



**NATIONAL DEVELOPMENT
AND INNOVATION COMMITTEE**

ADB



FINAL REPORT

The protection of minority shareholders rights in Mongolia

**TA-6428 (REG) Supporting Strategic
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Executive Summary

1. This report presents findings and final recommendations developed by the research team¹ based on research work done on topic "Ensuring Minority Shareholder Rights in Mongolia" during 24 August - 31 December 2009.
2. Although transition to market economy in Mongolia was made two decades ago, capital market development is still on very early stages of development, which negatively influences to financial sector development. Among others, main reasons that hinder efficiency of capital markets include low investor confidence resulted by poor corporate governance and failure to ensure equal treatment of minority shareholder rights. The final report summarizes main findings of the research team with regard to minority shareholders.
3. In order to identify the current situation and exact nature of problems and challenges faced by minority shareholders in Mongolia, a literature review was carried out of research work and reports previously done in this area. A diagnostic survey was taken involving 150 respondents. Review of complaints filed to Financial Regulatory Commission of Mongolia and court rulings on cases related with minority shareholders was done. Three most notable cases, which involved violation of rights of minority shareholders were looked into. Monitoring of effectiveness and efficiency of government agencies and institutions was also carried out.
4. It was revealed that main problems faced by minority shareholders with regard to ensuring their rights include: inability to receive timely material information; lack of means for effective voting during annual shareholder meetings, unequal distribution of dividends and/or corporate earnings; fraud and misconduct related with share ownership registration, trading; unauthorized sale of shares; poor corporate governance practices and lack of mechanisms for effective recourse.
5. Main factors that influence to this situation can be explained by weaknesses in legal, judicial and regulatory environment, lack of enforcement and accountability mechanisms, and absence of incentives for companies to voluntarily ensure equal treatment of minority shareholder rights.
6. Based on analysis of problems and challenges, recommendations are proposed by the research team for strengthening legal and regulatory frameworks, improving voluntary compliance by companies and instilling solid business practices with regard to ensuring minority shareholder rights in Mongolia.

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Introduction

At the outset of early 1990s, Mongolia embarked on a transition path from the centrally planned economy towards a free market economy. During this time, the Mongolian Stock Exchange emerged as a tool for privatizing numerous state-owned factories and companies. In an attempt to ensure an equitable distribution of assets, the Mongolian government chose to implement a voucher-based scheme. Vouchers were distributed to all citizens free of charge to allow them to buy shares of privatized companies on the stock exchange. However, most people lacked knowledge and experience with securities markets and did not understand the value of their vouchers or the shares of privatized companies. In 1995, secondary trading started and few investors began buying up shares at very low prices. It can be said that from this point on minority share holder rights were by and large overlooked.

As a result of the privatization efforts, over 480 share-holding companies were registered on the Mongolian Stock Exchange without any listing requirements. While 384 companies are currently listed on the MSE today, shares of 160 companies have been temporarily suspended from trading due to non-compliance to the listing requirements, discontinued operations and other violations of applicable laws and regulations. Given such violations the stock exchange and the regulators are not able or reluctant to take strong disciplinary actions. Consequently, shareholder rights in general and minority shareholder's in particular are often dismissed and violated. For instance, voting procedures during shareholders' meetings are sub-standard, dividends are not paid out and disclosure of information is poor at best.

In order to develop the securities market in Mongolia, it is necessary to promote transparency, fairness and rule of law, principles institutionalized in developed countries, while protecting both big and small investors through equalizing their rights, improving investor confidence and strengthening legal framework that encourage and expand investments. If a stable securities market is created, transparent and attractive to investors, prominent companies will go public. In turn, investors will have a bigger incentive to invest in the securities market rather than depositing in the bank. Creating a stable securities market means that the relationship between fund raiser and investor is regulated and relevant safeguards protecting their rights are in place. However, currently in Mongolia overall legal environment facilitating these relations is not adequate and consequently interests of market actors are not protected adequately.

Furthermore, assuring that investor rights and interests are protected can not be achieved by only strengthening corporate governance practices of stock companies. Capacity and efficiency of regulatory agencies and other actors involved in trading of stock on the securities market must be improved. Inability of the regulatory authorities to resolve problems between stock companies and shareholders creates more uncertainty and instability. This diminishes interest in the securities market, discourages the market participants from investing in the stock market, and leads to voluntary delisting of stock companies.

Traditionally the banking sector has been the main source of financing for Mongolian companies. Dependent on loans, most companies try to build good relationships with banks and comply with all of their demands. Internal corporate information is disclosed freely. However, these companies do not have the same high regard for the stock exchange and its shareholders. The simple fact that many stock companies fail to provide investors with basic financial and other company information required by the stock exchange and the regulation in a timely manner, if at all, illustrates the significance of the problem.

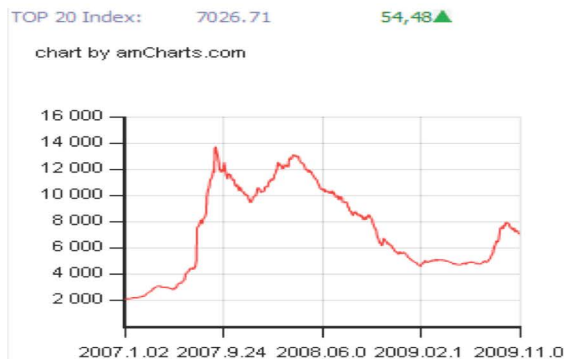
Since 2005, several projects, programs and research projects have been conducted in the order to strengthen the securities market. Unfortunately, no significant advances have been observed. In this report we have attempted to illustrate this point in detail. Furthermore, the report attempts to identify the underlying factors that lead to violation of minority shareholder rights, propose potential multi-faceted holistic measures to solve them and expected outcomes, rather than suggesting reactive (or *ex-post*) approaches to take actions against the parties responsible for share-holder rights and interests.

1

SURVEY STUDY ON MINORITY SHAREHOLDERS

Since 1992, over 470 state-owned enterprises worth MNT17.33 billion were privatised and listed on the Mongolian Stock Exchange. At that time, most people lacked sufficient knowledge and experience with investing and trading on the securities market with vouchers. According to some estimates, about 1.3 million people received vouchers and redeemed them for shares. However from the 1.3 million people over, 180,000 people still have not activated their brokerage accounts at the Central Depository and Clearing House, LLC.

Graph 1. Top-20 Companies index at MSE



It wasn't until 2005 the first domestic companies started to go public and listed at the Mongolian Stock Exchange for the purpose of raising funds. As of 2008, only 13 share-holding companies raised capital on the stock exchange in the amount of 58.3 billion MNT.

Along with the IPO activity trade volume and total market capitalization on the MSE started to increase. In September 2007, the TOP-20 Index reached its all time high at 13.276 points. Currently the TOP-20 Index has fallen back to 7.026, while the stock trade volume is at 669 billion MNT².

The sudden increase in trade volume and share values has been credited to emergence of foreign-invested brokerage houses. The foreign-invested

brokerage companies began buying shares in large quantities and increased demand for domestic shares. Currently, from the total of 45 brokerage and dealer companies 8 are foreign-invested. Signs of economic recession due to the current global financial crises were first observed in the second quarter of 2008, when values of shares also started to go down in parallel. Several companies planning on issuing shares on the MSE halted their plans for an unspecified period of time.

As the value of shares declined, it made it possible for some companies to re-purchase their shares back from minority shareholders and change their corporate structure into Limited Liabilities Companies.

1.1 Compliance to requirements and responsibilities of listed companies

Currently, there are 365 companies listed on the Mongolian Stock Exchange. From which, there are 21 companies with 100% state-ownership and 35 companies with partial state ownership.

Regular shareholder meetings (AGM) shall be announced and held within four months following the end of each fiscal year³. An extraordinary shareholder meeting may be called by the Board of Directors or by shareholders holding ten or more percent of the company's common shares.

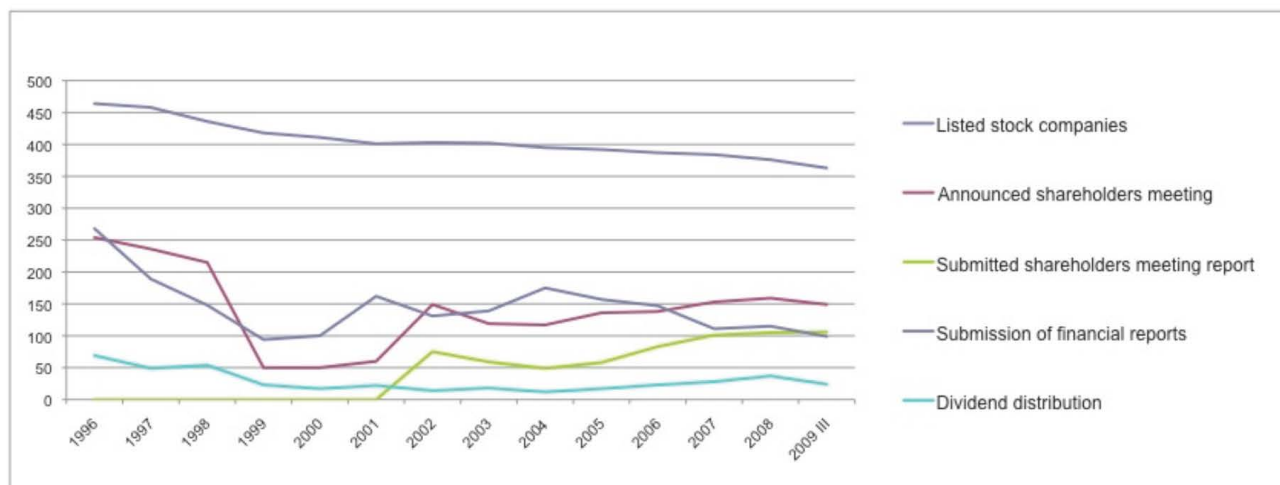
Regular shareholder meeting (AGM) of stock companies

The following chart illustrates compliance to relevant laws and regulations on shareholding companies.

² Official webpage of the Mongolian Stock Exchange

³ Article 60.3, Company law of Mongolia

Adherence to laws and regulations of listed companies during the period of 1996 - 2009

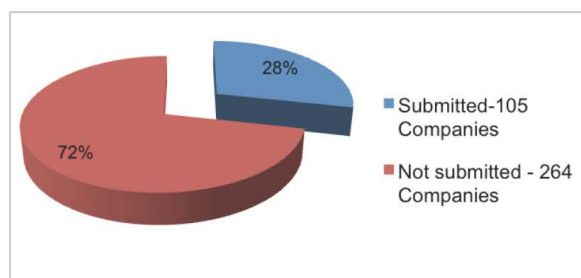


Graph 2. Information delivered to the Mongolian Stock Exchange

Voting

According to provisions of Article 33 in Company Law of Mongolia, shares give shareholders the right to vote at shareholder meetings and exercise voting rights based on investment. Any shareholder shall be allowed to attend shareholders meetings and exercise his/her voting rights over all agendas discussed at the shareholders meeting without any interventions and proportionally to shares owned.

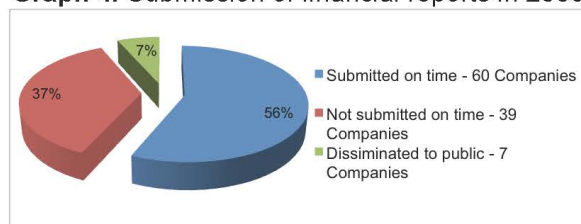
Graph 3. Submission of shareholders meeting report in 2009



Information disclosure and reporting

According to the law, stock companies must prepare and distribute the annual report to all shareholders. In addition, the Mongolian Stock Exchange rules state that stock companies must prepare and distribute company related information and statements to all shareholders annually. This includes, but is not limited to information about shareholders, changes in the information about shareholders, annual and semi-annual reports, decisions over distributing dividends, decisions taken by the shareholder meeting, financial statements, changes in organizational and management structure, etc.

Graph 4. Submission of financial reports in 2009

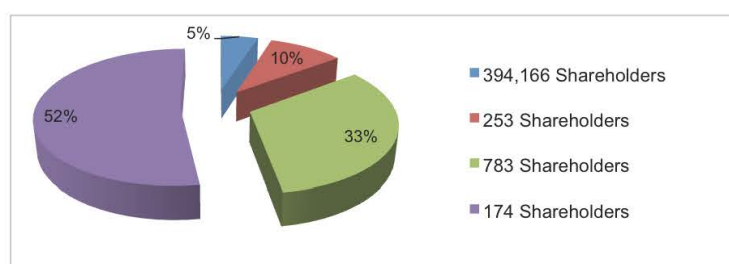


- Financial statements and Annual reports delivered by stock companies are disseminated to the general public by publishing them in "Development of Securities Market" magazine published by the MSE Public Relations and Media Department.

1.2 Distribution of shareholders

Currently, total of 2.5 billion shares have been listed on the MSE and while 1.9 billion shares (74.5%) are held by the Government and 636 million shares (25.5%) are held by individuals.

Graph 5. Total number of shareholders own certain percentage of all listed companies at Mongolian Stock Exchange

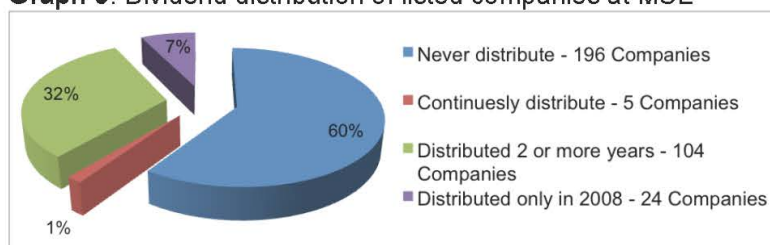


- 174 shareholders hold 33.3% or more, 783 shareholders hold 10-13.3%; 253 shareholders hold 5-10%; and 394,166 shareholders hold up to 5% of shares of a stock company.

1.3 Payment of dividends

- According to Article 47 of Company Law, the Board of Directors will make decisions to pay dividends to shareholders and notify shareholders the amount of the dividend per share, names of shareholders entitled to dividends and the dividend payment date.
- In case the company does not pay dividends, the Board of Directors must explain the reasons at a regular shareholder meeting.
- According to the survey study, only 5 companies regularly distribute dividends, 104 companies have paid dividends in the last two years and 196 companies never paid any dividends to their shareholders

Graph 6. Dividend distribution of listed companies at MSE



- In accordance with FRC Resolution #38 (2008), dividends payment by stock companies to shareholders is paid through the Central Depository and Clearing House, LLC's official account. Of 40 companies which announced to pay dividends earned in 2007, 16 companies made agreement and paid dividends worth 642.5 million MNT to 55,552 shareholders in 2008. However, in 2009, 25 companies announced to pay dividends earned in 2008 and only 10 of them made agreement and distributed dividends worth 403.6 million MNT to 36,430 shareholders.

1.4 Projects and activities implemented by government authorities to protect minority shareholders rights

- A number of activities have been implemented in order to strengthen accountability mechanisms to ensure compliance of relevant legislations among securities issuing bodies, to monitor internal information systems regularly, to remove companies violating shareholder rights from the market and to impose legal liabilities.
- In 2007 and 2008, for instance, inspection examinations were carried out among overall shareholders that cancelled some regulatory provisions which used to allow transferring shares without trading on exchange.
- Numerous serial trainings and seminars have been organized in regards to strengthening public awareness on securities market among the general public and implementing corporate governance in place.
- Ongoing activities have focusing on data and information disclosure through websites of actors operating on the securities market, in compliance with responsibilities specified in relevant legislations;
- Within the scope of "Strengthening technical technology and human resources of the MSE" project, there are activities underway aimed to upgrade the current trading system, improve clearing

processes in compliance with international practices, expand opportunities of online transactions among clients and members, as well as increase the quality of information disclosure services.

- Certain ongoing efforts are making progress in ensuring security and control system for monitoring transactions and balance deposits of shareholders' accounts, in addition to introducing online transactions in order to encourage active trainings among clients.
- It is decided to get account-holders' signatures approved by Brokerage-dealer companies in an attempt to protect saving deposits within the General Securities Account from unpermitted transactions. In case of frauding signature, the concerned account will be suspended, while a due notification delivered to the FRC. Consequently, incidents of unpermitted transactions have reduced significantly up to date.

1.5 Findings of questionnaires taken among shareholders

The research team has conducted a survey study among shareholders based on request from the National Development and Innovation Commission. Subsequent findings are presented below.

TABLE 1. Demograph of survey participants

Position	%	Gender	%	Education	%	Organization	%	Location	%
Officers	57	Female	47	Lower level	2	NGO	4	Rural	0
Mid level managers	27	Male	53	Mid level	6	Private	26	District	3
Hight level managers	16			High level	92	Government	70	City	97

The survey has covered 120 individuals who responded questionnaires prepared. Most of survey participants are shareholders who are individuals and institutional clients participating tradings of the MSE.

TABLE 1.1 Information about shareholders

1. Degree of awareness about stock market	%	2. Percentage of stocks owned	%	3. Stocks bought by vouchers or not	%	28. Satisfaction on stock market involvement	%
High	37	Up to 1%	84	Bought by myself	29	High	2
Medium	47	Up to 5%	9	By family member	46	Medium	56
Low	12	Up to 10%	2	Don't know	5	Low	42
Inadiquate	2	Up to 33 %	2	Never bought	20		
None	2	Up to 51%	2				

Of them, most respondents are minority shareholders who own shares up to 1% and whose knowledge of securities market are assumed "modest" and "high". They said of their degrees of satisfaction "fair" and "not good" in acting on the securities market.

TABLE 1.2 Interest on participating in stock market

4. Purpose of participating in stock market	%	29. Degree of interest on participating in stock market	%	30. Challenges on investing in stocks	%
Receive dividends	29	High	22	Financial restrictions	54
Earn capital gain from stock price increase	65	Medium	31	Lack of knowledge about stock market	43
Own controlling shares	2	Low	33	Physical distance to participate in stock market	3
Other	4	None	14		

One third of these shareholders want to benefit benefits from holdingh shares, whereas other two thirds want to make profits from increase in values of shares. Generally, survey respondents have rights to act on the securitities market and hold shares of companies. It is observed that main challenge appear financial capability and knnowledge of securities markets, and thus their rights get assumed as closely linked with such factors.

TABLE 1.3 Type of information and analysis

7. Types of information obtained	%	8. Analysis	%
Annual reports	42	Capable to read financial reports and do analysis	54
Financial reports	17	Able to read reports but cannot do analysis	32
Operational reports	33	Cannot read financial reports	14
Governing board meeting resolutions	8		

Shareholders mainly receive annual reports, operational profiles and financial statements of shareholding companies, but never resolutions or decisions taken by the Board of Directors. One half of survey participants can read and analyze such information and documents, while one third can understand little and 4% cannot understand at all. It means that the average knowledge looks quite low, in other words - insufficient.

TABLE 1.4 Source of information

9. Confronting issues to obtain information	%	10. Knowing the CEO of the stock owned company	%	11. Sources of channel to know the CEO of the stock owned company	%
Unrealistic information	59	Know	45	Media	48
Not disseminate the information to public	33	Don't know	55	Publicity	10
False information	7			Shareholders meeting	29
				Company reports	13

However, more than half of respondents express that the main challenge related with information is its inaccuracy. For instance, one third think that such information is never disclosed and reached out the general public as appropriate. A few said that delivered information is not adequate and possible to use in reality. The findings imply that information which should be available to shareholders is widely assumed inaccurate and inaccessible to the general public. Moreover, a half of respondents do not know the director of companies of which shares they hold. It means they themselves also do not pay adequate considerations to companies on the other hand. In many cases, they get to know some information on media in regard to activities of companies, as responded to the questionnaire.

TABLE 1.5 Services offered by brokerage companies

5. Sources of information when investing in stocks	%	13. Customer services of brokerage companies	%	Does brokerage company provide adequate information	%
Brokerage company	48	Excelent	35	Yes	14
Company itself	4	Satisfactory	47	Sometimes	61
Someone	10	Unsatisfactory	18	No	24
Publicity	38				

Shareholders make decisions based on information obtained through brokerage firms or media, instead of direct communications with companies concerned. They assessed "good" and "fair" over services of broakerage houses which sometimes provide company-related information.

TABLE 1.6 Shareholders meeting

12. Did you participate in shareholders meeting?	%	16. Number of board members	%	17. Ways to obtain the notice of shareholders meeting announcement	%	18. Chances to casting votes in shareholders meeting	%
Yes	46	9 members	67	Telephone	0	Always	12
No	54	5-8 members	21	Publicity	93	Sometimes	42
		3-5 members	10	Media	7	Never	46
		Up to 3	2	By invitation	0		

More than half of participants have never attended shareholders meetings, but often get meeting announcements from newspapers and sometimes on TV or radio. Mostly, they cannot often exercise to vote at shareholders meetings, but only sometimes at fewer occasions. The Board of Directors usually has nine members.

TABLE 1.7 Receiving votes and solutions

19. Receiving votes in the shareholders meeting or not	%	23. Influence of shareholders meeting on decision of not distributing dividends made by board of directors meeting	%
Consider and accept	4	Always	0
Consider but not discuss	53	Sometimes	6
No consideration	33	Never	94
Gives no opportunity to consider	9		

There are common practices that minority shareholders' opinions are not often seriously considered or discussed at shareholders meetings, even though they expressed their concerns and opinions. Minority shareholders have no opportunities to influence decisions of the Board whether or not to pay dividends to shareholders.

TABLE 1.8 Dividend distribution

20. Received dividends or not	%	21. Confronting issues to receive dividend	%	22. Fairness of dividend distribution	%
Always	0	Distribute dividends in rural area	56	Always	0
Sometimes	64	Period of dividend distribution is short	44	Sometimes	16
Never	36			Occasionally	9
				Never	75

It is revealed that one third of survey respondents have never received any dividends, while two thirds only sometimes receive dividends that there is none who receives dividends regularly. One of challenges related with dividends, companies pay dividends locally so that shareholders cannot visit the company to collect dividends within the specified time due to long distances. Basically, 75% of participants think dividend distribution practices as mostly unfair.

TABLE 1.9.1 Illegal actions

24. Stocks sold without stock owners consents	%	27. Asset confiscation made by company management	%
Yes	18	Yes	60
No	82	No	40

Some respondents witnessed facts that management staffs of some companies sold shares without shareholders' permission or approval, and embezzled company profits illegally.

TABLE 1.9.2 Recovery of the losses

25. Optimality of decisions issued by governed authorities to recover losses	%	26. Optimality of setting stock price during company restructuring	%
Always	6	Always	7
Sometimes	58	Sometimes	2
Never	35	Never	90

Current practices compensating shareholders' losses appear sometimes reasonable and sometimes unrealistic, as expressed by respondents. When companies de-listed from stock exchange to a limited liabilities company, they tend to pay unreasonably low stock prices to shareholders.

2

DEFINING MINORITY SHAREHOLDERS RIGHTS ISSUE

2.1 Duties and responsibilities of related government authorities regarding the protection of minority shareholders rights

Currently, following Government Authorities undertake their operation concerning the protection of minority shareholders rights: FRC, MSE and Central Depository and Clearing House, LLC. In the framework of protecting minority shareholders rights, these government authorities produce respective regulations which are compliant with concerning laws and uphold them in practice.

Concerning the protection of minority shareholders rights, following regulations are issued from above mentioned Government Authorities:

a) Financial Regulatory Commission

- "Corporate Governance Code of Mongolia"
- "Regulation on delivering notifications on shareholders meeting"
- "Regulation on insider information and activity of insider information holders"
- "Regulation on controlling dividend policy of publicly listed companies"
- "Regulation on proposing, registering and selling securities in the primary market"

б) Mongolian Stock Exchange

- "Supervision rule of stock exchange"
- "Securities trading rule of Mongolian Stock Exchange"
- "Stock Exchange membership regulation"
- "Information regulation"
- "Regulation on registering securities on stock exchange"

в) Central Depository and Clearing House

- "Regulation on the segregation of securities and suspending securities account transactions"

As a key government authority in regulating capital market activity, FRC undertakes its operation through three directions in the framework of protecting minority shareholders rights : (a) the right to seek information (b) the right to voice opinion (c) the right to seek redress.

On the other hand, MSE as securities trading centre, supervises the procedure of registration of securities and make changes on it in accordance with concerning laws and regulations.

In addition to these government authorities, the NGO named "The association of protecting minority shareholders rights" is undertaking its operation which was established by the initiative of minority shareholders of "State Department Store" listed company. Further a broad discussion about it will be provided in the next sections.

2.2 The aspect of minority shareholders rights protection in concerning laws and regulations

In order to consider this issue, we break down it into two sections:

- The aspect of minority shareholders rights in concerning laws (Company Law, Securities Law, Civil Law)
- The aspect of minority shareholders rights in concerning regulations issued from Government Authorities

1. The aspect of minority shareholders rights in concerning laws

Since their ratification, seven and one amendments have been made into Company and Securities Law of Mongolia respectively to modernize them. In addition to that, Corporate Governance Code of

Mongolia was issued from FRC in 2007 which should be guidance for Mongolian publicly listed companies to handle their corporate governance issue.

In our understanding, the definition that company net income shall be distributed to shareholders as a dividend or re-invested in order to increase the future net income and stock price of the company which is set out in the Company Law seems to be for the sake of shareholders rights.

As stipulated in the 35.5 article of the Company Law, one stock has one right of vote. Moreover as stipulated in the 64.4 article of the Company Law, to be effective, any matter submitted to a shareholders meeting for consideration, other than election of members of the Board of Directors (or in its absence, the executive body), must be adopted by a majority of the votes of shareholders

In the Company Law, the important matters shall be adopted by a majority of the votes of shareholders as are stipulated in the articles of 14.4, 26.3 and 64.5 which protects minority shareholders rights. But a majority means not all majority shareholders yet majority shareholders who participated in a shareholders meeting.

As stipulated in in the 70 article, there shall be a quorum at a shareholders meeting if shareholders holding more than fifty percent (50%) of the company's voting shares participate in the meeting. In the absence of a quorum as provided in Article 70.1 the shareholders meeting shall not be convened and a date for a new shareholders meeting shall be announced. Moreover, as stipulated in the 79.3 article, the decision of Governing Board must be adopted by a majority of the votes of board members. Governing Board meeting quorum shall be 2/3 of all Board members.

As set out in the Company Law, it is potentially possible to disseminate concerning information about the company to shareholders in a timely manner. But there seems to be a significant discrepancy between "the law on the books" and practical activity as carried-out by Mongolian publicly listed companies. The issue of dissemination of concerning information to shareholders is handled by the regulation, "Regulation on delivering notifications on shareholders meeting" issued from FRC.

2. The aspect of minority shareholders rights in concerning regulations issued from government authorities

In order to consider this issue, we have explored all regulations issued from following Government Authorities who directly and indirectly handle the securities market issues:

- 1) "Financial Regulatory Commission"
- 2) "Mongolian Stock Exchange"
- 3) "The Central Bank of Mongolia"

By each Government Authorities, let us consider regulations which protect minority shareholders rights.

- 1) The aspect of minority shareholders rights which is set out in regulations issued from FRC is provided in the table format (See attachment #3)
- 2) The aspect of minority shareholders rights which is set out in regulations issued from MSE is provided in the table format (See attachment #4)
- 3) "The Central Bank of Mongolia"

The Central Bank of Mongolia makes its contribution to the protection of minority shareholders rights by supervising publicly listed banks. Concerning the protection of minority shareholders rights, it issued "Corporate Governance Code of Mongolian Banks" by # 594 decree of the Governor of the Central Bank of Mongolia in 2006. This Corporate Governance guidance is ratified prior to "Corporate Governance Code of Mongolia" issued from FRC, and compared to it, the guidance is more summarized and the content is similar to. Hence "Corporate Governance Code of Mongolia" is broadly discussed in the attachment #3, it would be needless to consider about the "Corporate Governance Code of Mongolian Banks".

2.3 The main types of violation of minority shareholders rights

Based on our group discussion, we conclude that following main types of violation of minority shareholders rights are observed in the Mongolian capital market:

1. Concerning obtaining information
2. Concerning voting rights
3. Concerning Corporate Governance
4. Concerning receiving dividends
5. Concerning the rights to seek redress
6. Concerning the abuse of insider information
7. Concerning setting the stock price during the liquidation or restructuring of a company
8. Concerning the deals connected with related parties and other big deals

Let us take up detailed key mishandlings detected on each type of violation:

1. Concerning obtaining information

- Companies do not disseminate financial reporting information to shareholders in a timely manner
- Companies tend to conduct the shareholders meeting on working days during office hours by upholding the policy of not getting minority shareholders participated in the meeting as much as possible.
- Conduct the shareholders meeting without any distributed documents related to the meeting
- Conduct the shareholders meeting without adequately delivering the announcement of the meeting to shareholders
- Prior to the shareholders meeting, shareholders tend to be not fully informed about the agenda and draft of decisions of the meeting. Sometimes, these information is not disseminated to shareholders prior to the meeting.
- The opportunity cost of preparing, delivering and publishing the shareholders meeting information is much higher than the penalty awarded from not upholding concerning laws which leads to mispractice among publicly listed companies that in some cases, getting penalty is more rational way in terms of buying times and saving costs.
- The information about the market and company activity is delivered in a not equitable manner. That is why it is observed that stock traders carry out trading based on insider information which might be obtained from variable sources.
- The accountability issue concerning the validity of financial and operational reporting of the company seem to be ambiguous.
- The Governing Board meeting is conducted infrequently; financial reports are submitted in a not timely manner.
- Publicly listed companies must provide required information as stipulated in the accord established with MSE as they are registered in it and taking part in trading, but in practice very few companies are compliant with this rule. In case of not upholding this rule, companies could be delisted from stock exchange which might threaten to damage shareholders rights. Even though there is a regulation on information bureau, accountability issues are vaguely set out in this regulation.

2. Concerning voting rights

- Conventionally shareholders meeting is announced on working days during office hours. As for minority shareholders, it is troublesome to take time off from their principal jobs to participate in the shareholders meeting which might lead to failure of participation in the meeting.
- There are cases where the venue of shareholders meeting is located in the countryside which might restrict the rights of minority shareholders to voice opinion and cast vote. For instance, last year "Spirt Bal Buram" company announced its shareholders meeting to be taken in the place of the company factory premises located in Zuun-Kharaa soum.
- During the shareholders meeting, poll commission is tend to be composed of main shareholders and relatives of them.

3. Concerning Corporate Governance

- It is advised in the Corporate Governance of Mongolia that at least 1/3 of members of the Governing Board of companies should consist of independent members but this is not completely fulfilled in practice. The Governing Board is mainly composed of main shareholders and their inner circle people.
- The responsibility of Governing Board members is vaguely set out in the Company charter and their contribution to company activity is merely limited by inactively taking part in the Governing Board meeting and casting their vote on draft decisions ordered from the management team. Therefore the management team seems to neglect the role of Governing Board, and to be reluctant to initiate and have the Governing Board meeting.
- There is no specific position for the Secretary of Governing Board which is mainly executed by another position of the company. In reality, the Secretary of Governing Board should have sufficient knowledge of Corporate Governance Code and carry out technical tasks such as to deliver the Governing Board Meeting announcement to members, and put the agenda in the meeting etc.
- Supervisory Committee tends to be not elected autonomously and composed of inner circle people of CEO and main shareholders

4. Concerning receiving dividends

- As stipulated in the regulation issued from FRC, listed companies shall distribute their dividends through YLTXTT. However, in some cases, companies violate this rule by distributing dividends by themselves.
- Given that the venue of dividend distribution is located far away from Ulaanbaatar, the capital city as listed companies distribute dividends by themselves, in some cases the operational cost for receiving dividends such as travel cost exceeds the amount of dividend for minority shareholders. For example, "Baganuur" company distributed its dividend in its central premises far away from Ulaanbaatar.
- The issue of calculation and distribution of dividends is discussed and decided only by the Governing Board. In the resolution of Governing Board meeting, the decision of dividend distribution is merely set out and the covenants of not distributing dividends and the reason of it are not clearly set out.
- During the shareholders meeting, dividend distribution issue is not broadly discussed, and very few opinions about it are received from shareholders and very unclear comments are provided to them.
- The involvement of professional organizations in dividend issue tends to be very restricted so the protections of minority shareholders' rights are not maintained in this area.

5. Concerning the rights to seek redress

- The power of FRC on dealing with matters concerning the rights to seek redress seems to be weak. If detected wrongdoings are characterized to be administrative, the penalty on these wrongdoings are merely restricted by giving order to fix them or imposing monetary penalty.
- Since the inception of capital market, it has been passed over 18 years. Over these years, experienced lawyers and advocates who have knowledge about capital market are lacking which causes difficulties in the legal claim procedure.

6. Concerning the abuse of insider information

- By abusing insider information, to inflate or pump up stock prices
- By abusing insider information, to make an attempt to illegally impact on big deals and purchases

7. Concerning setting the stock price during the liquidation or restructuring of a company

- By making market valuation of the company purportedly lower, the company is privatized by affiliated shareholders who hold the control block of company shares
- Setting stock prices purportedly lower during the restructuring of a company by changing company form from publicly listed to limited.

The person who manage and hold the control block of company shares intentionally liquidate the company by making big deals which is not beneficial to the company and transferring core assets of the company to companies owned by them

8. Concerning the deals connected with related parties and other deals

- Getting no approval from other shareholders on deals big enough to impact on a company activity
- The management team and Governing Board members participate in decision making process of conflict of interest deals

3.1 Complaints filed to the regulator from shareholders and subsequent solutions

During the intense chaos of the securities market – between 1997 and 2003 – there were many illegal actions occurred that shareholders' stakes were traded without their consents, through either stock exchange or direct (non-exchange/price-bargaining) trades and frauds. Several years later the individuals, customers and investors discovered their stakes been harmed illegally and thus they filed complaints and disputes to then Securities Committee – the current Financial Regulatory Commission.

FRC normally investigate complaints filed from individuals, settle disputes, impose liabilities to impropriators, restore equity ownership rights certified with securities, ensure occurred damages recovered and transfer some allegedly criminal cases to courts and police, if necessary.

Currently, the FRC has transferred disputes, related to “Munkhud” brokerage-dealer company serving individuals of Zavkhan aimag and “Ajnai Invest” LLC serving individuals of Umnugobi aimag, to the authorized judicial organizations that are investigating allegations whether they illegally traded shareholders' equity and caused substantial damages.

As of the end of 2008, the FRC received over 300 complaints and requests from shareholders and investors that it has resolved them all within its legal competence through taking relevant actions, such as ensuring damages recovered, restoring equity ownership rights and imposing due liabilities to impropriators.

- Disputes and complaints filed from minority shareholders to the FRC in 2008-2009 have been sampled to show violations and breaches of particular legislations and subsequent resolutions in Table 2.
- In the past two years, the FRC has received about 200 complaints from shareholders over shares owned by them; of them, 80% are complaints claiming their stakes sold without their consents. The rest of complaints alleged shareholders' stakes transferred to others' names arbitrarily, dividends not paid duly and share prices determined unreasonably lower when shareholding companies restructured in to limited liabilities companies.

TABLE 2. Complaint letters received by the Financial Regulatory Commission (2008-2009)

No	Complaints and disputes	Settlements
1	Sold shares without shareowners consents	1. Transferred to the Courts as the issue is beyond the legal power of the FRC 2. The client brokerage-dealer companies which sold shares without shareholders' consent, have got bankrupted so it is impossible to resolve. 3. Provided advice to complainants to file lawsuit to the Courts through civil procedures 4. Transferred to the police 5. Brokerage-dealer companies admitted their illegal trades without consent and so paid the cash earned from the trades
2	Transferred shareholders' shares to others' names through frauding fake agreements	Transferred to the police.
3	Determine registrations of shares at which brokerage-dealer company through share queries	Notified the responsible brokerage-dealer companies and instruct them to provide relevant information to shareholders
4	Dividends unpaid and sold shares through brokerage-dealer company without shareholders' consent	Transferred to the police.

5	Still owning pink vouchers and so willing to get advice what to do with them further	Advised to come and get counseling from relevant officers of the FRC
6	No dividends from shareholding companies and no relevant information access/delivery for shareholders	Notified about complaints to concerned shareholding companies and instruct them to provide relevant information to shareholders promptly and present explanations over reasons why dividends are not paid to shareholders.

- Considering dispute settlements concluded by the FRC, most of its subsequent actions have included such as advising complainants to file the cases to courts through civil procedures, transferring some cases to affiliate courts, investigating concerned brokerage-dealer companies, and ensuring shareholders' damages recovered accordingly.
- Above-mentioned four main types of disputes and breaches specified in shareholders' complaints, Part 3.3 discusses potential factors and reasons causing such disputes and irregularities later.
- While reviewing resolutions passed by the FRC, in total the cash compensations worth 47,984,756MNT were repaid as a part of revoked-deal settlements, whereas the rest of revoked share-deal settlements been re-deposited in the form of shares as shown in Table 3.

TABLE 3. Revoked-deals by the decision of the Financial Regulatory Commission

Year	Number of revoked deals	Number of stocks referred to revoked deals	Volume of revoked deals
2006	5	5,635	146,510
2007	19	3,947,100	47,984,756
2008	73	3,333,904	Replaced in the form of shares
2009	n/a.	n/a.	n/a.

Trading without consents

- As of the end of the 3rd quarter of 2009, altogether 214 complaints were filed to the Securities Department of the FRC. Of them, 90% have alleged shareholders' shares traded without their consents.

3.2 Violated cases on the minority shareholders rights

Considering behaviors of brokerage-dealer companies, their managerial staffs and some major shareholders who violated ownership rights of other shareholders, investors and customers and so caused damages to them, such illegal actions have been categorized, in the following way, based on survey study findings:

- limit voting rights of minority or other shareholders;
- limit rights to earn dividends;
- violate rights to severance shares or dividends from the company equity when dissolved (cases of State Department Store, Erdenet carpet etc.)
- sell shareholders' shares without their consents;
- transfer shareholders' shares to others without their consents;
- devaluate company assets deliberately for embezzlement or fraud purposes;
- sell and transfer company assets/equity to others;
- put company assets as loan collaterals etc.

There are common practices in that most of over 380 shareholding companies listed at MSE tend to violate rights and interests of thousands of minority shareholders' rights. Some do not organize regular shareholders' meetings and provide relevant information to shareholders. Moreover, major stakeholders who are holding majority stakes do not comply their legal responsibilities when initiating to buy other shareholders' stakes. In other cases, company managers and major shareholders attempt to trade company assets and equity arbitrarily for their own profits without other shareholders' consents, yet often fail to pay dividends to shareholders, despite substantial profits earned in respective financial or reporting year.

Thus, it can be concluded that one of main reasons prompting the company management staffs failing to meet their legal responsibilities appears that minority shareholders, in general, lack of proper awareness regarding corporate governance of shareholding companies, their own roles and responsibilities and equity-ownership rights certified by securities (shares)

Survey findings reveal that “Munkhud” brokerage-dealing company caused damages worth 150 million MNT to over 180 individuals through its illegal actions and speculative trades, if calculated on the basis of discounted value of the concerned period of time, whereas “Ajnai Invest” LLC caused damages worth 1.5 billion MNT to about 50 individuals through manipulating trades of shares.

Tuuls Songino Water Resources, JSC

TSU LLC was established and registered with the State Registry Office in December 29, 2006. On March 15th, 2007, by the FRC decree number 33, the company obtained permission to issue 120 million common shares and change its status to Joint Stock Company. The FRC decree allocated 15.4 million common shares to the founders of the company G. Ganbat and G. Gangerel in compensation for their initial investment in the company. On October 11, 2007, by the FRC decree number 133 additional amendments was made to issue the common shares in several tranches. The first issue was set to 24 million shares. The remaining shares were isolated.

On December 3, 2007, the sale of the shares on the primary market began. 13.2 million shares were sold in 2007. Later a FRC inquiry revealed that the company paid out 396 million MNT from the 13.2 billion proceeds from share sales as trading fees to a company without a permission to carry out trading activities.

G. Ganbat, co-founder of the company, contributed his business plan that was based on a patent obtained in 2001 for a water power plant. The business plan was valued by Asset Valuation Center, LLC in the amount of 12,825,000 USD. Although the rights to the patent were not transferred to the company, the valuation of the business plan was recorded as intangible assets on the balance sheet of the company.

In May 2008, the company purchased 17 hectares of land for the amount of 1.5 billion MNT. However, the company was not able to obtain the official title for the land due an earlier ownership disputes. Notwithstanding the issue, the company began groundwork for the construction of the water power plant. The large amount of expenditures, including groundwork on a land without clearing the title disputes, caused some concern by other investors in the company.

The above-mentioned activities can be directly linked to poor oversight by shareholders, lack of proper corporate governance framework, and family control over key management positions. For example until February 23, 2009, founders of the company who were husband and wife held the positions of director of the Board of Advisors and CEO of the company. Furthermore, the subcontracting company that did the ground work on the construction site was a company owned by G. Ganbat, the co-founder and director of the BoD.

As soon as the foreign investors who own 79.59% of shares became aware of the situation took some measures to alleviate the problem. These included conducting financial audit by international audit firm, change members of the board and executive management, and amend original business plans.

If such measures were not taken the company faced a danger of going bust. By removing the founders of the company from the control of the company and installing clear and transparent flow of information, the company was able to prevent any major losses to the investors. Over 200 minority shareholders own 2.59% of the company shares.

In this case, the foreign investors were able to take drastic measures because they owned 79.59% of the common shares. Unfortunately, there are many companies that do not have strong foreign investors that can influence the operations of the company. These companies are not able to change their corporate governance structures and may fall into difficult financial problems in the future.

Hermes Center, JSC

Hermes Center, LLC obtained permission from the FRC to issue 23,562,900 common shares on the primary market in order to finance a new warehouse center in Erdenet city. The share issue constituted 30% of total shares and the owners of the company retained 70% or controlling stake in the company. The IPO trading begun on May 19, 2008 and within 4 days all shares offered on the primary market were sold out. Over 500 retail investors purchased the shares.

Hermes Center was established in 2003 with 3 people to carry out trade and other services. Currently the company employs over 50 people. In 2005, the company constructed 9,000 square meter warehouse shopping center called the Hermes Super Center in Ulaanbaatar city. In addition to the warehouse, the property is surrounded by 5000 square meter fenced area with asphalt cover. It has a parking lot for 150 vehicles and 300 square meters have been planted with trees and other plants. In 2005, the property was honored as having the best landscaping building by Bayangol district and capital city officials. The property is valued at 2.5 billion MNT.

According to the company prospectus, in 2008, 2009, and 2010 the company forecasted net profit of 0.97 billion MNT, 1.7 billion MNT, and 1.9 billion MNT, respectively. Furthermore, the warehouse center in Erdenet city was scheduled to be completed and operational in December, 2008. The warehouse center in Erdenet is planned to be 2 story high building with in-house storage facilities. The total usable area is 8,573 square meters. After this warehouse store becomes operational over 200 construction materials and supplies trading companies are expected to rent space from the warehouse store.

Currently there are over 900 shareholders of the company that hold 30% of the shares. According to some sources many of the shareholders are not satisfied with the company management and the majority stake holders. There have been accusations that the the original IPO process was flauwed and the management has been misappropriating company funds. For instance, the valuation of the above mentioned property in Ulaanbaatar city was not valued properly or unreasonably inflated and the land purchase agreement articles do not match with the information provided in the prospectus, and worst of all the warehouse store in Erdenet has not been built to this date.

The company has not taken any steps to ease the tensions with the minority shareholders and has not explained why the building that was expected to be completed in December, 2008 has not been completed. In one news article it was writing that the company spent 725 million MNT for unknown purposes, as the CEO of the company took 129 million MNT in cash and a check for the amount of 599 million MNT was writing without any documentation on spending. Another newspaper wrote that the company bought Toyota Landcruiser jeeps for 140 million MNT.

While many take such articles in newspapers with a little suspicion for the general public who has limited sources of information when it comes to stock companies it is hard to ignore them. If there is not enough information about the company or if there is a lot of mixed information and you don't know what is true and what is not, how can you make investment decisions?

State Department Store, JSC

State Department Store was originally established in 1924. The decision to privateze the former flagship store of Mongolia was made in 1998 and it was fully privatized in 2000. The 5 story high store building is the main asset of the company. The building is located in the center of the city, and has 14,767 square meters of usable area. It has a capacity to service 159 thousand people.

The company has over 50 thousand minority shareholders who own only 5.9 million shares or 16% of total shares. The remaining shares are held in one family group. Since privatization, in the past 9 years the company has held annual shareholder meetings 9 times, and paid dividends only once in 2001 (0.30 MNT per share).

On October 25, 2007 the Board of Directors announced an extraordinary shareholder meeting to make a decision on a proposal to buy-back shares of the company and change the company status to a private company. Out of the 52.7 thousand shareholders, only 71 people attended the extraordinary shareholder meeting. According to some officials this was due to very hasty manner in which the extraordinary shareholder meeting was organized. However, many shareholders have complained that it was due to the registration for the meeting being closed a whole month before the actual meeting date.

According to the State Department Store Board of Directors August 6, 2007 Decree 09/10, the board set the buy-back stock price at 150 MNT. The price was based on stock valuation done as of June 31, 2007 and 52 week average price. However, many investors were angry with the buy-back price because the market price at the time of announcement of the buy-back was 1,350 MNT. The 52 week average price as of October 1, 2007 was 388 MNT.

As a result of many complaints to the FRC and based on a FRC inquiry, it was decided that the State Department Store violated the Company Law, article 56.4, which state that a 6 months average official price provided by the MSE will be used to determine the value of shares and other publicly traded securities. On this basis, the FRC did not allow the State Department Store to announce a tender to buy-back its shares and change its status. Although the tender was not allowed, the process illustrates the weak points of the securities regulation dealing with public companies going private.

An example with a retail investor, published in a news article, illustrates one of these weak points. In August, Mr. Enkhbat purchased 517 shares of SDS at 360 MNT, in the same month Mr. Enkhbat bought 249 more shares at 822 MNT. At this time, the SDS board meeting was held and the buy-back price has been set at 150 MNT. The company did not release the information to the public and the board decision has not been disclosed properly. Since the share prices were going up and the general expectation was that it will continue to go up, Mr. Enkhbat bought 305 more shares of SDS at 1,220 MNT. He had spent about 800 thousand MNT to purchase 905 shares. However, with the buy-back price released in October, Mr. Enkhbat is left with 905 shares worth about 160 thousand.

3.3 Factors intervening rights of minority shareholders

The following factors may cause shareholders' rights abused and violated:

- lack of awareness and information of the securities market;
- no timely and sufficient information provided from shareholding companies to their shareholders about company activities;
- no legal power and competence held by the FRC and other government agencies to enforce their regulations and ensure accountability liabilities imposed to cases of breaches and violations;

Apparently, within the judicial organizations and police the officials working on disputes related to shares do not have sufficient knowledge of securities and corporate governance of shareholding companies.

Issues related with shareholders

- Shareholders themselves lack of basic understandings of shares, the securities market and property rights because their shareholding rights were entitled through a free voucher system, the properties were become owner-less due to knowledge-less shareholders and shareholders still maintain assumption of shares as 'free entitlement'.
- About 1.3 million people redeemed vouchers for shares and bought stakes from enterprises, yet 180,000 people have never opened accounts at the 'Central Depository and Clearing House' LLC. Individuals were not provided sufficient knowledge and information on trading and holding equity stakes.
- Eventually, it is observed that a small number of investors tend to dominate at the securities market that shareholders, in general, lack of knowledge and experience of the securities market, share trading and

their rights and entitlements, in addition to limited access to relevant information about their shareholding companies.

Voting rights

The following factors have caused complications related to organizing shareholders' meeting:

- Data and time of the meeting: It is common to announce and organize shareholders' meeting during office hours on a business day. Usually, shareholders find it difficult to miss their full-time work and attend the meeting so that most of minority shareholders cannot participate in shareholders' meetings.
- Location: In many cases, shareholders' meetings are held at the company premise located in a rural community. For example, 'Spirit Bal Buram' SHC has announced to organize shareholders' meeting at the factory premise which is located in Zuunkharaa town. In addition, it gets difficult for shareholders to get small amounts of dividends by paying expensive transportation costs, if the company is located in a remote community isolated from the Ulaanbaatar. For example, "Baganuur" SHC announced to pay dividends to shareholders at the company premise.
- Information delivery: There are limited possibilities to distribute agenda and relevant information prior to shareholders' meeting that the agenda is only announced briefly through media outlets in fewer cases. In some cases, meeting agendas are simply not notified or informed in advance at all.
- Meeting agendas: There are common practices in that the board of directors tend to make decisions over issues which are generally supposed to be decided by shareholders at shareholders' meeting.

Board of Directors and its meeting

- Components of the Board of Directors: The number of members with the independent status often fall short of the required level. The independent members shall account one third of members of the Board of Directors.
- Roles and responsibilities of the Board members are often not specified in the company rule so that their roles and contributions to the company appear confined to only attending Board meetings, but nothing significant activities and tasks performed by them. Thus, the company's managerial staffs do not value roles and responsibilities of the Board of Directors and so are reluctant to organize Board meetings.
- The secretary of the Board of Directors must know corporate governance and be responsible for distributing meeting agendas in advance and preparing agendas prior to meetings. In reality, there is no on-staff secretary to the Board of Directors and even the Board members have no sufficient knowledge of corporate governance.

Entitlement rights to dividends

- The Board of Directors independently make decisions over calculations and distributions of dividends. Their decision is reflected in the resolution issued from the Board meeting, yet conditions and reasons of withholding dividend payment are not clearly stated in case of dividends unpaid.
- Shareholders' meeting tends to discuss dividend payment related issues within the limited scope that such issues are often limited to only responding to fewer shareholders' comments and questions.
- Participation and due diligence of external professional organizations and the regulatory agency are apparently minor so that shareholders' rights cannot be appropriately protected and ensured.
- It is difficult for shareholders to travel to rural communities in order to get dividends earned for their shares.

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- In the regulations of FRC, it is stated that dividends shall be paid through the account of the 'Central Depository and Clearing House'. Shareholding companies do not follow the rule, but still tend to pay dividends at their company premises.
 - Some shareholding companies opened accounts on names of their shareholders at banks and so transfer dividends to their bank accounts without causing unnecessary complications. For example, Zoos Bank, Atar Urguu. Spirit Bal Buram etc.

Restoring violated rights

- The FRC receives complaints and requests of dispute settlements related with the securities market and assign state inspectors to settle concerned disputes after reviewing them. State inspectors review disputes and complaints, determine possible breaches of particular laws and regulations and prepare due diligence report, including own conclusions and opinions. Otherwise, state inspectors' enforcement power is limited beyond that. If concerned complaints are determined to claim violations of laws, the FRC discusses the matter at its meeting and make a resolution reflecting relevant liabilities and sending official notes instructing to pay damages to victims.
- Most of complaints filed to the Financial Regulatory Commission appear claiming that brokerage-dealer companies sold shares without consent and thus demanding payments of damages to victims victimized due to such trades. These trade deals have been revoked and sold shares were returned to original shareholders who legally owned. Moreover, the purchasers of the non-consented shares did not know about the illegal trades without shareholders' consent had to return shares back to legal owners and so face additional damages in consequence. Besides, dispute settlement processes have even included repayment of trade fees for carrying out those share trading deals to make things in order. If share-trading deals revoked, trade fees shall be cancelled as well.
- Complaints and dispute settlements have two forms; administration related complaints and criminal matters. It often appears unclear the ways how administration related complaints and issues are unclear. Criminal matters are returned to the complainants who are advised to file lawsuits to the Courts. Although the Courts and Prosecutors' office normally investigate cases, they often lack of professional knowledge of economics and securities market and thus tend to settle such cases based on provisions specifying damages expressed in numerical cash amounts. Otherwise, in current practices investigators hardly consider economic values of cash damages and further consequences realistically.
- Mongolia's securities market has 18 years of history and experiences qualified and experiences lawyers, prosecutors and investigators are still in shortage and insufficient to maintain an effective mechanism which can settle securities related disputes and complaints accordingly.
- Looking at current practices of the securities market, there is no effective mechanism which requires to bankrupt shareholding companies. Thus, it is necessary to amend the Law on bankruptcy and specify clear provisions pre-conditioning bankruptcy in there. Companies which have suspended operational activities and cannot sustain profitable operations must be bankrupted urgently so that investors should be paid severance compensations and due receivables.
- Shareholders shall fill and sign "Customers' agreement form" issued from the Financial Regulatory Commission when receiving services from brokerage-dealing companies. However, signatures do not match and brokerage dealers cannot check and confirm signatures so that 'Central Depository and Clearing House' LLC is working to introduce a new sophisticated system which can check and confirm transactions with e-signatures.
- One of common disputes is shareholders' complaints related with restructuring processes shifting from a shareholding company in to a limited liabilities company. The law specified that the price of shares shall be offered no cheaper than the average price of the past 52 weeks, in case of purchasing shares through tender bids. However, shares are often offered in cheaper prices as specified in bidding proposals. For

instance, “Erdenet carpet” shareholding company offered 400MNT per share in bidding proposals. However, shareholders disputed the price and revoked the price offer. From the next day, shares of the company (Erdenet) is offered and traded at MNT per share.

- Monitoring mechanisms ensuring listing rules and requirements for initial public offerings (IPOs) appear very low and there is no effective monitoring system to monitor the flows of the money raised through stock exchange trades. For instance, “Anod Bank” shareholding company previously issued bonds, yet failed to repay bond debts within the set deadlines. However, when it applied to re-issue shares, related permissions were provided without proper tracking of previous conducts. Such practices tend to be observed in prevalence.
- In case the securities market operators cause improper acts and conducts, severity of liabilities is very mild that becomes a major factor of incompliance and of neglecting legislations. For instance, the law requires shareholding companies to disclose annual reports and financial statements open to the general public. The liability fee for violating this legal provision appears much low and, ironically, even lower than the price for publishing reports and statements in newspapers. Thus, such mild punishment seemingly motivate some to neglect legal obligations, but rather pay insignificant amounts of penalty fines.
- In addition, it is important to strengthen “Procedures of risk fund” in order to mitigate risks and inactions possibly to be caused by securities market operators. According to law provision, brokerage-dealer companies shall set up a risk fund with cash no less than 30% of current assets. However, in reality it is questionable whether companies set up a such risk fund, deposit relevant funds in the fund account, and/or spend from the fund whenever necessary.
- Other common types of disputes raised against shareholding companies look related to underreporting profits, evading to pay dividends and determine the price of shares at unreasonably higher when issuing IPOs. To address those problems, the regulator should cooperate with other public and professional organizations. However, in reality it is often argued that these professional organizations do actually serve or favor interests of companies.

Information disclosure

- Shareholding companies shall trade their shares open and transparent to the general public, possess high integrity, commitment and social responsibilities, ensure efficient activities from both the executive management staff and board of directors, fulfill obligations to deliver and disclose relevant information to shareholders, and monitor closely changes in prices of shares on the market. Due to facts that Mongolian shareholding companies are originally privatized through privatization processes, shareholders’ complaints and disputes tend to occur in prevalence and the company management body shoulders responsibilities on behalf of shareholders rather than for own acts, it is quite common that shareholding companies tend to be restructured into limited liabilities companies.
- Apparently, shareholding companies tend to perceive information disclosure, meeting of the Board of Directors and shareholders’ meeting burdensome and pressurous to company activities. In particular, company management staff and board of directors do not have sufficient knowledge of corporate governance and thus do not fully understand their responsibilities and obligations which they should be accountable for before shareholders.
- Some shareholding companies do not have Chief financial officer (CFO) who can analyze financial documents and statements. Most executive directors are not sufficiently qualified to analyze and manage financial affairs and appear simply acting as the secretary of the board of directors so that his/her roles have become confined to only bridge company activities with members of the board of directors. Therefore, the secretary demonstrates poor performance in delivering relevant documents to responsible agencies after being approved by the meeting of the board of directors and in publishing disclosed information through media to the general public.

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- Companies operating on the securities market cannot receive such disclosed information and utilize it effectively due to insufficient understandings of its importance and needs. On the other hand, as accuracy and confidentiality of company information are not fully and adequately ensured, information exchange and transfer mechanisms among client organizations cause delays and risks to leak sensitive information. Thus, information management systems should be conveniently strengthened.
 - Incurring costs for delivering and publishing company information through media and press are ironically higher than penalty fees for violating related legal provisions on information disclosure. That's why some companies prefer to not to follow the legal obligations.
 - Since information disclosure and accessibility are not balanced and transparent, trading participants try to obtain information in various arbitrary ways and engage in deals based on internal information, as observed from practices.
 - It is not clear who will be held accountable through what ways, in case financial statements and operation related information of the shareholding companies are inaccurate and manipulated.
 - Currently, company information cannot be distributed to all shareholders with balanced and timely manners. Thus, shareholders do not have possibilities to make decisions to sell and purchase shares based on such information. Since underwriting and valuation of company equity/assets are not accurately performed, accounts data and tariffs tend to be calculated inaccurately in consequence. No basic analysis is carried out over shares, nor are there any investors who can understand such analysis results.
 - Shareholding companies do not all organize Board meetings regularly and deliver annual or periodical reports to Board members on time. Although there is a procedure of consolidated information database in place, the obligations provided by this procedural rule are not only followed, but also the in compliance penalties are unclear and just remain on paper.
 - Shareholding companies shall provide and disclose information on a regular basis in order to be listed at the MSE, yet in reality few companies fulfill this obligation. If companies do not follow the rule, they shall be removed from the list of the stock exchange on one hand, but on the other – removing companies from the list often raises a question to eventually victimize investors rather than the company.
 - Currently, shareholding companies can directly inquire 'Central Depository and Clearing House' LLC for information on distribution profiles of shareholders to pay dividends.

4

INTERNATIONAL BEST PRACTICES AND CORPORATE GOVERNANCE RESEARCH CONDUCTED IN MONGOLIA

Sections 4.1-4.2 have been omitted from translation as they were mainly intended for Mongolian audience

4.3 Summary of previous research reports

There have been several reports on current corporate practices in Mongolia and how it compares to international best standards. For the most part these reports are requisitioned by multi-lateral and donor organizations such as the USAID and World Bank. The following three reports have been reviewed while conducting research for the TA Project.

1. Shareholders Rights in Mongolia, 2002, a report writing by Econsulting Co. Ltd. for the 3rd meeting of the Eurasian Corporate Governance Round table in Ukraine organized by OECD
2. Mongolia Corporate Review, 2008, USAID EPRC Project
3. ROSC, 2009, World Bank

Among the three reports the Mongolia Corporate Review by USAID provides the most in-depth analysis on Mongolian corporate governance framework. The World Bank report compares OECD corporate governance principles with corporate governance practice in Mongolia. The OECD report was written in 2002; however while comparing it with the two most recent reports written in 2008-2009 it is obvious that not much progress has been made since 2002 in improving corporate governance in Mongolia. All three reports come to a conclusion that while on paper Mongolia has addressed corporate governance and minority shareholder rights issues, in practice they are not followed.

There are many reasons why the rule of law is not followed. It is a multi-faceted problem that is based on lack of knowledge about corporate governance at all levels, weak rule of law, lack of sources of financing, and relatively young age of the market. Therefore, there is not simple fix over night and a long-term systematic approach is needed to fix the problem.

According to the 2002 Shareholders Rights in Mongolia report, written for the OECD Eurasian Corporate Governance Roundtable meeting, the situation at the Mongolian stock exchange were worse off in 2001 than in 1998. The main reasons for the worsening conditions were:

1. Few companies were profitable
2. Lack effort to promote investor rights and increase public awareness
3. Limited interest by main investors, lack of institutional investors
4. Reporting is done only for the reporting sake and does not corelaate with the operations or the market
5. Business is based on who knows who
6. Neither the investor nor the companies trying to raise capital know the benefits of being a listed company
7. Since it is harder to evade taxes for Joint Stock Companies, the companies prefer to become private companies

The report also mentioned that there are many rules and regulations that protect shareholder rights, however the legal documents for the most part seem to be copied from various counties and do not correspond with conditions in Mongolia very well. In some instances it is very costly to comply with the regulation.

Mongolian stock companies began trading their stock from 1994-1995. Although there were about 470 stock companies starting from 1995, when the secondary market begun, shares of companies were bought up by

few investors. By 2000, majority of shares of the stock companies were owned by 1 or two people. This in effect means that about 500 people control all of the 470 stock companies.

A study revealed that less than 10 companies pay dividends on regular basis, 70 companies pay dividends occasionally and the rest never pay dividends. Because the size of the dividend is so small, there are some investors who do not collect their dividend payments.

The 2008 Mongolia Corporate Review, USAID EPRC project has ranked Mongolian stock market as a developing market. This was due to adoption of the Corporate Governance Codecs and several new laws are in the process of being adopted.

Although the economy is growing, according to the 2008 data the main players in the finance sector are commercial banks. Almost half of the loan portfolios by the banks have term of 1 year or less. Because banks lend to companies with better corporate governance practices there is a very low default rate.

The stock market is still in its infant stages. Although there have been several IPOs in the past five years, it's not enough proof that market is developing. There is a lack of policy to develop the stock market and other non-banking financial sector. The finance sector needs to have other options for domestic companies to raise capital besides bank loans. Furthermore, even though there are over 40 broker dealer companies in 2008 just two brokerage companies accounted for 52% of all transaction.

The government needs to take measure to create institutional investors such as pension funds, insurance firms, and other investment funds.

The ROSC report by World Bank has sited the following shortcomings in corporate governance practices:

1. Most Board of Directors are involved too much in the day to day operations rather than focusing on executive management oversight and strategic guidance
2. Most companies do not have risk management, internal monitoring and auditing, strategic planning guidelines. Majority shareholder appoints members of the board and members of the executive management are appointed as members
3. Financial statements are in developmental stages. Other reports are almost non-existent
4. Basic rights of the shareholders are not met. For example from the 384 Joint Stock Companies only 158 companies held annual shareholder meetings

The report concluded that the securities market is not transparent, regulators do not have receive any input from market participants in creating new laws and regulations, the laws are not followed, although the new Corporate Governance Codecs is very comprehensive it is implemented in real life, the various agencies do not coordinate their work, some laws and regulations are contradictory to each other and compliance burden is too high for small companies. FRC does not have enough power and the MSE staff is paid at the government employee levels and therefore can not effectively broaden its operations.

5.1 Conclusion

Mongolia mostly relies on imported goods and has higher living costs in comparison with other similar developing economies, in addition to higher interest rates to savings deposits and expansive amounts of cash savings in hands of people instead of bank transactions. Thus, the country needs investments to develop domestic industries and strengthen the financial market which attracts potential investors and investments. With developing financial markets appropriately, it will allow potential foreign and domestic investors invest their money in the economy and thus contribute to gear development of domestic industries, increase GDP, stabilize inflations, reduce unemployment and improve livelihoods of people ultimately.

Corporate governance practices do not appear uniquely weaker in Mongolia, but also unstable upon international areas as well. However, considering international research studies, it is widely advocated to strengthen legal frameworks relevant to improve corporate governance and protect minority shareholders' rights in many parts of the world. In case shareholders' rights and rights are not appropriately safeguarded, they tend to lose their confidence in investing their money within such unsafe and uncertain environments. Besides promoting rule of law and accountability among shareholding companies, it is important to build up capacity of equally both regulators and actors of the financial market and improve operational efficiency and accountability within corporate governance regulations, in general.

As authorized regulators cannot effectively solve disputable matters raised between stock companies and shareholders, the scale of conflicts and disputes are increasing more than ever. Thus, market actors lose interests to engage in market transactions that they investors tend to retain investments and stock companies prefer to become limited liabilities companies. Generally, businesses need investments to expand their scale of economy and so make efforts to comply with requirements and demands of banks, however they do not equally consider importance of money raised through tradings of the securities market that they often violate legal provisions to provide investors with relevant information about their activities and financial status. Thus, the securities market has obviously lost its reputation and confidence among potential actors.

Therefore, it is in urgent needs to develop the securities market which can attract potential investors' confidence through maintaining rule of law and transparency so that major stock companies will emerge by and large. In this regard, ongoing efforts in developing the securities market should be strongly promoted and supported under the government policies and comprehensive measures to develop the securities market in the way to adequately safeguard interests of minority shareholders and potential strategic investors. In addition, it is important to reconsider current practices in that regulations tend to impose strict obligations to any of market actors and so push them from the market eventually. Instead, it is necessary to encourage and motivate market actors through improving corporate reputations of stock companies and making regulations more clear and specific gradually.

5.2 Recommendations for solving challenges

The existing Company Law and Law on Securities Market cannot fully and adequately regulate current market relations so that the main principles of market regulations tend to fall short in reality, as revealed in findings of the research analysis. For instance:

- initial public offerings;
- determining share prices of IPOs;
- links and integrations of primary and secondary markets;
- unclear responsibilities of professional organizations acting on the securities market;
- responsibilities and activities of underwriting companies falling short in comparison with international practices;
- unclear roles and responsibilities of the regulator of the securities market;
- limited power (legal competence) of above-mentioned institutions
- unclear mechanisms for protecting rights of minority shareholders;
- shareholders cannot participate and influence the authority of the companies based on the share of stakes held;
- insufficient information disclosure towards shareholders;
- inefficient mechanisms requiring/enforcing information disclosure open to shareholders;

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- unfair dividend distribution practices;
 - inefficient implementations of responsibilities among company managers and executive officers;
 - Limited rights for shareholders to file complaints and ineffective dispute settlement mechanisms.

Thus, it is in urgent needs to amend and strengthen legal frameworks regulating above-mentioned issues and practices.

Moreover, effective measures and actions should be taken to address numerous issues, including to promote public awareness of developing the securities market among both government institutions and the general public; to improve disciplines and code of conduct among share-issuing bodies, in other words, improve efficiency of enforcement mechanisms of corporate governance; build up capacity of professional organizations operating within the securities market; improve efficiency of monitoring and regulatory mechanisms; increase participations and information access among potential investors and general public; and strengthen information disclosure practices and responsibilities. In this regard, more effective tools are needed to encourage active participations of investors and shareholders in activities to improve public awareness and information accessibility.

The Financial Regulatory Commission issued Resolution #210 on December 26, 2008 and approved "Corporate governance codex of Mongolia" that companies are allowed to follow the procedure in their activities. However, the document remains as a motto on paper.

Currently, a few number of shareholders tend to own majority of stakes that allow them make independent decisions regardless of concerns and rights of minority shareholders. For instance, they can manipulate financial documents and company assets as if the company has a single owner, besides devaluing shares, frauding financial statements as if no profits earned and embezzle company profits and assets. Thus, the existing Company Law should be amended to address these common challenges urgently.

Recommendations for strengthening mechanisms

1. Establish a non-governmental organization with operations protecting minority shareholders' rights, similar to *watch dog* groups, and ensure some of its operational costs subsidized from the government;
2. Establish a research and development institution which runs analyzes and publicizes securities market activities and actors;
3. Create monitoring mechanisms regulating agreements subject and sensitive to conflict of interests;
4. Eliminate duplicity of responsibilities of regulators and inspectors on the securities market and clarify functions effectively;
5. Ensure decisions of courts and judicial organizations to prevail in case of disputes and rights violations, based on due diligence opinions of professional organizations;
6. Train and prepare external experts who will act on the securities market;
7. Improve efficiency and importance of auditing and underwriting companies, disclose inaccurate statements and reports produced by such companies, strengthen accountability mechanisms with severe punishments for any such financial frauds;
8. Create a single aggregated database which collects financial statements of shareholding companies and distributes to relevant agencies and institutions;
9. Create a national database which provides financial statements of shareholding companies for public disclosure;
10. Determine ranks for officers of professional organizations, depending on degrees of accessibility of confidential information of shareholders and internal transactions; address challenges faced in disclose of confidential information;
11. Create mechanisms to monitor performance of members of the Board of Directors and ensure efficient accountability mechanisms;

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Recommendations for strengthening voluntary compliance by companies

1. Organize capacity building trainings on securities market and corporate governance among members of the Board of Directors, CEOs and CFOs;
2. Encourage participations of professional organizations and experts in activities to develop and strengthen legislations and regulations on securities market;
3. Mobilize media means to run public awareness campaigns and deliver information on securities market to the general public;

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4. Organize regular serial in-service trainings for actors on the securities market;
 5. Improve standards of financial statements and reporting among shareholding companies, in compliance of IFRSs;
 6. Require shareholding companies to have an official webpage and public relations unit, and present performance and financial reports to public scrutiny on a quarterly basis;
 7. Specify rights, responsibilities and liabilities of members of the Board of Directors clearly in the Charter of the Company;
 8. Publicize "Corporate governance codex of Mongolia" among the general public and implement systematic public awareness campaigns.

5.3 Laws and regulations subject to further amendments

Recommendations for improving legal environment

A. Recommendations for amendments to be made to the Company Law

1. At least 5 members in the Board of Directors of a shareholding company;
2. Specify criteria requirements to appoint members of the Board of Directors, based on professional qualifications and work experiences;
3. Specify the number of independent members in the Board of Directors; for example, one independent member in case total of 5 members in the Board of Directors, or one third out of total in case of more than 5 members in the Board;
4. Allow minority shareholders the right to nominate candidates to appoint independent Board members and implement the principle of "one shareholder vs. one vote" to appoint independent Board members;
5. Require the Board to have Auditing Committee, to reflect responsibilities of the committee in the Company charter, to include one or more independent Board members in the committee;
6. Appoint independent Board members as the chair of the Auditing Committee;
7. Elect/appoint members of the Auditing Committee from a shareholding meeting;

B. Recommendations for amendments to be made to the Securities Market Law

1. Amend provisions ensuring mechanisms to monitor income and disbursement transactions of risk-pooling fund assets;
2. Upgrade liabilities to violations and crimes, impose more severe punishments and penalties and put strict fiduciary duties;

C. Recommendations for amendments to be made to the rules and procedures of Central Bank of Mongolia

1. Specify provisions in relevant procedures of that the Central Bank to determine transition processes from a closed company to a public (listed) company;

D. Recommendations for amendments to be made to the rules and procedures of the Financial Regulatory Commission

1. Clearly specify responsibilities of different parties/actors involved in initial public offerings (IPO) in "Procedures on listing and trading securities on the market" issued by the FRC;
2. Improve efficiency of mechanisms to identify and detect illegal actions and breaches occurred on the securities market;
3. Impose liabilities and/or cash penalties, in case of failure to organize shareholders' meeting, specify systematic penalties;
4. Amend provisions defining mechanisms to organize shareholders meetings and voting processes;
5. Requirements to explain reasons of withheld dividends to shareholders meeting in details, in case of dividends unpaid to shareholders;
6. Organize shareholders meetings at locations where most of shareholders reside;

E. Recommendations for amendments to be made to the Criminal code

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1. Article 158 of Criminal code does not clearly specify liabilities to be imposed in case of breaches and violations. For example, it is necessary to clarify “major damages” (large amounts of losses) and “severe damages” (extremely large amounts of losses).

F. Recommendations for amendments to be made to Law on Bankruptcy

1. Require auditing, social insurance and tax offices to deliver company related information and statements to the Financial Regulatory Commission;
2. Reduce timeframes to handle bankruptcy processes and payments of compensations and settle investors' losses through settling with outside-courts means

Policy recommendations

1. Create favorable legal environment and incentives for companies which comply with corporate governance code effectively;
2. Provide legal framework regulating rights of shareholders, who have not redeemed shareholding rights and opened securities accounts in order to let their stakes deposited in the Securities Savings Account and participate in tradings with fair and transparent terms and conditions;
3. Ensure the Government implement activities to allow the FRC run self-sustaining and independent operations through generating profits from its regulatory activities;
4. Create favorable environment for independent institutions which run activities to protect shareholders' rights and interests, provide relevant information to the general public and run external monitoring activities;
5. Take decisive actions to speed up privatization processes of MSE through transparent, open and efficient means;
6. Ensure opportunities to attract investments and upgrade existing technical equipment and technology employed by MSE.