Banking Law, FRC Law, Insurance Law. These are significant contributions to the improvement of the corporate governance environment. **ANNEX D** provides summary comparative overview of the current Mongolian legal and regulatory frameworks underlying corporate governance practices.

The Mongolian Corporate Governance Code has been introduced in December 2007. With the introduction of the Code, the important foundations for establishing sound corporate governance systems have been formed. The Code is, in some areas a mandatory regulation, and in some other areas it is voluntary, subject to the “*comply or explain*” regime. However the magnitude of challenges ahead is still significant.

Given the legal and regulatory frameworks in place, the objective of the relevant public and private sector institutions – whether it is the businesses themselves, the regulatory authorities, or the financial institutions – should be to focus on key priorities for reform and encourage their firm implementation within the framework of the law.

The priorities of corporate reform need to be seen as objectives and the concrete measures to implement these priorities should be designed with special attention to national circumstances.

One ought to keep in mind that the governance framework also changes shape and develops through time. Therefore, future work on corporate governance would need to focus on the nature of changes in specific corporate governance areas and on how their direction may be influenced through policy design and implementation.

B. The legal and regulatory environment for corporate governance

The legislative and regulatory efforts in Mongolia should be matched by progress in its implementation and enforcement. The credibility of the corporate governance framework depends on its enforceability.

There are a number of areas in the legislation relevant to corporate governance that gaps between the regulations and the laws exist. While substantial progress has been made in upgrading the legal framework, especially following the banking sector problems of the late 1990s, Mongolia still suffers from a number of weaknesses that should be addressed in order to support stable financial sector development.

Many of the necessary new laws have been drafted, and the government should move quickly to pass them. These laws include: (i) a revised banking law; (ii) a revised securities market law; (iii) a draft law on mortgage collateral; (iv) a draft mortgage securitization law; and, (v) revised company law. It is our understanding that these are forthcoming.

The company law is one example. The obligations of companies towards minority shareholders are not properly set out and sanctions for non-compliance of the obligations that are codified are not sufficiently serious to encourage compliance. Both gaps serve to undermine the development of the capital markets in Mongolia. The company law also does not require any independent directors on a company's board.

While the Corporate Governance Code does clearly provide for the minimum three independent directors requirement, the Company law is silent. Another issue is about the multiple listings, where Company law is silent about whose jurisdiction the Mongolian issuer will be under. This may be necessary for conditions where some banks may be considering seeking listings in Singapore or London. It is expected that the draft new Company Law will remedy these deficiencies.

The bankruptcy law was passed in 1996 but there have been only a handful of cases and the process is slow and cumbersome.

In addition, deficiencies in the enforcement and the rule of law are also part of the legacy of past and the conditions surrounding the transition phenomenon. Sustained political commitment at the highest levels is crucial if enforcement is to be successful and will instill public confidence in reforms.

The credibility of enforcement will also depend on an enhanced mandate and capacities of the regulatory authorities, especially those of securities regulators. Experience in all transition economies has shown that regulators are the main line of defense for shareholders.

The capacity of the regulators should be significantly improved in terms of financial and human resources, including through adequate capacity development training and skills upgrade programs as part of a career enhancement initiative. The criteria for selection and appointment of members of the regulatory bodies need to be based on professional merit and integrity.

Regulators must strengthen their role in ensuring that the Mongolian Stock Exchange and other relevant self-regulatory bodies observe high ethical and professional standards.

On the other hand, remedies to protect the rights of minority shareholders used by the regulators need to be extended, from mostly suspending trading and de-listing of company stocks, which in turn hurts small investors, to increased recourse to civil remedies, such as significant fines. Where appropriate, the regulators should have the capacity to enforce sanctions without their decisions being subject to automatic appeal through the judicial system.

The judiciary constitutes the backbone of a strong enforcement system. The following areas require special focus in Mongolia:

- increasing the independence of the judiciary;
- enhancing the knowledge and capacity of judges in dealing with company, securities and bankruptcy law cases;
- encouraging the specialization of the judiciary.

Judges need to receive adequate compensation to ensure that the individuals attracted by the profession possess the necessary education, experience and integrity. Moreover, court written opinions should be made public to increase awareness, facilitate interpretation of the law and enhance the accountability of the legal system.

C. Recommendations for the Mongolian Corporate Governance Code

A quick review of the Mongolian Corporate Governance Code reflects solid content and an excellent effort to adapt the OECD Principles to the domestic Mongolian context. This is no easy task by itself.

Often, however, the most difficult task facing regulators is the challenge of organizing and presenting the code's contents in an accessible manner, which ensures clarity of understanding and its accessibility by corporate stakeholders.

The following recommendations relate to suggested improvements designed to address this aspect of the Mongolian Code.

1. **Clearly distinguish voluntary norms**, which are subject to the voluntary 'comply or explain' regime. The current Mongolian Code does not clearly distinguish between measures which are mandatory under effective Mongolian legislation and those, which are voluntary. Distinguishing clearly, which categories the various Code provisions belong to will ultimately aid corporate compliance with the 'comply or explain' regime.
2. **Clarify section headers and numbering scheme**, to improve the clarity of the Code's presentation, and to make its contents more easily accessible to stakeholders and end-users. To the extent possible, major high-level sections should be made more consistent with the organization of the OECD Principles. More frequent use should be made of subsection headers to clearly identify the Code's specific areas of domestic focus.

The idea behind this is to provide the greatest degree of parallelism and consistency in presentation to facilitate ease of understanding and future compliance with the Mongolian Code's stated norms.

3. **Incorporate citations, references and commentary to relevant OECD principles and Mongolian legislation**, to facilitate the educational function and purpose of the Mongolian Code. These elements are missing from the present and are absolute essentials to make the code an effective working document for end-users. Global practice indicates that most non-compliance with corporate governance norms stem almost exclusively from a lack of clarity and understanding of the requirements and their underlying legislative sources.
4. **Consider restructuring or reorienting the Mongolian code around the voluntary 'comply or explain' norms**, to the extent possible. The ostensible – but not necessarily exclusive - purpose of a corporate governance code is to set attainable corporate governance objectives and goals higher than the minimum compliance requirements mandated by relevant Mongolian legislation.

A code where legal minimums predominate leaves no room for promoting attainable improvements on a voluntary basis. A reasonable balance should be struck between mandatory and voluntary provisions.

Thus, the primary and organizational effort should be centered around the voluntary 'comply or explain' provisions. Notwithstanding this, the mandatory requirements should be retained in the Mongolian Code-- as either commentary or introductory background to the various voluntary code provisions themselves.

SECTION IV: SHAREHOLDERS

A. Shareholders rights

Improved shareholder rights are an important prerequisite for the emergence of effective owners, capable to engage in corporate restructuring and development.

With effective ownership and strengthened shareholder rights, company management will have incentives to restructure the companies, improve operations, and look for profitable opportunities to take the company forward and attract new investors.

Until recently, it has not been feasible for most small shareholders to sell their shares to controlling owners. These minority shareholders are stuck in a corner unable to do anything with their shares. However, a controlling owner, if full control can be gained, can exercise his rights as a shareholder more effectively. This will result in a winning situation for both the company and the country, because of added benefits of increased managerial and governance competency and competitiveness achieved.

On the other hand, large and controlling shareholders encounter numerous obstacles towards the consolidation of their stakes and generally to their participation in the corporate governance process of the companies they own.

Weak shareholder rights are one of the major impediments to the further development of the market for corporate control in Mongolia.

The right to sell the shares can be among the most powerful tools for the protection of minority shareholders, who cannot otherwise be effective owners. This also requires facilitating the effectively controlling owner's ability, and sometimes, obligation to buy. To this effect, buy out procedures should be developed that can be initiated by the company or shareholders, during control transactions or when the fraction of shares held by minority investors falls below a certain threshold.

Under these procedures, the controlling shareholder buy-outs of minority shareholders at a price set through a fair and independent appraisal of the share's value. These sorts of procedures may be the only way for minority shareholders to be able to sell their shares for a fair price in Mongolia's highly illiquid capital market.

In addition to the framework for changes in control, basic shareholder rights in Mongolia and their enforcement require serious attention. The need for improving the provisions related to general shareholder meetings, including on convening and voting procedures are recognized as among the most important areas requiring action. The clarifications of provisions on share registration and payment of dividends are also urgent issues to address.

B. Emergence of a private sector with effective ownership structure

In order to improve corporate governance in Mongolia today, it is recommended that top priority should be given to facilitating the emergence of a strong private sector with an effective ownership and control structure.

It is important for the Mongolian authorities to focus on the development of a sound private sector complying with high corporate governance standards as a priority. Supporting and accelerating the emergence of a private sector with effective investors, capable of restructuring the enterprise sector and promoting sound corporate governance practices ought to be considered a priority of national interests. This is critical for improving company performance and achieving sustained economic growth.

A central element of such an effort is accelerated privatization, which could include a program for improved corporate governance of large enterprises in which the state is likely to retain a stake in the foreseeable future. It is also important that public policy priorities are clearly defined in legislation and exercised through regulation rather than ownership.

Mongolian private sector development policies need to pay serious attention to corporate ownership structures, as they have a direct influence on the main corporate governance challenges encountered.

C. Corporate ownership structures and share ownership

Large shareholders and related insiders are a prominent feature of corporate ownership structures in Mongolia at the present time. Additionally, ownership and control are likely to remain concentrated for the near future, together with the presence of a sizeable number of minority and individual shareholders that emerged as a result of the privatization process.

Improved corporate governance and continued capital market development will require converting the ownership structures of many smaller joint stock companies into LLCs. This will mean de-listing of these shares and having the controlling shareholder to buy-out the shares of minority shareholders.

This process, if done in an orderly fashion, will lead to a stronger stock market with a few shares however, more appealing to the investing public as it will include the more viable enterprises.

In order to facilitate ownership consolidation, regulation should provide for incentives for the controlling interests in listed companies to buy out dispersed shareholders through a fair and equitable process. The establishment of an independent authority to assist in consolidating claims may also constitute an element of such a process.

In the short and medium-term, pressure for restructuring and better corporate governance in Mongolia is likely to come from strategic investors with controlling or large blocks of shares. This is the case because of the still insufficient shareholder culture, underdeveloped market for corporate control and illiquid equity market that is prevalent.

Therefore, the role of large shareholders should not be underestimated. They are already an important aspect of the Mongolian corporate governance system and need to become effective and law-abiding owners.

In addition, these large shareholders may potentially counterbalance the weaknesses of the institutional and legal corporate governance framework and serve as a disciplining mechanism, provided adequate transparency and disclosure frameworks, and mechanisms for effective monitoring by minority shareholders are in place.

D. Shareholders rights protection

Another important priority in Mongolia should be to strengthen the legal framework for minority shareholder protection and ensure its proper application and enforcement.

As discussed above, turning controlling shareholders into effective owners is important, but only provided adequate safeguards for minority shareholders are in place.

In the absence of well functioning or enforced laws, managers with or without shares can effectively expropriate minority owners, who acquired their stakes by default through mass-privatization or employee ownership schemes.

Important steps in this respect should include strengthening disclosure requirements of decision making mechanisms and related party transactions, as well as forbidding self-dealing, and insider trading. Regulators should have the capacity to monitor compliance with such requirements and to impose sanctions for misconduct.

E. The role of the state as shareholders in SOEs

The legal framework in Mongolia does not make a distinction between the rights of the state as a shareholder and the rights of other shareholders. However, evidence shows that the state does not act as an efficient owner in Mongolia and there is a vast scope for improvement in this area.

The main underlying reason for this is the unfinished business of privatization, which has significant implications on the functioning of the State Owned Enterprises (SOEs) as well as its impact on the behavior of Mongolia Stock Exchange prices.

The state should behave as prescribed by the existing legal framework and state representatives should refrain from intervention in day-to-day operations of businesses and from practices, which may be detrimental to other investors, especially minority shareholders.

Ideally, there should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state owned enterprises, particularly with regard to market regulation.

There are significant issues with respect to the Mongolian government's approach as shareholders in SOEs. For instance, members of the Boards of Directors of SOEs are government employees, appointed to the job for short term periods. They leave before they become familiar with the operation.

Secondly, There is little transparency and accountability in the directors of the SOEs. Often there are no annual meetings. Since the owners of the SOEs are the Mongolian People, more transparency is required to provide relevant, timely and material information to the public. No sub committee's exist. Annual Reports do not exist.

Third, the SOE directors do not have a good understanding of their rights and responsibilities as directors serving on the boards of SOEs. This may be attributable partly to the lack of information-or the lack of transparency. Another issue is the political will of the government.

There are three major corporate governance challenges at Mongolian SOEs. They are (i) at the government level; (ii) at the board level; and, (iii) at the management level.

- **At the government level:** There are multiple governmental shareholders such as the Ministry of Finance, the Ministry of Energy and the State Property Commission, all with conflicting objectives. Secondly, there are other governmental bodies that also attempt to influence the SOEs. These may be other ministries or parliamentary linkages. Thirdly, there are agency problems between the government as a shareholder and the management of the SOEs. Often times, line Ministries that own shares of Energy SOEs (41% share for the Ministry of Energy; 20% Ministry of Finance; and 39% State Property Committee), surpass the Board and communicate directly with the SOE management. This is due to the conflict of interest between these government partners.
- **At the board level:** Boards with little or no authority, including the power to hire/fire CEO. In addition, boards are dominated by politically based appointees who do not devote sufficient time to board matters. Last but not the least; boards are passed by shareholders and management, to be given an irrelevant status. The boards of state-

owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

- **At the management level:** There are insufficient tools to incentivize and discipline management through compensation, threats to termination, or through takeovers and or bankruptcy. There is no performance assessment measures applied on the management. In most cases, management of SOEs have free reign until a governmental institution remembers that fact and intervenes, in most cases as an arbitrary measure. There are no systematic performance evaluations.

The above arguments lend credence to the conclusion that without proper corporate governance structure, SOEs can not be expected to perform at their potential, other than just trying to maintain employment for the employees—who are in effect not productive.

Even though most SOEs have been **corporatized** as a means to make the ownership of state owned enterprises operate as independent companies, they have not been **commercialized** as a means to make the financial and technical operation of state owned enterprises more efficient, viable and profitable.

SOEs are run by capable civil servants; however, state interference is a constant problem that hinders the effective functioning of the given SOE. Often times they will need to obtain approval in executing the goals of the enterprises. The interference by the state in running the SOE as a viable enterprise requires the shareholder to allow them to perform, but maintain monitoring and control over the activities.

There are also issues among the various government agencies or institutions that are party to the State Ownership structure of the enterprises. Often times one of the partners, would directly go to the CEO of an SOE, surpassing the board as the ultimate representative of the state in the firm as a shareholder. This impedes the proper functioning of the corporatized SOEs and possibly gives conflicting messages to the given SOE regarding strategic directions that ought to be taken. If the board is excluded from the strategy formulation, it will be ineffectual. From time to time, it so happened that even SPC was not informed of the decisions or actions of the Ministries on a given SOE.

In order to improve corporate governance practices at the SOEs, there must be:

1. Clear mandate with clear performance objectives for the SOE in question;
2. Performance based pay and performance tied to real consequences for failure;
3. High level of disclosure; good communications with stakeholders.

Only if an incentives discipline is established within the SOEs and with isolating the SOE from Government, there will be a successful, transparent environment in which the State will conduct its business at SOEs. Transparency is the key element that brings all Corporate Governance activities to successful conclusion.

As the OECD principles of corporate governance for the state owned enterprises suggest, the state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness¹.

In this regard, our recommendations are as follows:

¹ OECD Principles of Corporate Governance for State Owned Enterprises

- Encourage the introduction of a Corporate Governance Code for SOEs only.
- Introduce a Corporate Governance Rating Index that will provide the metrics for assessing the SOEs compliance with the corporate governance codes, as well as providing the SOEs a benchmark to measure performance. We shall introduce a detailed section in the Annex regarding this recommendation.

SECTION V: THE BOARDS

In most listed Mongolian corporations, the fiduciary duty of directors to act in the interest of the company and all its shareholders needs to be clarified and strengthened.

Shareholders who have suffered abuse of their rights and incurred financial losses need to be provided with private and collective rights of action against controlling shareholders and directors.

While the general lack of an equity culture does not help, the mostly small stakes held by individual minority shareholders are another disincentive for them to play a greater role in corporate governance by becoming more effective participants in the formation of the members of the Boards.

Educational and public awareness programs need to be implemented to allow for a better understanding of corporate governance issues by the numerous disenfranchised individual minority shareholders of Mongolia. The however slowly emerging, institutional investors, including foreign ones should also be encouraged to formulate and publicize their ownership policies.

Boards of directors should improve their role and understanding in strategic planning, monitoring of internal control systems and independent review of transactions involving managers, controlling shareholders and other insiders.

Present problems with the exploitation of minority shareholders have called into question the independence and diligence of the boards that ought to be their protectors. To address this challenge in Mongolian companies, the functions of the board are not clearly distinguished from that of management.

It must be recognized that in the current environment in Mongolia, the market for corporate control by a family is the ongoing process. However, the ownership structures are still incomplete, and many controlling owners obtain effective control by acquiring 50% +1 share.

In this case the abuses to minority shareholders are rampant because of the lack of institutional integrity. The management and the shareholding public at large are both at the mercy of the controlling family. Stronger corporate governance environment will allow for minority shareholders to influence to general meeting to elect their representative to the board.

Mongolian board members often lack independence from insiders or major shareholders. These shortcomings have led to persistent problems with the abuse of power and further alienation of the minority shareholders.

In addressing these challenges, boards would benefit from special director training programs. Adoption and promotion of voluntary codes of conduct provide another opportunity for improving Mongolian boards.

Director standards need to also be tightened in terms of independence and by making directors liable for their actions, by imposing adequate sanctions, especially for violations of the duties of loyalty and care, as well as by prohibiting self-dealing. Adequate remuneration and increased resources and authority *vis-à-vis* management will enable directors to fulfill their functions.

To this effect, improved access to corporate information by all members of the boards is critical. This is only possible through improvements reached in the internal accounting procedures in firms as well as disclosure practices achieved by all the firms.

SECTION VI: TRANSPARENCY AND DISCLOSURE

The Mongolian authorities and the corporate sector should pay special attention to increasing transparency and disclosure as this area is the most important deficiency towards achieving improvements in corporate governance. It is almost conceivable that improving transparency and disclosure would lead to an overall improvement in corporate governance practices.

The predominant role of controlling shareholders, including insiders, is associated with various risks. Improved transparency and disclosure are critical to prevent abuse and promote sound corporate governance, in the absence of developed corporate governance institutions.

Lack of transparency can be recognized as one of the weakest areas of corporate governance in Mongolia. In this regard, the legislators and the regulators need to ensure that ownership structures are transparent. For instance, unless an investor purchases 5% or more of a given stock, access to information regarding the owners of the company is not allowed at the MSE nor at the Securities Clearing House and Central Depository. One needs to find it through word of mouth or through the rumor mills. Obtaining ownership information is not easy this way. Besides, in a thin market such as the MSE, rumors on a given company could severely distort the price discovery mechanism of the market.

The corporate governance framework and practices should also guarantee transparency regarding major decisions and actions of managers and controlling investors. For such an approach to be effective, adequate legal means to eliminate self-dealing and to monitor controlling shareholders also need to be put in place by the FRC.

Convergence with international standards and practices for accounting, audit and non-financial disclosure should continue to be a top priority, especially regarding ownership and control in Mongolian companies.

The recent ROSC (Report on the Observance of Standards and Codes) exercise on accounting and auditing in Mongolia conducted by the World Bank in March 2008 will shed light and offers guidance and direction for improvements for disclosure and relevant and timely reporting for all listed and unlisted companies.

The ROSC study recommends that Mongolia modernizes its accounting and auditing professions and develop a business environment that is conducive to the transparent disclosure of financial information compliant with the international norms and standards. In order to achieve this, Mongolia needs to revise its business oriented legal and regulatory frameworks, its institutions, and accounting and auditing professions. This would also include the updating of its tertiary educational system in order to affect fundamental changes in its mind set relative to business.

The ROSC cautions Mongolian policy makers and reformers that unless the country is prepared undertake such a change in terms of capacity and resources in the short term; it ought to improve those areas before going forward. Unless it is enforceable, undertaking such regulatory and legal changes would be futile.

Improving transparency and disclosure is particularly important in increasing the liquidity of shares and lower the cost of capital in order to attract additional domestic and foreign investment. The potential benefits are likely to outweigh the cost of greater transparency, including the costs incurred by fighting resistance from insiders.

Government needs to license and regulate the audit process and oversee the accounting and audit profession in a more credible and efficient manner. The accounting and audit profession,

its self-regulatory bodies, and the reporting companies also have an important role to play in improving transparency and disclosure.

SECTION VII: THE ROLE OF THE STAKEHOLDERS

The role of banks as the main source for corporate finance could also enable them to play a major role in improving corporate governance. Banks could affect changes in the way corporate governance is practiced by their customer firms through their standard disclosure requirements by requiring relevant, timely and material financial and managerial information that will lead to a realistic estimation of the cash flows of the customer. Instead of focusing on collateral based loan processes. This, in and of itself, would improve the quality of disclosure, and improve transparency.

The development of banks and their role in imposing financial discipline and efficiently allocating capital should be given special attention. More concretely, FRC and BoM should coordinate their regulatory functions towards by intensifying their efforts to improve the regulatory frameworks for banking and securities markets. Improving corporate governance of banks will set a good example within the economy.

Information on creditors' rights protection is limited even when the ratio of private credit is rising rapidly. Borrowing against the collateral on the same underlying property may be one fundamental problem. Insolvency and bankruptcy legislation needs to be rapidly passed to provide a degree of relief on this matter.

Further, companies with employee ownership could play a constructive role in the evolution of good corporate governance practices. Employee owners have been facing significant challenges as owners—such as restrictions on their participation in shareholders' meetings, using their votes, or have their shares voted for them by management. Employee owners may be organized to learn more about their rights and responsibilities as employee shareholders and demand to exercise their rights in the firms.

SECTION VIII: CONCLUSIONS

Good corporate governance practice is essential in setting effective relationships among the corporate agents and principals through which enterprises are directed and controlled. Corporate governance also provides a structure of public and private rules that specify the distribution of rights and responsibilities among the different counterparts of an economic entity such as its management, shareholders, the board, and other stakeholders.

Corporate governance is an important part of the economic and social development that will directly support corporate restructuring and socio-economic development programs in a transition country. Effective corporate governance contributes to the rule of law, anti-corruption efforts and building the well-functioning institutions in a market economy. In a way, corporate governance can be thought of the antidote to corruption!

Practicing effective corporate governance is also essential for the creation of competitive enterprise sector, which is a fundamental aspect of economic growth. Corporate governance also serves both as an important catalyst for attracting both domestic and foreign direct investment and the integration of the country with the global financial markets by channeling the financial resources into their most efficient uses.

Corporate governance reforms in Mongolia pose a serious policy challenge. They require political will, long-term focus, resources and determination to overcome serious resistance from vested interest groups.

To lay the foundations for their success, it is also important to ensure competition and pressure from not only the shareholders but from all the stakeholders including the suppliers, customers and creditors, as constituencies for better corporate governance.

A strong emphasis should also be put on the direct commitment of the private sector to improve corporate governance practices and to develop a series of initiatives that enhance corporate governance culture and standards.

In order to ensure the success of corporate governance reform efforts, the unfinished privatization must be brought to a closure in a rapid fashion. Mongolia will be better off if the state should decrease its direct intervention in the economy through ownership in SOEs to a position where it takes on the role of an enabling, prudential regulator.

Improvement in the position of the state ownership in SOEs will improve the corporate governance environment by example, rather than an opaque shareholder. Since corporatization has already been accomplished, the next step is ensuring the commercialization of the SOE operations, into transparent, viable and competitive self sustaining enterprises.

Moreover, adherence to and implementation of widely recognized principles, including the OECD Corporate Governance Principles, is an important basis for the private sector as well as for policy development and implementation. It also sends a strong signal about the commitment of governments and corporations to reform.

Some concluding thoughts are as follows:

- Mongolia is at a cross roads in terms of corporate governance,
- The legal and regulatory frameworks are largely in place,
- Due to the corporate finance patterns, finance is mostly through banking based transactions. Measures must be developed to allow the further evolution of securities markets,

- The incomplete privatization (75% of all shares traded have state ownership) leads to opacity and the persistent lack of depth in capital markets,
- Rapid conversion of shares into controlling owners hands must be facilitated so that private sector is fully privately owned,
- Minority shareholders rights must be protected through various means,
- FRCs enforcement capacity must be increased,
- Directors' capacities must be increased, through training and educations programs. Boards' capacity to formulate strategy and to provide effective oversight on the execution of corporate strategy needs to be improved,
- Board responsibilities must be widened,
- Shareholders rights and their equitable treatment must be increased,
- Transparency and disclosure is the most important source of weakness in the CG practices in Mongolia,
- Public education is a very important aspect of increasing CG awareness,
- Banks must play a larger role in the promotion of effective corporate governance practices, especially in the area of transparency and disclosure requirements,
- Mongolian Stock Exchange must be transformed into a vibrant market. Government bonds, and/or asset backed securities instruments may help improve the liquidity,
- Accounting and auditing profession must be further developed through licensing and certifications programs,
- IFRC accounting standards must be firmly put in place.

Recent events has demonstrated very effectively that corporate governance is a public policy concern that is critical to economic growth. Operationalizing the emerging international principles and standards of business conduct, including the OECD Principles of Corporate Governance (2004) and the Mongolian Code of Corporate Governance (2007), within the complexities of global economy must be a matter of national development strategy and a public policy concern for Mongolia. This requires continued technical development assistance.

In Mongolia, the rule of law could only be firmly established if legal and regulatory institutions and frameworks surrounding property ownership and control, securities and financial markets are strengthened, and enforcement skills and judicial capacity are significantly upgraded.

In addition to the government, private sector must also take action to remedy the issues within its grasp as an operator of the market economy. Eliminating the weaknesses in the enterprise sector due to incomplete privatization, restructuring and improving competitiveness, liberating the enterprise sector from the shadow economy, increasing transparency, enhancement of managerial capacity and improvements in the overall management culture are essential ingredients for success in strengthening corporate governance.

Public education is a major component of creating effective corporate governance in a given country. In order to get investors, issuers and financial intermediary institutions to interact effectively, the participants must understand the rights and responsibilities of property ownership.

In order to ensure the interaction between the three participants of financial markets, the investors, the issuers and the intermediaries, management education must be enhanced, civil society organizations, well functioning civil and professional bodies such as NGOs and SROs must be formed, and professional associations to be empowered for effective influence on corporate agendas, and to provide duality in the governance processes.

SECTION IX: RECOMMENDATIONS

A. Main objectives

USAID has a unique opportunity to provide technical assistance to Mongolia with significant deliverables. The challenges of establishing a strong corporate governance culture in the globally integrated economies would require close cooperation by the donor community.

In order to achieve the USAID strategic objectives of “accelerated growth and development of private enterprise” and “a more competitive and market responsive private sector.” The main purpose of a USAID intervention in corporate governance reform must be to operationalize the OECD principles of Corporate Governance or the Mongolian Code for Corporate Governance currently in effect.

BOX 1:
The final outcome of Mongolian Corporate Governance Reform

The reform interventions will result in achieving the general “voluntary” compliance and implementation of the following six OECD principles:

1. Ensuring the basis for an effective corporate governance framework in which the corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.
2. The rights of shareholders are effectively protected through the establishment and implementation of necessary legal and regulatory frameworks and the founding of the necessary institutions.
3. The equitable treatment of all shareholders, including minority and foreign shareholders is achieved through the effective enforcement of the legal and regulatory frameworks, giving the shareholders an equal opportunity to obtain effective redress for any violation of their rights.
4. The role and the rights of stakeholders are recognized as an integral part of the corporate governance frameworks, as established by legal and regulatory frameworks, and are actively encouraged through the co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
5. The disclosure and transparency aspect of corporate governance framework should ensure that timely and accurate disclosure is made on all of the material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
6. The responsibilities of the board of directors of a company aspect of the corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's responsibility and accountability to the company and the shareholders.

In order to achieve the strategic objectives, the results framework would need to have the following principal expected outcomes:

1. Competitive and efficient Mongolian private sector enterprises;
2. Increased access to market driven business skills;
3. Creation of an enabling legal and regulatory framework; and
4. Transparent and open financial system created.

In order to accomplish these goals, USAID/EPRC technical assistance could engage in the following efforts to:

1. Improve and enhance the directors’ education. In addition, enhancement of management education and training in Mongolia is necessary;
2. Build and strengthen effective legal and regulatory institutions, civil society organizations such as investor NGOs, SROs, and regulatory oversight capacity for enforcement, and the creation of a business friendly environment.
3. Public education to increase awareness of the public in general towards implementation of good

corporate governance practices.

B. Promoting the basic values of corporate governance

The intermediate results of the efforts leading to the improvements in the six OECD principles can only be achieved as a result of creating a sea change in business practices and values through the adoption of the four crucial pillars of good governance: and **transparency, accountability, responsibility** and, **fairness**.

The technical assistance program for corporate governance reform will require a comprehensive perspective to private sector development. In order to create the business friendly, prudentially regulated environment, the corporate governance reform program ought to be centered around public and professional education as its major component.

This effort would involve institutions such as graduate and undergraduate level management educational programs at universities, business associations and centers of excellence, and financial-sector non-governmental organizations (NGOs). The program will help establish programs that will emphasize international standards of business, corporate governance, finance, accounting, and auditing so that the current thinking on business can be affected.

In addition to the “*principal-agent*” question resulting from the conflict of interest between the owner/shareholders and management as discussed above, effective corporate governance reform activities need to recognize that a broader field of players is required to support this effort new stakeholders must be identified and encouraged, and current efforts given an additional focus. This would include activities supporting:

- legal reform and judicial training,
- civil society development (business and shareholder rights groups),
- bankruptcy reform,
- the role of debt and equity in governance,
- better accounting standards and training,
- anti-corruption efforts, and
- management training, consulting, and corporatization of the business community.

Given the institutional weaknesses, it is recommended that corporate governance be viewed as a long-term goal of the reform activities.

While training and professional development of financial supervision offices and intermediaries are an important component of any comprehensive strategy, it should be accepted that good corporate governance requires a fundamental acceptance of basic business values and practices among a broad cross-section of stakeholders.

The goals of corporate governance reform program requires the establishment of “*civil society*,” however, an understanding and support for the components of effective corporate governance practices is a much longer-term undertaking. This undertaking is complicated by the current lack of existence of such institutions and apparent apathy and/or resistance to such practices as internationally accepted practices of corporate governance.

The best practice corporate governance development programs are best delivered through training programs, awards, certification and management education programs, as well as institution building efforts and institutional technical assistance to regulatory and legislative reforms.

Three overarching objectives would define this type of initiative:

- Identifying corporate governance landmarks for public or non-publicly traded corporations.

- Identifying key priorities in corporate governance and related issues for the government and the business community.
- Communicating key needs and concerns of main groups involved in corporate governance to policymakers, and to recommend improvements in government policies and laws.

C. Strategy for technical assistance in corporate governance

A successful strategy for the delivery of programs in Mongolian corporate governance reform should recognize that certain elements of institutional development must occur before a concerted corporate governance awareness program can be undertaken.

This would be undertaken under a **three-phase strategy**, that includes programs for sustainable *institution building*, *capacity building*, and *training and public education*. These programs may be simultaneously delivered or sequenced. However, Simultaneous delivery would be more effective.

It is believed that through these measures, voluntary compliance with the Mongolian Corporate Governance Code is more likely to be followed by the listed firms.

1. Institution building and policy frameworks on regulatory reform:

The purpose of this aspect is to heighten policy dialogue among the nation's various government and private sector institutions; increase investor confidence through more effective enforcement and to articulate and advocate for improvements in the legal and regulatory frameworks through various means.

Investors and creditors rely on the protections that a sound legal, regulatory, and enforcement environment provides. This second component of the corporate governance would work with NGOs, think tanks, and advocacy groups to advance the policy and regulatory agenda of the financial industry.

A key emphasis should be to heighten the policy dialogue regarding legislation; regulation and enforcement. This is needed to ensure the development of a favorable investment environment in Mongolia.

Effective enforcement is a crucial element to increasing investor confidence and will be emphasized by this activity. This program will thus have a significant training component.

The forums and advocacy groups likely to be assisted in articulating and advocating improvements in the investment environment and corporate governance regime are the following:

- **Corporate Governance Forum.** In collaboration with IFC, World Bank., EBRD, ADB and other international developmental institutions these Forums and Roundtables are designed to conduct high level conferences, workshops, papers, and assessments involving local private sector and government decision-makers and the international financial community (donor and financial industry). The Forum ought to be an annual event supported by the FRC, the MNCCI, MONEF, MSE, MOF, BOM and academic institutions. The Forum should also have support from the private sector, banks and international donor community, including IFC, IMF, the World Bank, EBRD, and ADB. It will conduct ongoing Mongolia specific roundtables and workshops led by leading speakers from Mongolia and International practices. The Annual Forum will be evolved into a “must go” event by all parties concerned.

The Corporate Governance Forum could, work with international institutions and donor agencies in building indigenous solutions and support for the development and implementation of corporate governance practices and principles through workshops, conferences, creation of a network of business groups and policy organizations to share experiences and approaches; engaging the local business community as a critical sponsor of CG reform; providing local businesses with access to educational and training materials; and identifying successful models for promoting corporate governance.

- **Establishing special task force on corporate governance and shareholders rights.** The Corporate Governance Forum could form an ad-hoc task force that will play an important role of developing consensus among government agencies and the private sector on a number of issues. This task force will work to widen the participation of the private sector in its activities and serve as an advisor to the Forum and relevant government bodies towards strengthening the corporate governance practices. Good partners in this endeavor would be the Mongolian National Chamber of Commerce and Industry along with the FRC and the BOM in cooperation with the private business leaders.
- **Investment communities.** Communities of enterprise managers, academics, and local government officials promoting improved better business practices to increase investment into their communities would need to be assisted. They will be supported in their efforts to restructure enterprises according to international standards of corporate governance, accounting, and auditing and best business practices. This activity should aim to increase the responsiveness of participating enterprises to their stakeholders and making them more profitable. The technical assistance would need to be flexible to shift resources away from lax advocacy groups to the better performing groups, if and when it is necessary.
- **Legislation.** The NGOs, forums, think tanks, and advocacy groups also ought to be assisted in articulating and promoting key legislation necessary to improve the investment environment in the region: Joint Stock Company Law; Audit Law, Securities and Stock Exchange Law; Laws on Collective Investment Institutions.

2. Capacity building: Development of NGOs That support transparency and accountability.

Mongolian Corporate Governance Code requires that each JSC must have at least three independent directors on the Board. At this point in time, internationally qualified and certified independent (non-executive) directors are very few if any, and far in between. We propose a certification programs to be begun immediately for independent directors training. In addition, through training and partnership programs, relevant authorities, most preferably civil society organizations, supported by the regulatory oversight authority, will assist all eligible NGOs to establish the following types of institutions key to enhancing the investment environment of a country in the region:

- **Corporate governance training for directors.** A “*Corporate Governance for Director’s Training Program*” is recommended for immediate implementation. The properly developed curriculum would provide the much needed core course through which these questions could be explored by placing the corporate pursuit of economic objectives in a wider ethical and societal context. Weak governance is the core cause of business failure. It is time for teaching ethics in management integrated with the better understanding of the four values of governance. In addition to ethics, management

programs must also offer a solid background in corporate governance. The board of directors of a company is the line of first defense against risks faced by a firm. In order to enhance the strategy formulation skills to serve shareholder interests better, corporate directors must gain a good understanding of all of the appropriate topics in corporate governance.

A 30-36 hour, 10 or 12 module program of rigorous study is being proposed. The modular training program will be a certification program that will eventually be globally recognized through securing international strategic partnerships. The program will impart the global best practice corporate governance knowledge to implement the OECD principles of corporate governance as embodied in the Mongolian Code.

The program will begin with a train the trainers program, upgrading the skills of the Mongolian instructors, which in turn will be taught to the directors. This will entail, the development of 12 modules, its ancillary materials including the local Mongolian case material, exams, training videos and other readings and reference materials.

Additionally, the Directors' training program will enhance the capacity of the partnered institution to increase its curriculum offerings, and the capacity for Train-the-Trainers programs. In the ToT programs, partnering academic institution will need to offer open the opportunities for knowledge to all eligible Mongolian trainers, wherever they come from.

Further details for the Corporate Governance for Directors Training program is provided in **ANNEX E**.

- **Corporate governance rating index can be developed** to help monitor the quality of corporate governance compliance at the enterprises that are listed and traded at the MSE. A recent perspective in this area comes from the corporate governance scoring methodology developed by Standard and Poor's and a number of other organizations such as The Corporate Library (TCL); International Shareholder Services CGQ; Governance Metrics International; Deutsche Bank; and Deminor Ratings. It is proposed here that USAID/EPRC develop a preliminary CGRI questionnaire instrument for discussion purposes based upon the current Mongolian Code. The purpose is to demonstrate design methodology and strategy. Further details on developing a CGRI Index is described in **ANNEX F**.
- **Shareholder protection organizations.** Many of the countries in the region have not developed meaningful NGOs advocating shareholders rights, policing corporations on behalf of shareholders, and supporting offended shareholders in the courts and regulatory system. Shareholder protection organizations will buy one share of every publicly listed stock and serve as a corporate watchdog for shareholders.
- **Public information networks.** Financial sector NGOs that monitor and disseminate enterprise information to investors and the public are vital to a healthy investment climate. Establish information centers that keep the annual reports of publicly listed companies available on a website to be accessed by the general public. Training assistance needs to be provided to established NGOs/SROs to assume the role of monitoring and disseminating this valuable information to the public.
- **Pilot programs with select companies.** The program will bring company level corporate governance assistance to help the select firms obtain new external financing through a series of improvements on the internal corporate governance structures. External enterprise financing (initial public offerings of stocks, bonds and other

corporate financial instruments) will be facilitated by enterprises practicing international standards of business norms and good corporate governance practices. Training will be given to the boards of these companies and their executive managers through executive seminars, round tables and other types of programs. Trainings provided in partnership with local participating academic institutions will provide guidance to financial intermediaries and business consultants the practical steps needed to attract finance. Promising candidates will be directed to international financial partners (banks and securities firms), and the International Finance Corporation in order to ensure that they will be rewarded with prospects of financing.

3. Public education and training

Members of the financial industry NGOs such as securities exchanges, brokers and dealers associations, bankers association, clearing and depository, accounting and auditors associations will have a direct and indirect impact to ensure the highest levels of business standards.

Corporate governance programs and the International Federation of Accounting Committees, which has a widely accepted program of standards for accountants and auditors, could be taught at the educational programs.

Financial sector, through its NGOs, needs to ensure its own compliance with these international standards and transmit them through its professionals to the enterprises throughout the region.

In addition, financial sector NGOs need to require their members to be certificate holders of such designation as Association of Chartered Certified Accountants (ACCA), Chartered Financial Analyst (CFA), and Master of Business Administration (MBA).

The NGOs/SRO will also progress toward membership in international organizations as the International Federation of Accountants (IFAC), International Federation of Stock Exchanges (FIBV), Federation of Eurasian Stock Exchanges (FEAS) and the Association of Investment Management Research (AIMR) in US.

This activity would guide all relevant NGOs in licensing and certification programs that fully incorporate international standards. Certification will work as firms having met the quality standards set by ISO.

It will also assist management institutes and universities incorporate into their curriculum courses that support professional licensing and certification programs such as the one that is being proposed with the IFE in Ulaanbaatar.

Using the already existing USAPD/EPRC public education programs such as the “Facts, Figures and Opinions,” and TV Chat programs and sketches would be extremely helpful in delivering the messages to the public regarding their rights and responsibilities as stockholder in a given firm, what to expect from the firm, what to look for in reports, how to obtain information on companies from MSE and FRC, train or educate journalists on investigative reporting on financial, economic and corporate governance related news, other TV and Press media and internet based informational educational programs to benefit the shareholders of Mongolia.

**ANNEX A: PEOPLE INTERVIEWED FOR THE MONGOLIA CORPORATE
GOVERNANCE SURVEY**

ANNEX A: PEOPLE INTERVIEWED FOR THE MONGOLIA CORPORATE GOVERNANCE SURVEY

#	Organization	Name	Position	E-mail	Phone
1	“Gobi” Co.	Dashzeveg	Member of the committee		99191313
2	“Ulaanbaatar Hivs” Co.	Munhjargal D. Tseveenravdan L.	CEO Secretary of Board		99110124 99351273
3	“Altan Taria” Co.	Nergui T.			99092546
4	“Niislel Urguu” Co.	Baatarsuren Ch.	Director administration and management department	info@niislelurguu.mn	88114948
5	“Eermel” Co.	Gulguu M.			99194537
6	“Moninjbar” Co	Myagmarjav N.	Finance Manager		96667741
7	“Hermes Center” Co.				305830
8	“Olloo” Co.	Ganbold D.	Head of Board		99110137
9	“State Department Store” Co.	Enhbayar Sh.			313239
10	“Zoos goyol” Co.	Gantuya D.	CEO		99091884
11	“Spirt Bal Buram” Co.	Tsevelsuren V.			99095300
12	“APU” Co.	Batkhishig P.	Director, Strategic Planning Department	batkhishig@apu.mn	99112863
13	“Atar-Urguu” Co.	Enhsaihan L.	Secretary of Board		70118901
14	NUM, Economic School	Enh-Otgon	Teacher of Economic Department		99050399
15	Trade and Development Bank	Randolph S. Koppa	President	r.koppa@tdbm.mn	(976-11) 318970
16	MNCCI	Demberel S.	Chairman and CEO	chamber@mongolchamber.mn	99112509
17	Institute of Finance and Economics	Batjargal D. (Ph.D)	President	dorlbatj@ife.edu.mn , dorlbatj@yahoo.com	99118297
18	Mongolian Securities Dealers and Brokers Association	Tseveenravdan L.	Executive Director	tsravdan@mongolchamber.mn	99110325
19	Mongolian Shareholders Association	Molotov T.	Vice President	t_molotov@yahoo.com	99166910
20	Dheroy Financial Advisory	Ariunsan Ch.	Investment Officer	ariunsan@dheroy.com	99116416
21	International Finance Corporation	David Lawrence	Program Manager, Advisory Services	dlawrence@ifc.org	99103336
22	Emeelt Mines LLC	Dr. Gerald Harper	Senior Vice President	gharper@westernprospector.com	99090817

			Mongolian Operations	gharpergamah@yahoo.com	
23	Ivenhoe Mines	Munkhbat A.	Senior Vice President, Executive Director, Country Manager	munkhbata@ivancorp.net	99112385
24	ING wholesale banking	Ir. Bert van der Toorn	Managing Director, Head of Natural Resources, Asia Structured Finance	bert.van.der.toorn@asia.ing.com	+65 9452 8623
25	GTs Advocates	Lucia Van Bebber	Managing Partner	lucia@gtsadvocates.mn	99118607
26	Nomin Holding	Enkhbayar Sh.	CEO	enkhbayar@nomin.net	99115515
Anod Bank					
27		Gur-Aranz E.	Head of Board		464114
28		Ulambayar L.	Chief Executive Officer	Ulambayar_fd@anod.mn	99116365
Bayangol Hotel Co.					
29		Batjargal D.			312255
30		Z. Tserenchimeg	Director of Finance	tserenchimeg@bayangolhotel.mn	99055732
Zoos Bank					
31		Batbayar D.	Chairman of the governing board		99114558
32		Tsolmon B.	Chief Operations Officer	tsolmon@zoosbank.mn , tsolmonb@gmail.com	99117582
33		Chudanji Sh.	President and CEO	chudanji@zoosbank.mn	330573
MCS group					
34		Gantumur Lingov	Vice President, Human Resources	gantumur.l@mcs.mn	99118123
35		Enkhtsetseg D.	Vice president	enkhee@mcs.mn	88114849
Financial Regulatory Commission of Mongolia					
36		Sharavsambuu B.	Member	sharavsambuu@frc.mn	330873

37		Ayush B.	Deputy director	ayush@frc.mn	99184130
38		Bayarsaikhan D.	Chairman	bayarsaikhan@frc.mn	262811
39		D. Dugerjav	Commissioner	dugerjav@frc.mn	313665
40		H. Bum-Erdene	Head of Securities Department	bumerdene@frc.mn	261893
Mongolian National Employers Federation					
41		Ganbaatar Kh.	Vise president, Executive Director	monef@magicnet.mn	99118449
42		Narmandakh D.	Head of Industrial Relations Department	narmandakh@monef.com	326445
43		Udval D.	Specialist of Industrial Relations Department	d.udval@yahoo.com	99719131
Mongolian Stock Exchange					
44		Tsendmaa Ts.	Head of Listing and Surveillance Department	tsendmaa@mse.mn	99099556
45		Zayadelger S.	Head of Administrative Division	zayadelger@mse.mn	99099558
Khan Bank					
46		Oyunbileg E.	Corporate Governance Executive	oyunbileg@khanbank.com	(976-11) 332 343-3056
47		Barry Madams	Deputy CEO	barry@khanbank.com	99114323
48		Ed Coll	Senior Advisor	ed.coll@khanbank.com	99109916
Lynch and Mahoney					
49		Jocelyn E. Steiner	Attorney-At-Law	jocelyn.steiner@mongolialaw.com	99100304
50		Bayarmaa B.	Attorney-At-Law	bayarmaa@magicnet.mn	99112820
ADB, Capacity Building for Financial Sector Reforms in Mongolia					
51		Adrian H. Ruthenberg	Country Director, Mongolia Resident Mission	aruthenberg@adb.org	976 11 329 836/323 507
52		Mandar P. Jayawant	Deputy Country Director, Mongolia Resident Mission	mjayawant@adb.org	976-11-329836/ 323507
53		Byambaa	National Team Leader	byambaa.losolsuren@gmail.com	99094223

		Losorsuren			
Mongolian Securities Clearing House and Central Depository Co., Ltd					
54		Narantuya L.	Deputy Director	narantuya_luvsan@yahoo.com	99009097
55		Baigalmaa J.	Manager of Public Relations Department	bglm_09@yahoo.com	99098558
Khas Bank					
56		Tur-Od L.	Vice President and Chief Compliance Officer, Director of Legal and Compliance Division, Social and Environmental Manager	turod.l@xacbank.mn	99118612
57		Ganhuyag G.	Chief Executive Officer	ganhuyag.ch@xacbank.mn	318185
58		Tserenhand G.	Social Environmental Compliance Officer, Legal and Compliance Division	tserenhand.g@xacbank.mn	99113025
BDsec, Inc.					
58		Lkhagvadorj B.	Deputy Director	lkh@bdsec.mn	323411
59		Dayanbilguun D.	Executive director	bdsec@bdsec.mn	99112846
State Property Commission					
60		Ganbold B.	Expert on state property administration	ganbold_1969@yahoo.com	99110860
61		Bailikhuu D.	Adviser	bailikhuu@yahoo.co.uk	(976-11)262466

**ANNEX B: MONGOLIA CORPORATE GOVERNANCE REVIEW: SURVEY
QUESTIONNAIRE**

ANNEX B: MONGOLIA CORPORATE GOVERNANCE REVIEW: SURVEY QUESTIONNAIRE

Shareholders rights and equitable treatment	
1. Privatization process ought to be accelerated and structured in order to improve the corporate governance of both state-owned and newly privatized companies. How does this fit into the environment in Mongolia?	State of privatization in Mongolia: Incomplete. Lack of political will to finalize is detrimental on improvements in corporate governance.
2. The ownership of privatized SME corporations must be consolidated while protecting the rights of their minority shareholders. What is your perspective on this vis-à-vis Mongolia?	The ownership of privatized SME corporations must be consolidated while protecting the rights of their minority shareholders. Essentially one person controls the board of directors of small and medium enterprises.
3. Are independent and secured registrations of shares guaranteed for all companies with a significant number of shareholders, and not only for companies quoted on the exchange?	The Financial Regulatory Commission completes the registration. Unregistered companies register by themselves.
4. Is the free transferability of shares granted for public companies as with private ones?	State companies are privatized directly through “corporatization” and held by the government until a foreseeable future without a possibility of a transfer. When the government decides to privatize, some of the SOE shares are sold through the MSE for privatization. This is the only way the free transferability of shares can be granted for public companies as with private ones. Mostly the Chinese model is applied.
5. Is information concerning the ownership and control structure of widely held companies accessible to shareholders and publicly available for all listed companies?	Information concerning the ownership and control structure of widely held companies are not accessible to shareholders and publicly available for all listed companies. Participating entities (shareholders) do not have easy access to information.
6. Does the management encourage shareholders’ active participation in shareholders meetings?	The management of listed companies does not necessarily encourage shareholders’ for active participation in shareholders meetings There is no support from the management.
7. In order to achieve full participation of shareholders in shareholders meetings, in general, are procedures to convene shareholders meeting: (i) more stringent? (ii) provide all shareholders with sufficient, relevant and timely information regarding issues on the agenda?	Some ads are placed in the local newspapers to announce the shareholders meetings. However, there are not enough efforts by the company management or the Board to achieve full participation of all shareholders in shareholders meetings. In general, the procedures to convene shareholders meeting are not too stringent, and the ads provide shareholders only with insufficient information, even though some of the information is relevant but somewhat timely information regarding the issues on the agenda.
8. Are shareholders provided with or have easy access to substantial, relevant and reliable information on issues on the agenda prior to the shareholders meetings?	Shareholders are not provided with nor do they have easy access to substantial, relevant and reliable information on issues on the agenda prior to the shareholders meetings. Satisfactory information is scarce for shareholders.

9. Are shareholders provided with faithful minutes and results of these meetings within a reasonable timeframe in combination with the use of media, and own corporate websites?	Shareholders are not provided with faithful minutes in most of the cases. Results of the general shareholders meetings are never provided within a reasonable timeframe in combination with the use of media, and own corporate websites. Information is usually unavailable or rare.
10. Could listed (or unlisted) Mongolian companies be prevented from setting up procedures that impede shareholder voting?	Listed (or unlisted) Mongolian companies could theoretically be prevented from setting up procedures that impede shareholder voting. Registration information must be provided to the Stock Exchange. However, these have been experienced events.
11. Do the Mongolian companies provide effective and secured procedures to vote in absentia as well as proxy voting?	It is possible for the Mongolian companies to provide effective and secured procedures in order to allow for voting in absentia as well as proxy voting.
12. What is the practice and percentage of large and listed firms that have established an active investor relationship department for the sole benefit of shareholders?	The practice and percentage of large and listed firms establishing an active investor relationship department for the sole benefit of shareholders is a rare occurrence in Mongolia. There is no such service. The secretary of the board of directors, or a designated manager currently implements the investor relations.
13. To what extent does the government encourage the Mongolian institutional investors to become more active corporate governance participants in order to protect the interests of their investors and beneficiaries?	There is no government policy. To what extent does the government encourage the Mongolian institutional investors to become more active corporate governance participants in order to protect the interests of their investors and beneficiaries?
14. What are the kinds of activities of shareholders' associations that support or encourage informed participation by individual investors? What is the current status of the development of shareholders' associations?	Shareholders' associations are not as effective in supporting or encouraging informed participation by individual investors. As a result, the current status of the development of shareholders' associations such that the rights of majority and minority shareholders are breached because associations of shareholders are not well developed.
15. Do all corporations that are in a position to pay dividend do so within a reasonable period and follow clear rules regarding who is entitled to such dividends?	There is no specific regulation on distributing dividends. Corporations that are in a position to pay dividends do not necessarily distribute dividends within a reasonable period and follow clear rules regarding who is entitled to such dividends. This aspect of corporate governance is not developed in Mongolia.
16. Are any changes in capital structures performed in a manner that ensures equitable treatment of shareholders? (i.e. through fair pricing mechanisms, the respect of pre-emptive rights in case of new issues, and the respect of pre-established procedures for changes in control).	Changes in capital structures are not performed in a manner that ensures equitable treatment of shareholders. Fair pricing mechanisms are not followed. Pre-emptive rights in case of new issues are not respected. With respect to the pre-established procedures for changes in control, these are not followed even though there is a regulation. Regulations are not implemented accordingly, which causes abuses of minority shareholders rights.
17. Are procedures for approval of major transactions, strengthened and respected, and do they include fair evaluation processes?	There are no procedures for approval of major transactions, they are not strengthened and respected. There is no fair evaluation processes implemented.
18. Are there, if any, monitoring and control mechanisms that are put in place	There are no monitoring and control mechanisms that are put in place or

or reinforced to avoid abusive related party transactions?	reinforced to avoid abusive related party transactions. A regulation of affiliated entities is very important in Mongolia.
Enforcement and implementation	
1. Is the capacity of the judicial system to effectively deal with commercial disputes adequately strong?	No, due to a lack of sufficient knowledge background in judges.
2. Do shareholders, and where relevant, other stakeholders, have access to effective redress mechanisms, including professional arbitration and low cost collective efforts?	Access is available but is not effective.
3. How independent is the Mongolia FRC?	The Financial Regulatory Commission is an independent institution established by the parliament.
4. Does the Mongolian FRC have the resources, remedies and accountability necessary to oversee financial markets and self-regulatory organisations effectively?	Yes.
5. Are there ongoing efforts to strengthen FRC capacity for enforcement? Has there been an effective establishment of criminal liability for managers and board members failing to disclose their interest in Mongolia?	There are ongoing efforts to strengthen the capacity of FRC. The Criminal Code stipulates crimes of financial nature.
Board structure	
1. Numbers of directors on board on average in Mongolia corporations?	The current Company Law requires up to 9 directors on the Board. Directors are not selected to their positions based on their meritorious achievements.
2. Number of independent directors on board?	The new Corporate Governance Code of December 2007 requires minimum of 30% independent board members to be in the board of directors. However, this clause is not yet implemented by many of the corporations.
3. What is the general experience in appointing directors that are permanent members (management)?	The general experience in appointing directors that are permanent members of the company management is a greater likelihood. However, the Code requires a nominating committee to select the director and recommend it to the general Shareholders meeting, for election.
4. Is the number of directors on the board adequate for effective operations?	There are no specific rational policies that are followed by Mongolian companies to include non-executive directors as yet, even though the Corporate Governance Code specifies that “no less than one third of the Board of Directors” must consist of independent or non-executive directors.
5. Are there too many directors on the boards for effective operations?	The number of directors on the Mongolian boards for effective operations could never be considered too much. The general observation is that the listed companies simply have just the adequate numbers that the law requires. But

	unless these directors are shareholders, they have no authority.
6. Are there too few directors on the board for effective operations?	The possibility of having too few directors on the board for effective operations would probably be greater likelihood in Mongolia.
7. Do the boards in Mongolia allow individual directors to engage outside advisors to assist them?	Generally, there are no practices in Mongolian boards to allow individual directors to engage outside advisors to assist them. But this may not always be practiced. Poor selection of an executive management.
8. Do the boards in Mongolia have a definition of independent directors?	The independent directors are well defined in the Corporate Governance Code (Regulation). However, the Company Law is silent on this matter. An outside independent director or non-executive director is a member of the board of directors of a company who does not form part of the executive management team. Generally the non-executive director is not an employee of the company or affiliated with it in any other way. They are differentiated from inside directors, who are members of the board also serving as executive managers of the company (most often as corporate officers). Non-executive directors have responsibilities in the formulation of strategy, performance evaluation of the management based on meeting agreed goals and objectives and monitoring, and where necessary removing, senior management and in succession planning. Non-exec directors, theoretically in an ideal case, would provide independent views on resources; management appointments and the standards of conduct. Non-executive directors must act as the custodians of the governance process. Independent directors are not involved in the day-to-day running of business, but they monitor the executive activity and contribute to the development of strategy. The Mongolian Corporate Governance Code attempts to limit the numbers of members of the executive management in a BOD in order to ensure the independence of the Board.
9. Can the chairman of the board also be a member of the management, and is this healthy?	The CG Code explicitly disallows the Chairman of the Board to be the same person as the CEO in order to ensure the independence of the Boards. The complete implementation of this is not too clear.
10. Is there any requirement for each board member to hold a minimum percentage of shares?	The Mongolian Company Law does not explicitly require a minimum share holdership for a board member. However, the CG Code prohibits share ownership for independent board members.
Committee structure	

1. How many firms have established the following committees by initiation of the Board? (a) Audit committee; (b) Corporate governance committee; (c) Nominating committee	Major companies.
Audit committee	
1. Number of directors on the audit committee	No less than three members of the board of directors.
2. Number of independent directors on the audit committee	Two thirds shall be independent members.
3. Does at least one member of the audit committee have an accounting designation?	Yes.
4. Each member of the audit committee is financially literate	At least one member.
5. The audit committee has direct communication channels with a. The internal auditors b. The external auditors	Internal and external auditors.
6. The audit committee discusses with the external auditors, the auditors' judgment about the quality of accounting principles applied in the firm's (corporation's) financial reporting and disclosure	Yes.
7. The board reviews and re-assesses the audit committee's mandate annually	Yes.
8. The audit committee requires the external auditors deliver an annual statement to the audit committee disclosing all relationships between the external auditors and the firm (corporation)	Yes.
Nominating committee	
1. Number of directors on the corporate governance and/or nominating committee	Not specified in the corporate governance code.
2. Number of independent directors on the corporate governance and/or nominating committees	Not specified in the corporate governance code.
3. The corporate governance and/or nominating committee is responsible for recommending new directors for appointment to the board	Yes.
4. The corporate governance and/or nominating committee is responsible for ongoing assessments of each director	The nominating committee engages in regular overviews and assessments of each director.
5. The corporate governance and/or nominating committee is responsible for director remuneration	No. The corporate governance code requires a separate remuneration committee.

Board policies, practices and procedures	
1. Written position descriptions have been developed for: a. The board b. The Chief Executive Officer	In some cases Yes. IN most cases however, there are no such situations. Many board members are a close relation of the control interest holder.
2. The board: a. Approves corporate objectives b. Develops corporate objectives	Both functions.
3. The board has documented the roles and responsibilities of the following committees: a. The audit committee b. The corporate governance committee c. The nominating committee	Yes, the corporate governance code and the Law on Companies provide that that the board of directors shall operate these committees.
4. The board has documented which decisions require prior board approval	The deals concerning large amounts or involving affiliated entities.
5. The corporation allows directors to engage outside advisors at the corporation's expense	No specific provision in the legislation.
6. The board or a committee of the board must approve engagement of outside advisors	No specific provision in the legislation.
7. The board has adopted a code of conduct an ethics for itself	No.
8. The corporation provides an orientation and education program for new directors	No requirement in the legislation.
9. The board has implemented an assessment process for: a. Itself as a whole b. Each committee c. Each director	All of the listed assumptions. The corporate governance code stipulates on assessments of the board and directors.
10. The board and the audit committee have an appropriate and adequate process to choose or change the external auditors	Not specified clearly, although the external auditors work on the basis of a contract.
11. The board's expectations of each member of senior management are: a. Clearly defined b. Communicated to the management c. Documented	Not specifically defined in the legislative acts.
12. The boards are fully aware of: a. The existing legal and regulatory issues about corporations in	The board of directors is aware of the legislation of Mongolia, especially, the Laws on Company and on Securities Markets. The board also knows about

Mongolia? b. Other emerging global business standards (Pensions, Insurance, BIS, IAS, ISA) c. EU directives on corporate governance d. The OECD Principles of corporate governance?	global business standards. EU directives are not relevant in Mongolia. The OECD principles of corporate governance have been the inspiration of the Mongolian code.
What are your reactions to the following situations?	
13. Each director attends a minimum number of a percentage of board meetings each year.	Yes, the Law on Companies and the code require mandatory attendance of board meetings. Otherwise, the disciplinary actions shall be taken.
14. The board formally meets without management and management directors present.	Yes.
15. Independent directors formally meet separately as a group.	The law and the code do not specify this assumption.
Risk assessment and strategic planning	
1. Does the board in a Mongolian corporation try to ensure integrity of the corporation's internal control and management information systems?	The internal supervision unit under the board of directors manages the company's operation plan and maintains accounting and information.
2. Are there any observed practices in which the board has formally identified the corporation's principal business risks?	The obligation of the board of directors is to identify the risks.
3. How does the board accomplish this?	Through the regular risk analysis.
4. Are there any observed practices in which the board has implemented a process to manage the corporation's principal business risks	The board of directors implements a regular risk analysis among its other functions as stated in 3.1.2 of the corporate governance code.
5. Is there a common practice by which the board has adopted a strategic planning process?	It is the primary duty of the board of directors to define a strategic plan.
6. Are there any practices in Mongolia where the board has established a succession plan for senior management, which includes identifying, appointing and training of new senior management?	No specific practices of succession planning.
7. Are there cases where the board has established formal procedures for responding to shareholder feedback and concerns?	The meeting of shareholders is the main event where the board and shareholders communicate.
Board compensation	
1. Do all directors receive remuneration?	The directors are compensated.
2. Do only independent directors (if any) receive remuneration?	Yes, according to the committee on remunerations.
3. The director remuneration is in most cases is: a. Appropriate given their risks and responsibilities b. Too low given their risks and responsibilities c. Too high given their risk and responsibilities	The remuneration of directors is appropriate given their risks and responsibilities.

4. Directors receive stock-based compensation.	Not specified in the corporate governance code.
Corporate disclosure and transparency	
1. The boards have established formal communications policies for the corporation in most of the Mongolian corporations.	Yes.
2. The boards of Mongolian corporations have established policies whereby press releases, etc. are reviewed, prior to distribution of corporate communications (dissemination to the public) by: <ul style="list-style-type: none"> a. The Board b. Senior management c. In-house legal advisor-counsel d. External legal advisor-counsel e. External auditors 	Press releases are reviewed by public relations departments or the members of the board themselves.
3. Are there cases where the boards use an investor relations firm concerning the distribution and dissemination of corporate communications?	No.
4. The board discloses annually or otherwise how an independent director is defined	No.
5. How is such disclosure made?	There is no disclosure.
6. The following matters are disclosed in the annual report or proxy: <ul style="list-style-type: none"> a. Measures for receiving shareholder feedback and concerns b. The board's expectations of senior management c. Director remuneration and shareholdings d. Board effectiveness assessments e. The procedures for recruiting new directors f. The board's mandate g. Board committee mandates and activities h. Board composition, including independent directors 	All of the requirements are stipulated in the corporate governance code.
7. Is the adoption of International Financial Reporting Standards (IFRS) pursued and fully implemented in Mongolia? How is the consolidation requirements dealt with?	It is pursued, but not fully implemented. The Law on Accounting stipulates the International Accounting Standards.
8. Is information concerning the ownership and control structure of widely held companies accessible to all shareholders? Are they publicly available for all listed companies? This information should encompass beneficial ownership.	The information concerning the ownership and control structure of widely held companies is confidential and potential investors cannot obtain such information.
9. How are the material events disclosed by corporations?	Corporations disclose these events to shareholders and regulators through their statements.

10. Are regulations concerning event information disclosure complete and does the stock exchange actively monitor such disclosure and sanction companies who fail to comply with the rules?	The relevant laws, corporate governance code and other regulations of FRC and MSE require event information disclosure. The stock exchange actively monitors and sanctions companies but the enforcement is not sufficient.
11. Do companies disclose on a voluntary basis all relevant non-financial information in order to allow a better understanding and assessment of the company's business, activity and situation?	Only major companies. Most companies disclose in compliance with regulations.
12. Is there a complete clarity in the respective responsibilities of the different company organs and the external auditors regarding disclosure?	No.
13. Does the Mongolian FRC actively monitor companies' compliance with disclosure requirements and have the capacity to prescribe and enforce these requirements?	FRC monitors the compliance and has not the capacity to prescribe and enforce.
14. What are some of the efforts to enhance the shareholders' access to information? Do companies as well as authorities use efficient and modern communication to reach the targeted audiences?	Publications in newspapers and websites.
15. What are some of the efforts in strengthening the regulation of the accounting and audit function?	Ensuring the fairness and independence of accountants and auditors.
16. Is there regulation of the audit function that especially focuses on ensuring auditors' independence?	The Law on Auditing provides the regulation on independence of auditors.
17. In Mongolia, has the quality and strength of professional organizations of accountants and auditors been significantly reinforced in the recent few years to strengthen corporate governance?	Yes, to a small degree.
18. Are there ongoing efforts to training accountants and auditors in international accounting standards to enhance their capacity?	Yes, the institute of accountants conducts trainings for their members.
19. Is the role of the independent media in the dissemination of company information and in promoting global transparency in business practices strengthened and supported?	No. Due to a practice of information confidentiality.
20. Should all listed corporations be required to fully disclose at least annually, their corporate governance practices in reference to the generally accepted best practices (i.e. OECD Principles) of corporate governance	Yes.
Other questions:	
1. Please briefly discuss any other governance questions that affect your corporation	Lack of understanding of corporate governance. Low commitment of financial resources.
2. Please describe what would be most helpful corporate governance tool that could be created to help privatized firms, or any new issuers to achieve better corporate governance.	Education and training of directors and members of the board.

3. Any additional comments about disclosure, boards, shareholders?	Activity, scope and capitalization of companies must be clearly communicated to the investing public.
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**ANNEX C: OBSERVATIONS AND RECOMMENDATIONS ON SECURITIES
MARKET AND RECOMMENDATIONS**

ANNEX C: OBSERVATIONS AND RECOMMENDATIONS ON SECURITIES MARKET AND RECOMMENDATIONS

The issuers:

Economic incentive structure

- As issuers, the economic incentive structure for Mongolian firms to issue new debt or equity issues seem to be very few, and far in between.
- The main problem for Mongolian listed firms is about full disclosure, which costs a lot of added capital requirement at this time to convert and comply, the perception of prohibitive fees and commissions for underwriting, distribution and listing requirements.
- Entrenched managements are not so interested in making their inefficiencies and weaknesses known to third parties.

Capacity and skills

- Listed firms that are nonperforming either need to have market oriented management to pursue new outside financing, without causing dilution of their shareholdings during this period of consolidation or they must leave the MSE to become fully private.
- Another concern for the would be issuers in Mongolia is the lack of understanding of the market benefits and the lack of recognition that good corporate governance allows for better access to finance.
- The third important issue is the lack of proper capital markets infrastructure to undertake a new issue through the primary markets.

Structural considerations

- Most of the firms listed in MSE need to be restructured in order to become more viable, so that they can meet the rigorous listing requirements based on disclosure and transparency rules which rely heavily upon the international accounting and auditing rules.
- Other important consideration in this regard are that companies are not attractive investments to new investors because privatized companies listed have not been completely privatized, and the government does not seem to have the political will to let them go completely, by holding on to a certain proportion to retain control.
- The other, more profound reason is that the economy did not yet allow for the creation of more profitable and sizable companies.

The investors:

Economic incentive structure

- For individual investors to participate in the Mongolian capital markets, brokerage fees and commissions, as well as other hidden costs may be too high.
- For the institutional investors, opportunities to find shares of economically viable enterprises to invest in are few and far in between. If they exist, they are possibly subject to manipulated market prices.
- Other reasons which may keep the willing investors out of investing may be the overbearing regulatory disincentives, and the potential for double tax burden on investors.

- The environment under these circumstances seems to punish the earnest investors, while the corrupt ones seem to benefit from certain loopholes.

Capacity and skills

- There are some statutory liquidity and investment directives that constrain the financial flows to investors, there are few institutional investors who are willing and able to take the risks associated with trading, and thus they do not participate in securities trading.
- Most importantly, there are very few, qualified investment advisors and asset management specialists (portfolio managers) who would be effectively involved in trading and asset management transactions.
- This problem may become acute, when eventually life insurers, private pension funds and management companies vie for business, without proper licensing and certification.

Structural considerations

- A very important reason why there are not too many investors actively participating in securities markets transactions is because of lack of capable institutional investors in Mongolia.
- This situation is exacerbated by the fact that there are a few dominant institutional investors that are too large for the size of the market, and not find enough opportunities to trade, with one or two dominant players in the market.
- The market intermediaries so far have been ineffectual in providing an effective force in the market place, however, with the expected plan surpluses following the pension reform in a few years, there may be more worthy institutional investors to create value in the markets.

The intermediaries:

Economic incentive structure

- There is excessive number of broker/dealers in existence in Mongolia, 36 to be exact. However, only two of them account for more than 50 percent of business. This many intermediaries, without much knowledge and professional background are crowding out the market for opportunities for the more knowledgeable and competitive market intermediaries to transact in the markets.
- The Financial Regulatory Commission could quickly take care of this situation by enforcing prudential regulations requiring higher capital adequacy, and licensing structures as well as empowering self regulatory organizations (SROs) to handle much of the licensing and training requirements.
- For the intermediaries to flourish in Mongolia securities markets, there needs to be good opportunities. The current situation is that there are

Capacity and skills

- Most of the market intermediaries in existence are unprofitable and can not sustain their existence, due to high industry competition for very low volumes.
- Regulations are also proving to be costly but the most important problem is the lack of business skills in this area.
- Crucial skills needed for effective intermediation is to be able to conduct accurate market and economic research, marketing, pricing of deals and services. This causes the main difficulty in creating any volume, coupled with the lack of investors.

Structural considerations

- The most important problem in this area is the existence of just too many intermediaries, and not enough business for all of them.
- Financial Regulatory Committee could empower the SROs, and raise the ante for licensing of the intermediaries and increase the capital adequacy requirements.
- SROs must be well supervised and regulated.

Recommendations:

- In light of the above summary and conclusions, the following sections will attempt to identify strengths and weaknesses of the Mongolia securities markets, and will provide policy recommendations for immediate action.

Strengths in market structure

- Secondary market trading takes place on MSE. The inefficiencies and problems in the price discovery mechanism in the secondary market are not primarily systemic. It results mainly from the lack of transparency; insider trading, excessive returns by intermediaries (broker/dealers) on sales of strategic stakes and large blocks of shares to trade purchasers, strategic investors and rarely foreign investors.
- Insider trading and other major manipulations in equities markets trading are diminishing as an increasing proportion of outstanding equity is consolidated by long term strategic holders.
- The Mongolian Stock Exchange is a medium in which smaller, retail, orders are traded. The larger, wholesale, orders are executed through informal market-makers in the direct trade sector of the market, which functions relatively well. Price volatility and lack of liquidity in stocks below the top six firms is more a rational reflection of the size and poor fundamentals of the underlying issuers and poor corporate disclosure than of defective market mechanisms. However, all trades must be made through the MSE for further deepening the market
- Even though it is improving, price discovery mechanism still needs to be more transparent due to informal market making, and to continuous auctions process at the MSE.
- There should be further improvements in disclosure and transparency. Further, improvements are necessary in the quality of pricing.
- Increasing the effectiveness of enforcement by the FRC to require final settlements of all securities traded through the exchange would be a vital step.

Strengths in the regulatory framework

- The legal and regulatory frameworks are aimed at emulating the international best practices and standards such as the IOSCO principles of securities regulations or the OECD Principles of Corporate Governance. There are however, gaps between the Mongolian legal and regulatory frameworks. For instance, these gaps between the securities law, the company law and the Corporate Governance Code of 2007 must be eliminated through further harmonization work.
- The contemplated future revisions on legal and regulatory frameworks aim at further harmonization. Efforts are made in improving the transparency of information flow through adequate disclosures from a new law on Companies.
- The Financial Regulatory Commission exists as an independent regulatory body and has been operational since 2002.
- The Financial Commission has the power to initiate adequate rules and regulations and, increasingly, to enforce them.
- The Financial Regulatory Commission is accountable to the parliament, and the Commission Chairman reports to the Parliamentary Economic Standing Committee.
- The Commission is, dependent on the government budget, even though it has the authorization to charge fees to market participants in order to supplement its budget.
- The Financial Regulatory Commission law stipulates the need for co-ordination with other supervisory authorities, generating synergies in the supervisory process.

Weaknesses in market structure

- Despite recent improvements, the most serious defect of the Mongolia securities market continues to be the lack of price integrity. This is due to the lack of transparency in the markets, off market transactions, and rampant market malfeasance.
- Lack of price integrity, apart from permitting fraud, lowering investor confidence and undermining primary market operations (because "issuers do not dare to issue and investors do not dare to invest"), could create inequitable treatment of the holders of shares. This has significant wealth effects on shareholders of these stocks, whose holdings lose value due to liquidation of the underlying company assets at highly discounted prices. This price loss is a result of lack of transparency if financial information relative to the assets values, earnings or prospects of the underlying issuers. Conversely, new buyers of shares may suffer from over-valuation of the shares until they settle in equilibrium. There is a very wide range of opportunity for abuse, and even without abuse, the price discovery mechanism does not allow for fair and equitable treatment of all security investors, whether they make buy, hold or sell decisions.
- Mis-pricing is a secondary issue, which occurs as a result of failure of the regulatory system to enforce adequate corporate disclosure (both on issuers and on takeover and substantial acquisitions target companies). The FRC's decision to suspend 166 shares for lack of trading action was a bold move. However, concerns for minority shareholder protection has precluded the regulatory agency from completely de-listing these securities until they resolve the issues with the minority owners.
- There is also the systemic undervaluation of less liquid stocks with price earnings ratios of less than one. This is mainly due to the market perception that firms are not well managed, they have excessive financial leverage, and have high levels of unutilized capacity. But it is also due to the under pricing of shares because investors are dissatisfied with the quality of disclosure they are getting.
- New equity issues (IPO's) are very few and not very significant. Lack of new demand for equity may be explained by several factors: first, by an unfavorable investment climate; perceived high level of risk in equities; second, by incomplete level of privatization in most of joint stock companies

with continued state ownership, precludes the firms from issuing additional new shares; third, by unwillingness of the new owners of privatized enterprises to use this particular financial instrument, fearing to lose control over an enterprise.

- The market for corporate debt is practically non-existent in the domestic stock market. The main reasons for why enterprises do not use corporate bonds as a source of new corporate finance is the possible negative impact of tax legislation and high interest rate on debt. This can be improved by taking effective new macro economic measures to lower the interest rates, and change tax rates as well as improving corporate governance.
- The market is ill-suited for new issues of IPO's. Corporate finance activities are hindered because of the regulatory requirements relative to share issuance, the delays in registration of new issues by the courts, and the prospectus provisions of the Securities Law. This defect inhibits takeovers and capital restructuring which could play an important role in the more general restructuring within the corporate sector. The Civil Code should provide the empowerment needed for this purpose.

Weaknesses in regulatory framework

- The process of harmonization between laws and regulations is limited by the national laws when conflicts arise. This may require some kind of updated “arbitration court” system.
- The laws related to financial sector and the impact on Corporate Governance Code are not adequately reconciled leaving loopholes or inconsistencies, particularly in respect to the Civil Code.
- Lack of integrity in pricing reflects a failure to establish and enforce standards of ethical conduct by the securities market institutions and by the regulatory authority. Empowerment of Self Regulatory Organizations (SROs) may help in this regard.
- The enforcement of capital markets regulations requires highly specialized skills in enforcement such as investigation, monitoring and surveillance by the regulatory authority. These functions may require more capacity building and may require significant resources for FRC.
- In addition, judicial system, court bailiffs, investigators and prosecutors are not equipped well to deal with financial sector cases effectively, and much in the way of increasing capacity and skills in this area is required.

Recommendations for course of action

Recommendations for improvements in market structure

- Consider implementation of a universal clearing/settlement center project. Analysis of costs would indicate whether center could operate on a competitive basis and withstand competition from cross-border clearing centers.
- Consider interaction of block trades with market maker quotations.
- Consider de-listing majority of companies from MSE and others if they are not traded for a significant lengths of time, or are illiquid.

Recommendations for improvements in the regulatory framework

- Promote and enforce ethical conduct:
- The subordination of the interests of licensed persons and persons with fiduciary responsibilities in the financial sector—requires certification and continued education.

- Establish, duties of skill and care, suitability of advice, and suppression of fraudulent conduct (particularly by "related persons" transactions with funds and companies and by insiders generally).
- Promote adequate corporate disclosure through stringent enforcement.
- Create an environment, in cooperation with other government authorities where appropriate, to facilitate raising new capital and restructuring.
- Co-ordinate the development of voluntary, private, self-regulatory organizations with effective prudential regulatory supervision avoiding direct interference in the affairs of private market activities.
- Establish a prioritized program with policy options which should take account of Mongolia Government priorities combined with the leading international advisory institutions such as IOSCO and OECD.
- Reinforce the State bodies' relationship to securities market activities, create a clear regime for the regulatory responsibilities of SROs formed by market organizers, and make use of professional bodies, trade associations and service providers.
- Organize training programs for senior civil servants, prosecutors, judges and other senior staff of agencies which deals with financial sector issues.
- Amend the law of Mongolia on "Company" to introduce rules covering the licensing of market professionals. Provide the enabling environment for cross border trading, and integration of capital markets.
- Encourage the development of professional associations (including those licensed under the Securities Law) to supplement the Commission's role in promoting standards of competence and integrity in operating an accreditation regime.
- Encourage trade associations (including fund managers and brokers) to provide a focus for consultation and practitioner involvement in regulatory activity.
- The FRC should restrict the number of publicly traded companies through de-listings
- Integrate the different trading channels, improve price discovery mechanism.
- Ensure compliance with the regulatory framework while also proposing and implementing further improvements in legislation
- Improve regulatory framework and enforcement by:
 - Reviewing the jurisdiction of the FRC
 - Creating a body of regulations consistent with IOSCO recommendations
 - Introduce a better compliance regime
 - Developing procedures for criminal prosecution against those who violate the rights of shareholders and misappropriate corporate funds
 - Explore the self regulatory powers of the stock exchange
 - Empower SROs for professional conduct and licensing
 - Deal with the market malfunctioning by:
 - Enforcing timely and comprehensive price disclosure
 - Strictly enforcing comprehensive disclosure by issuers
 - Providing guidance to publicly traded companies
 - Strictly enforce compliance with the accounting and auditing law requirements

**ANNEX D: CORPORATE GOVERNANCE LEGAL AND REGULATORY
FRAMEWORK IN MONGOLIA**

ANNEX D: CORPORATE GOVERNANCE LEGAL AND REGULATORY FRAMEWORK IN MONGOLIA

Law	Purpose and current situation in Mongolia	Enforcing agency	Next steps/impact
(1) Civil Law (2002).	<ul style="list-style-type: none"> • Regulates all commercial and contractual cases in general—Legal entities; entrepreneurial enterprises; objects of civil rights • Property rights --- Rights of property, ownership, possession. • Intellectual Property Rights • Industrial Property Rights • Rights to use the trade name, trade marks, copyrights, • Obligations: performance of obligations, enforcement of obligations; debtor creditor relationships, bank deposits, factoring; Trust management • Inheritance Law • Private International Law • Private right of contract, facilitation of securities lending and hypothecation • Property rights, including rights attaching to securities, and the rules governing the transfer of those rights 	Judicial System: Criminal, Administrative and Civil Courts‘	Need to improve capacity of judges and court bailiffs, investigators and prosecutors.
(2) Company Law (1999)	<ul style="list-style-type: none"> • Regulates the activities relative to the establishment, registration, and reorganization of companies, its management, and organizations supervisory structure, the rights and obligations of its shareholders and its liquidation. • Company registry information: duties of directors and officers • Regulation of takeover bids and other transactions intended to effect a change in control: laws governing the issue and offer for sale of securities • Disclosure of information to security holders to enable informed voting decisions; disclosure of material shareholdings. • A working group consisting of members from FRC, SPC, Ministry of Justice, Ministry of Finance, is currently developing the new Draft Company Law. 	Civil courts, Administrative Courts, State Property Committee and Financial Regulatory Commission	Need to improve enforcement capacity of regulatory agencies. Judicial court system to prosecute corporate cases effectively.
(3) Securities Market Law (2002)	<ul style="list-style-type: none"> • Regulates the issuance, registration, depositing or sale or trading of securities, transfer of rights certified by securities, provision of information on securities market to investors, and protection of their rights, activities of securities issuers, market professionals, and entities operating on the securities market and monitoring. • Basis for the existing legislation, and regulatory frameworks • A new Securities Law has been drafted by ADB and it is currently under review at the FRC. • A draft Securities Market Law is currently under review. It has provided many updates 	Judicial System, administrative, criminal or civil courts. Financial Regulatory Committee	Enforcement

(4) Non-Bank Financial Institutions Law (2002)	<ul style="list-style-type: none"> Regulates all non-banking financial activities such as lending, factoring, leasing, foreign currency exchange, trust service, investing in short term financial instruments, investment and financial consultancy. Will bring clarity to asset management practice, more stringent measures in managing money on behalf of investors 	Financial Regulatory Commission	Regulatory Enforcement. Development of SROs.
(5) Taxation Law (2006)	<ul style="list-style-type: none"> Clarity and consistency, including, but not limited to, the treatment of investments and investment products Depreciation of invested asset 	Ministry of Finance	More reasonable and enabling tax legislation, effective collection
(6) Bankruptcy and Insolvency Law (1997)	<ul style="list-style-type: none"> Rights of security holders on foreclosure rights of clients on insolvency of intermediary netting Immediate clarity must be brought forth to improve the rights of creditors on issues of foreclosure, and bankruptcy as a tool to improve corporate governance. New law must be passed as soon as possible. 	State Bankruptcy Committee or equivalent, Commercial courts	Need for improvement in judicial system, capacity building for judges and other judicial staff
(7) Competition Law (2000)	<ul style="list-style-type: none"> Regulates the issues pertaining to the prevention of anti-competitive practices Prevention of unfair barriers to entry prevention of abuse of a market dominant position 	State Agency on Regulating Unfair Competition	Capacity building
(8) Banking Law (1996, amended in 1999)	<ul style="list-style-type: none"> Regulates the issues concerning licensing of banks, the revocation of licenses, the establishment of general principles of a bank's management, organization and activities, and taking enforcement measures to a bank. The legislation on banking activities is comprised of the Constitution of Mongolia, the Central Bank Law (Bank of Mongolia), this law and other relevant legislation, which is consistent with them. Existing Law is currently deemed adequate 	Bank of Mongolia, Bank Supervision Department, Commercial court system	Enforcement capacity needs to be improved
(9) Dispute resolution system	<ul style="list-style-type: none"> The Mongolian National Arbitration Court (MNAC) was founded on July 2, 1960 at the Mongolian National Chamber of Commerce and Industry (MNCCI). MNAC is of a non-governmental and nonprofit nature empowered to carry out its operations in private dispute settlements A fair and efficient judicial system is required (including the alternative of arbitration or other alternative dispute resolution mechanisms)—however, courts may be overburdened with large numbers of dockets and a timely consideration for a case is difficult. Also there are weaknesses in judicial capacity. Enforceability of court orders and arbitration awards, including foreign orders and awards 	No such level of authority, other than the MNAC	Improvements in the capacity of judicial staff
(10) Law on the Legal Status of the	<ul style="list-style-type: none"> Defines the structure of the Committee on Financial Regulations, the legal grounds of its activities, and govern relations arising from regulation and monitoring financial activities other than banking. 	FRC and the Judicial system	Enforcement capacity

Financial Regulatory Committee (2004)			
(11) Law on Insurance (2004)	<ul style="list-style-type: none"> Regulates the relationships between the establishment of the legal frameworks for conducting insurance activities, regulation of insurance activities by authorized state body, its monitoring, granting insurance licenses, protecting the rights of the insured 	FRC	Enforcement capacity
(12) Corporate Governance Code (2007)	<ul style="list-style-type: none"> Regulates the manner in which matters related to corporate governance in all listed companies are practiced Consists of 9 chapters (based on the OECD Principles) covering provisions for shareholders protections, and equitable treatment of all shareholders, shareholders meetings, the board of directors rights and responsibilities, executive management, transparency and disclosure of information, stakeholders, supervision of financial and economic operations of a company, dividend policy and dispute resolution issues 	FRC	Enforcement capacity

ANNEX E: CORPORATE GOVERNANCE FOR DIRECTORS TRAINING PROGRAM

ANNEX E: CORPORATE GOVERNANCE FOR DIRECTORS TRAINING PROGRAM

CONTENTS

- I. What goes into Corporate Governance Education?
- II. Corporate Governance environment in Mongolia and the need for directors training
- III. Course design and the developmental approach

I. What goes into corporate governance education?

Corporate governance is concerned with issues of the ownership, control and accountability of companies. It raises some of the key issues and dilemmas of our time. In the context of a particular corporation, corporate governance seeks to determine the weight that should be given to the interests of directors, shareholders, employees and other stakeholders, and how precisely can these interests be expressed, aligned and reconciled.

More broadly, in the light of the globalization of product and capital markets, higher education institutions conferring business and economic degrees must reconcile the corporate pursuit of economic objectives with political interests in democracy and equity, environmental concerns over sustainability, and personal concerns with morality.

The proposed Corporate Governance for Director's Training Program curriculum would provide the much needed core course through which these questions could be explored by placing the corporate pursuit of economic objectives in a wider ethical and societal context.

It is clear that corporate governance exists at a complex intersection of law, morality, and economic efficiency. Less clear, however, is the extent to which current business and economics education reflects that complexity. Corporate governance is usually not a distinct academic discipline, but integrated into other courses. Considering that issues of executive compensation, financial scandals, and shareholder activism are all tied up with corporate governance, its teaching is a topic worth investigation.

There will always be a 'problem' in the sense that we will never get a perfect solution to governance that there will be no break downs in the corporate governance. The optimal governance system will be one that just balances the benefits of reducing malfeasance with the added costs of more stringent governance. So there will still be costs being incurred: costs due to malfeasance and costs created by the governance and control systems themselves.

The Corporate Governance for Directors' Training Program Curriculum that is being recommended will address these issues, while keeping these important observations in mind.

The corporate government education environment in Mongolia

In order to make its economy competitive and well integrated with the rest of the world, Mongolia needs a system of higher education that will prepare capable managers and business leaders to manage enterprises under very competitive market conditions.

The process of reform in Mongolian economy requires the strengthening of management capacity and business leadership in both the private and public sector institutions. This will accelerate private sector to successfully utilize the scarce resources to produce globally competitive products. Future business leaders need to be equipped with technology and market-driven business skills and knowledge.

Mongolia institutions of higher education have been facing serious challenges for some time. Schools where business and economics education are offered have actually faced these

challenges more severely, due to the sheer numbers of students wanting to study business, accounting, economics and similar topics.

This is where there is overlap between what the market needs in workforce skills and what the educational institutions offer and how that will impact the ongoing implementation of economic reform agenda in Mongolia.

There are serious weaknesses in Mongolian institutions of higher education in five main areas: (1) the capacity of faculty; (2) the deterioration of physical infrastructure; (3) use of technology in the delivery and learning process; (4) scarcity of resources; and, (5) issues faced in the administrative governance of these institutions.

While there may be many possible ways to improve the shortcomings of the Mongolia higher education, the proposed program will address only one very small part by assisting curriculum development in corporate governance and assist in developing the capacity of faculty at various institutions of higher learning in Mongolia.

A recent visit to the campus of Mongolia Institute for Finance and Economics have revealed that they have the facilities to deliver a high quality education to the top level business leaders, including executives and directors of the boards, in addition to graduate and undergraduate level business and accounting degree students. Given the commitment to excellence in teaching and the quality of their business and accounting and finance programs, their highly skilled training staff and their new facilities, we think that IFE may be a proper local academic partner that USAID/EPRC and IFC could use in the Corporate Governance for Directors Training program.

Challenges in promoting good corporate governance education

The importance of corporate governance for financing and reducing the cost of capital, improving valuation of the shares and the value of the firm, and overall performance has substantially been evidenced in an increasing number of academic and professional circles and events.

The corporate failures that took place in US, Europe and the rest of the world in late 1990s and early 2000s, as with the currently unraveling banking and financial crisis had and will have disastrous consequences to investor confidence in the markets. The crises cause major drawbacks especially in the economic structures of emerging markets. The several large corporate scandals in the US and Europe during the recent years, as well as in Japan has brought home the realization of the importance of corporate governance as a serious public policy concern that involves not only investors but all of the stakeholders in an economy.

This issue is more pronounced in emerging markets. Some of the evidence points out to several weaknesses that needs to be addressed at the policy level, but that also has implications to the business and economics education. The literature has identified several channels through which corporate governance affects growth and development (Stijn Claessens, 2003)²:

- The first is the increased access to external financing by firms. This in turn can lead to larger investment, higher growth, and greater employment creation.
- The second channel is a lowering of the cost of capital and associated higher firm valuation. This makes more investments attractive to investors, also leading to growth and more employment.

² Stijn Claessens. Corporate Governance and Development. Global Corporate Governance Forum. The World Bank. 2003.

- The third channel is better operational performance through better allocation of resources and better management. This creates wealth more generally.
- Fourth, good corporate governance can be associated with a reduced risk of financial crises. This is particularly important, as financial crises can have large economic and social costs.
- Fifth, good corporate governance can mean generally better relationships with all stakeholders. This helps improve social and labor relationships and aspects such as environmental protection.

All these channels matter for growth, employment, poverty reduction, and well-being in general terms. Empirical evidence has documented these relationships at the level of the country, the sector, the individual firm and from the investor perspectives.

Thus at the present time, the importance of corporate governance as a development tool for public and private sector has been quite well established. However, there are areas of corporate governance phenomenon that still remain unclear, or weak, at best. These areas are:

- The corporate governance of banks.
- The role of institutional investors.
- Enforcement.
- State-owned firms.
- Family-owned firms.
- Best practice in relation to other stakeholders.
- The impact on poverty alleviation.
- The dynamic aspects of institutional change.

Any degree oriented program in corporate governance ought to investigate and raise questions in these areas.

Corporate governance in business education

In the globally integrated world of business, leadership is the ability to think strategically, anticipate effectively and direct decisively. Business leaders must possess dynamic leadership abilities and adapt to rapid changes, whether locally, nationally or internationally.

Business management education is a critical component in developing leadership skills in today's business world. A sustainable graduate business school will offer a curriculum of education that is relevant to global demands of business and public sector alike, incorporating the latest teaching technologies and techniques.

The recent corporate scandals in the US and other parts of the world created a crisis of confidence in corporate behavior, and affected investor risk perceptions, leading to a general risk premium increase for investments in similar companies. The perpetrators of these scandals all had business degrees from quite well known business schools. Educators in business had to ask themselves the question of what is really being taught to these business leaders at graduate school, and what was missing. The obvious answer would be they are taught economics, finance, accounting, management, marketing, etc. While greed would be one factor that results in the mis-behavior of business executives the issue of whether weakness in business education has anything to do with the scandalous behavior.

We believe that modern business education must incorporate the values of good governance along with the functional skills. This, however, is where traditional business education has not yet been effective. While some universities in the US and Europe have established ethics as

part of their curriculum, there are yet parallel but not converging thoughts in the preparation and the delivery of curricula.

Modern business and economics education ought to be built on the four pillars of governance: **(1) responsibility; (2) accountability; (3) transparency; and, (4) fairness.**

These four values are crucial in enhancing the educational quality of business and management education, and will form the basics of the principles of corporate governance curriculum.

Weak governance is the core cause of business failure. Having understood this fact, time has come for teaching ethics in management integrated with the better understanding of the four values of governance. This ought to lay the keel of any corporate governance education.

Management degree programs should not only offer students or their targeted audience's ethics education, but they must also offer a solid background in corporate governance.

The board of directors of a company is the line of first defense against risks faced by a firm or a bank. Thus to help the directors enhance their strategy formulation skills on behalf of shareholder interests, the appropriate topics in corporate governance educational programs would include the following:

- The role and the responsibilities of the governing board of directors.
- The role and responsibilities of the board committees including the audit, compensations, nomination etc...
- An understanding of internal financial controls, the roles and responsibilities of management, and critical monitoring activities such as internal auditing.
- Elements of an effective code of conduct.
- Understanding of the international and Mongolian legal and regulatory frameworks, including the Mongolian Corporate Governance Code, the US Federal Sentencing Guidelines, and Sarbanes-Oxley Act, the UK Cadbury Code of Corporate Governance, the South African King Report, and similar regulations and recommendations for other parts of the world.
- Components of an effective compliance program.
- Disclosure and transparency: The roles and responsibilities of independent public accountants, counsel and regulatory bodies in Mongolia and elsewhere.
- Corporate social responsibility
- Risk management
- Role of stakeholders in corporate governance

These topics are actually embedded in the OECD Principles of corporate Governance, and thus the certification or degree programs in corporate governance will emphasize the global best practice knowledge to learning corporate governance.

In the design and delivery of this program, the following, however incomplete, list of learning priorities are of crucial importance:

- Developing excellent communications abilities.
- Emphasis on critical thinking as well as functional skills development.
- Achieving full cognizance of ethical responsibilities of business leaders.
- Financial theories, financial analysis and reporting and financial markets.
- Value creation oriented management.
- Effective group and individual dynamics.
- Understanding domestic and global business environment.
- Adaptability to new situations and innovativeness under competitive pressures.

- A rewarding learning experience in both theory and applications.

The above mentioned issues and factors will form the core philosophy of the proposed corporate governance curriculum.

II. Current issues in directors' education programs

The private sector led sustainable development demanded by the emerging economies, as in Mongolia, presents a significant challenge and opportunity for the creation of new sustainable business models that foster economic, environmental and social advances with special attention to good corporate governance.

As the ambitious economic reform agenda is taking root successfully in Mongolia, better understanding of good corporate governance is a required knowledge with no recourse. If Mongolian corporations wish to access the financial capital infusion they need, it is clear that their leadership and their boards or directors ought to be better informed about corporate governance.

As the Mongolian Corporate Governance Code of 2007 and Company Laws (the draft one) stipulate the inclusion of at least three independent directors on the boards of every one of the listed companies, this task requires a huge educational undertaking. This requires institutional capacity, both in terms of human resources, financial resources and in terms of facilities.

Already, The Institute of Finance and Economics in Ulaan Baatar and the National University of Mongolia have embarked upon executive training and educational programs that focus on corporate governance. The Institute of Finance and Economics delivers corporate governance programs as part of its general management curriculum to executives and have been developing teaching and research capacity in this area.

These are undoubtedly very useful, and would be the resources to be tapped in the course of this program. However, they address the phenomenon to an advanced stage of audiences and are mainly directed towards enhancing the knowledge of the executives and board members of a corporation or a bank. It does not extend to the level of younger generation of managers and the future managers who happen to be currently enrolled as undergraduate or graduate students at an institution of higher education and receiving their formal education.

The proposed USAID/EPRC-IFC and Institute for Finance and Economics joint Corporate Governance for Directors' training program will address this gap, and will be directed mainly towards the independent directors education as well as having a forward linkage to the other levels of tertiary education so that in time it will reach a larger group of graduate and undergraduate level students and professional participants.

The Institute of Finance and Economics seem to have the resources necessary to build a dedicated auditorium for the education of high level executives and board members in its current buildings and facilities. It has also been ascertained that they have the budgetary capability to be able to cover the cost of such an undertaking that USAID will not, as a matter of policy, undertake in its technical assistance interventions. This point has been clearly made to the current administration of the IFE.

The proposed program will be conducted in full cooperation with the IFC. IFC has offered unfettered access to its already existing directors training teaching materials and corporate governance at executive, directors, and student levels that were prepared during the recent years in the Ukraine, Azerbaijan and elsewhere. EPRC will build on the existing programs developed by IFC in conjunction with IFE.

During the design phase of the corporate governance for directors' curriculum program, we will ensure that all training course materials that have been developed by IFC are fully utilized.

Traditional business school curricula are not particularly well-structured or organized to help managers develop an appreciation for the broader social environment in which managerial decision making and leadership exist. This has especially been true in teaching corporate governance.

Further, the standard management disciplines (marketing, finance, strategy) operate from a rich research base, and they are focused primarily on for-profit business enterprises, giving different weights and interpretations to the broader social, political and cultural business environment. However, the value of ethics and good corporate governance is not highlighted in their delivery.

Other areas such as business ethics, social innovation, socially responsible management practice, as well as public and not-for-profit management, either lack a rigorous foundation and/or are simply separated from the rest of the management curriculum. As a result, the entire social impact area has, to this point, lacked a defining paradigm that has enjoyed credibility with researchers in mainline disciplines in U.S. business schools.

These new business models presented in the good corporate governance and directors' training course curriculum will be delivered so as to provide the entrepreneurial and corporate community of Mongolia. In addition, the Corporate Governance curriculum program will be developing the ability to evaluate and value the financial and market potential of innovative business plans, and their compliance with sustainability requirements.

Additionally, an important activity will be to help especially the graduate students and faculty teaching the general corporate governance topics, as well as the directors' training programs to publish research focused on the process of creating new sustainable and technology-based businesses in emerging economies and more specifically Mongolia. Thus the overall curriculum will have a secondary impact by inspiring research ideas.

The side effect of this academic program would be to attract the best innovative research projects from the research centers at the IFE and all around Mongolia, with the active and sustainable financial support and involvement from public and private sectors, and the best practices in the creation of new businesses from partner universities around the world.

Finally, this project will be aligned to FRC's strategy of being an assertive change agent in banking as well as private sector in Mongolia. The program will help FRC in redefining the concept of business as-usual to new sustainable businesses based on technology and better governance and access to finance, in order to create the potential for an economy of innovation, knowledge, entrepreneurship and value added.

III. The design and development approach for the course

Objective of the program

The main objective of this program is to develop a Corporate Governance for Directors, which will certify the graduates as having completed the rigorous program.

Upon successfully completing the course, participants will receive certification with the insignias of IFE, IFC and possibly, a reputable US University that will be sought to join in the program as a strategic partner.

Ten basic modules with 3 hours each will be prepared as the foundation course for the executive level Corporate Governance for Directors' course. If necessary, so as to adjust the course to Mongolian environment, two additional modules may be added for a twelve module course framework with advanced features to be delivered at the executive or the graduate level. Each module will consist of three units.

We recommend that the delivery of these three units are developed around a combination of lectures, problems and short cases, with a short test at the end of each module, and mid-term and final exams.

The mission of this program will be the following:

The Corporate Governance for Directors course curriculum prepares participants for leadership positions within Mongolian corporate boards, and non-profit and public organizations, by giving them the opportunity to pursue an in-depth study of the interplay of stakeholder groups within the broader political and social environment in which these organizations must pursue their missions.

The program would combine a rich set of competencies, including:

- How for profit private business firms fail and thrive as a function of how well they grasp the nuances of the shareholding public or private individuals at Mongolian enterprises, media, regulatory and legal environment and anticipate action by activist and interest groups that affect corporate governance in those arenas.
- How the main theoretical underpinning of corporate governance and economic returns to scale concepts overlap in wealth maximization purpose of a firm.
- The management of non-profit organizations including NGOs, volunteer and philanthropic organizations, and educational institutions.
- The management and governance at state owned enterprises and public institutions including governmental agencies and international organizations. The economic underpinnings of regulatory and fiscal policies and how regulatory and fiscal policies can affect the cost structures and strategic opportunities of business firms.
- The need to appreciate how ethical dilemmas and complexities can arise and the importance of thinking through the ethical ramifications of decisions.
- How socially responsible strategies can position firms to achieve competitive advantage in the markets in which they operate.

Faculty members teaching in the Corporate Governance for Directors program would approach the analysis of these issues from a number of disciplinary lenses, including political science, economics, law and business administration such as finance, marketing, management.

It is hoped that as part of this program a *Center of Excellence for Corporate Governance* at the IFE is created under the guidance of USAID/EPRC and IFC, which will build a solid administrative structure led by top interdisciplinary faculty from all over Mongolia and an advisory board including corporate leaders with first-hand knowledge of the importance of social impact management.

We believe that the program will quickly enjoy widespread directors and executive level participation that will spur on long-term research and begin to provide a base of knowledge that will lead business education into the future.

The Corporate Governance for Directors program we shall develop would seek to integrate social impact management into a broader management education program that would combine IFC and USAID/EPRC's strong resources and help create an underpinning of research and

teaching methodology at the IFE, for the areas of social impact management and a sustainable global society.

Methodology

The proposed project is based on the design of a concentration, within the IFE programs focusing on improved corporate governance and business administration capacity that supports the creation of new sustainable businesses by the future and current business leaders who graduate from the program.

The design of this concentration includes learning processes for business leaders to acquire the ability of combining financial goals and sustainability goals in the context of a new economy emphasizing good corporate governance. The participants will be able to innovate and use technology as a means to create wealth and contribute to sustainable development.

As part of the preparation of this academic program, we will seek ways to integrate the research of other concentration areas of economics and business administration in collaboration with the network of research centers in Mongolia and in the Asia-Pacific region as well as around the world, coordinated by the IFE in collaboration with IFC and any other international partnering institution. This course program will eventually seek to create a platform of innovative technology ideas capable of becoming new sustainable businesses.

The Corporate Governance for Directors course curriculum we develop will be taught with the aid of a number of learning enhancing hands on tools, such as mini-cases, in class discussions, interactive and participative lectures. The program will emphasize the following:

- Each module will be delivered as a combination of lectures, cases, problem solving, and research and class discussions.
- Mini cases developed will be oriented towards Mongolian applications. Class discussions will be designed to provide the student with the relevance of the concepts taught with the theory and best practices as promoted by the OECD and Global Corporate Governance Forum and other international standard setting institutions.
- The course will be supported by a list of relevant readings and periodicals that the student will be required to read and prepare briefs before class.

Illustrative course outline

Tentative required texts/materials:

1. Corporate Governance, by Christine A. Mallin, Oxford University Press, ISBN 0-19-926131-8
2. Corporate Governance, by Monks, Robert and N. Minow. 3rd Ed. 2003. Blackwell.
3. IFC documents and materials.
4. Cases, Teaching Notes, and Readings (to be provided via the class webpage to be created and may also require one or two cases)
5. Other –Class coverage will be augmented with the Financial Times and Wall Street Journal and websites of various exchanges and banks.

Course optional prerequisite:

Participants who will enroll in this course will benefit from having taken fundamental courses in Finance, Accounting, Economics, Management courses, in order to relate to the concepts that will be covered in the Corporate Governance for Directors Training course.

Course description:

The Corporate Governance for Directors course will bring underscore the important topics of international corporate governance, particularly as it relates to Mongolia with relevant connections with the US, UK, and other European and Asian countries. The location and setting of Ulaanbaatar as the financial center of Mongolia will provide an excellent backdrop for the topics covered. Throughout the course, students will visit certain venues to illustrate and reinforce the concepts discussed in the classroom.

[Video Conferences with international counterparts can also be introduced]

Course objectives:

This course will examine international corporate governance topics as applied to the corporation, with focus on the separation of ownership and control and related issues.

The formal and informal contracts that bind together shareholders, bondholders, directors, managers, employees, suppliers, customers, and communities will be explored and the concept of Agency Theory will be introduced.

The instructors will discuss how firm value depends on corporate governance practices and investor protection around the world. Greater investor protection lowers the cost of capital and results in greater financial development and economic growth.

Students will learn about the ongoing convergence of the corporate and capital market laws of various jurisdictions, and the role of international law and international organizations in that process.

The divergent approaches of the contemporary corporate governance theories, including market, political, cultural, and historical approaches, will be briefly reviewed.

Importantly, students will research governance issues in selected countries and debate current issues related to convergence towards a global standard.

Each class will cover mini- case studies from Mongolia, US, European countries and explore with the students how and why the respective corporate and securities laws of some European countries are converging with those of the United States. Historical, political, cultural, and market approaches to corporate governance issues will be applied to these case studies and field trips.

Illustrative course outline:

This outline is tentative and will be adjusted upon discussions with IFC and IFE counterparts accordingly. All relevant corporate governance topics will be fitted under these broad guidelines.

I. Basics of Corporate Governance

Module 1 – Introduction: Political, Legal and Business Environment: Ethics, Social Responsibility of Business

Module 2 – Current Mongolian and Global Investment Environment: Ownership and Control Issues and the role of the Board of Directors. Conflicts of Interest, Insider Trading, Market Manipulation.

II. The Governance Debate: Issues and Controversies

Module 3 – Board Organization, Composition and Selection: Comparative International Models.

- Module 4** – Board Committees: Remuneration (Compensation), Nomination, Risk and Audit
- Module 5** – The Board Meetings: Strategic Decision Making Process, Agenda and Preparation for meetings.
- Module 6** – Risk Assessment, Enterprise Risk Management and the Role of Directors
- III. Historical, Political, Cultural, and Market Issues Related to Corporate Governance
 - Module 7** – Legal and Regulatory Frameworks and the Boards
- IV. Corporate Governance Special Issues
 - Module 8** – Banking and Financial Institution Boards
 - Module 9** – Takeovers, Acquisitions, and Mergers. Bankruptcy and Insolvency.
- V. Convergence of international corporate governance practices
 - Module 10** – Emerging Standards and Codes of Conduct: Mongolia Code of CG. Financial Stability Forum. Basel II. IOSCO Principles of Securities Regulation and implementation.
- VI. Other Critical Issues in International Corporate Governance
 - Module 11** – Case Reports
 - Module 12** – Other relevant topics to be agreed upon with the IFE and IFC. Could include Corporate Social Responsibility and Ethics and its impact on corporate governance.
- VII. Case Studies, Video Conferencing and Field Trips

Course structure:

The course material will be presented in three primary ways: lecture, case presentation and discussion.

For each module, mini-cases and field trips will be used to reinforce concepts covered in class, as well as to provide a context for issues related to international corporate governance. Guest speakers may be invited to add more value to class discussions. Video conferencing arrangements may be desirable.

Participants will form groups to analyze corporate governance structures of selected Mongolian companies, and will develop Corporate Governance Scoring Models to apply to Mongolia Stock Exchange listed companies.

Participants will be required to play roles in cases and other debates to enhance learning.

At the end of each class, there will be a practice and a self-test to enhance learning.

Field Trips, or Lead Guest Speakers Programs – Tentatively, field visits will be made to the Mongolian Stock Exchange, The Central Bank of Mongolia, Corporate headquarters of leading Mongolian firms that champion good corporate governance, including interviews with corporate executives and members of the board of directors and other financial and private sector institutions.

Class coverage will be augmented with the *Financial Times*, *Wall Street Journal* and websites of various global exchanges and banks and private sector institutions such as the British Petroleum, CalPers, TIAA-CREF, etc.

Illustrative grading procedures:

	<u>Undergraduate</u>	<u>Graduate</u>	<u>Executive</u>
Exams(2)	50 %	50 %	50%
Homework, readings, and cases	25 %	25 %	20%
Participation in class discussions	25 %	15 %	25%
CG Project Analysis & Presentation	<u>N/A</u>	<u>10 %</u>	<u>5%</u>
Total	100 %	100 %	100%

Grading would be based on the following scale: 90% or above = A; 80-89%=B; 70-79%=C; 60-60%=D. Below 60 % is failing.

Graduate students only: To receive graduate credit, graduate students will be required to complete a corporate governance project in addition to other course assignments. This involves the assessment and design of the corporate governance structure of an actual company. This analysis can be done individually or with another graduate student (i.e., as a group of 2 people). Graduate students will make a presentation of their analysis to the class towards the end of the course.

Faculty training program:

A 5 day long Train-the-Trainer Program will be presented to the selected teaching faculty members from across Mongolian universities at the IFE. The program will provide capacity upgrade for faculty who will be teaching in the program. Upon demand, the program duration could be adjusted downwards.

This seminar will provide the framework, as well as innovative methods for effective teaching of the corporate governance course in today's increasingly competitive academic environment. Academically qualified scholars and teaching faculty members will gain the knowledge, skills, and tools needed to balance the call for scholarship with the creation and delivery of highly relevant, student-focused courses.

Who should attend (suggested faculty selection criterion):

Faculty who want to continually improve their teaching effectiveness, faculty new to the classroom, executives transitioning from the corporate world to the classroom, faculty who want to update their skills in the latest teaching innovations and technology, and doctoral students

Learning outcomes of T-o-T for corporate governance teaching faculty:

- Learn methods for improving instructional effectiveness and assuring overall student achievement, with an emphasis on converting scholarship to practice.
- Learn to actively engage students in the learning process, provide feedback, and encourage collaboration and cooperation.
- Understand how personality affects student/teacher interactions and student learning.
- Use technology and other innovations to improve the way that learning occurs in and out of the classroom.
- Ensure that learning goals are met and that the information from assessment data is driven back into the curriculum to enhance learning.
- Take time to reflect and discuss possibilities for personal improvement with regard to teaching effectiveness.

- Share ideas, problem solve, and network with colleagues and peers.
- Increase case writing and case teaching skills.

ANNEX F: CORPORATE GOVERNANCE RATING INDEX (CGRI)

ANNEX F: CORPORATE GOVERNANCE RATING INDEX (CGRI)

A preliminary Corporate Governance Rating Index (CGRI) questionnaire can be developed for discussion purposes based upon the current Mongolian Code. The purpose is to demonstrate design methodology and strategy as further described below. The preliminary CGRI questionnaire can easily be adapted and/or modified by FRC staff as they move forward with the implementation of the Mongolian Code.

1. **Commercial CGRI product limitations.** EPRC recommendations for the design of a Mongolian CGRI are intended to overcome the limitations reflected in most all of the commercially available corporate governance products. These limitations include, among others:
 - High Cost / Complex Methodologies
 - Scoring Results Not Always Public
 - Varied Corporate Governance Focus
 - Methodologies Not “Monitoring Oriented”
 - Cross-Border Comparisons Are “One Size Fits All”
 - OECD and Country Specific Norms Not Assessed
2. **CGRI questionnaire strategy.** EPRC’s CGRI questionnaire strategy will complement the Mongolian Code and to support its implementation by listed MSE issuers. The questionnaire is conceptually designed to track most of the key voluntary ‘*comply or explain*’ provisions of the Mongolian Code, which listed issuers will be required to disclose in their future corporate annual reports.
3. **The CGRI questionnaire should be electronically filed with the FRC** in conjunction with the annual reporting cycle, using an MS Excel or Adobe PDF format, at least, initially before an electronic filing system is implemented. Filing the questionnaire in an electronic format will make it possible to collect the raw data and calculate scoring without resort to a time consuming manual process.
4. **The choice of CGRI measures should reflect a policy driven perspective, and establish voluntary best practices higher than legally mandated minimums.** It is not necessary that the questionnaire cover each and every voluntary ‘comply or explain’ element of the Mongolian Code. The FRC should, however, consider carefully, which elements they wish to prioritize or emphasize from a policy perspective. The focus should be on defining CGRI questionnaire measures, which reflect an attainable improvement in Mongolia’s corporate governance practices beyond the legally mandated minimums, and on a voluntary basis.
5. **The CGRI should be monitoring and benchmark oriented.** CGRI response data should be collected over time to enable meaningful comparisons in Code compliance. The FRC could use the CGRI to monitor and identify code compliance gaps, which may require adjustments in corporate governance policies and other disclosure related directives. Although the CGRI can and should be adjusted over time as policy priorities shift, or code provisions are amended, frequent year-on-year changes in CGRI measures are to be avoided. Issuers will also require several yearly cycles to adjust their corporate governance practices.
6. **CGRI measures should be objective, easily quantified and scored.** Linguistically, each CGRI measure should be developed as an affirmative (Yes/No) question or statement,

reflecting a Mongolian ‘best practice’ as derived from the voluntary ‘comply or explain’ components of the Code.

The question or statement should be edited objectively -- the practice either exists or is implemented, or it is not. Subjective questions should not be used. As such, only ‘yes’ answers will be scored and awarded a weighted or un-weighted value. ‘No’ answers are not scored, and will subsequently require further explanation in the listed issuer’s annual report under revised disclosure directives. (No further explanation is required in response to the questionnaire.)

As noted previously, several cycles may be required to see changes and improvements in CGRI responses. Early CGRI results should also be expected to produce low compliance scores, however, improvements will be registered quickly over subsequent cycles as issuers discover what best practices may be easily introduced to yield an improved score and ranking.

7. **Each CGRI measure should include a brief narrative ‘justification’** to educate stakeholders as to the policy objective and/or best practice recommended by each measure to facilitate the educational function and purpose of the questionnaire.
8. **Each CGRI justification should also include clear citations to the OECD principles, Mongolian legislation and Mongolian code.** Combining narrative justifications with citations essentially converts the CGRI questionnaire into an effective work plan for the improvement of issuer corporate governance practices.
9. **Weighted scoring.** Depending on their relative importance and policy priority, weighted scores can be assigned either to individual questions or to whole CGRI category components. CGRI will assign illustrative weightings only by corporate governance category and in relative proportion to the voluntary provisions identified in the Code. The preliminary questionnaire contains 50 Yes/No questions, each worth 2 points, and is designed have a total aggregate raw scoring of 100 points, distributed among 5 identified corporate governance categories, as follows:

Category	Number of questions	CGRI percentage
1. Board structures and policies	25	50%
2. Stakeholder policies	5	10%
3. Shareholder rights	5	10%
4. Financial disclosure & transparency	5	10%
5. Audit structures & policies	10	20%
TOTALS	50	100%

10. **Public Scoring.** To increase public and investment community awareness of issuer compliance with the Mongolian Code, the CGRI raw data, weighted scoring (total and sub-categories), and ratings should be publicly disseminated to the investment media via the FRC and MSE websites.

Given that the CGRI is based on the voluntary ‘comply or explain’ elements of the Mongolian Code, this should pose no policy issues for the FRC -- especially as issuers will ultimately be required to disclose the same information, albeit in a slightly different format in their annual reports. If this should still prove problematic, the raw scores can be

converted into percentile rankings, which will still permit public benchmarking and ranking of issuer compliance with the CGRI.

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