

Mongolia Adopts An Amended Securities Market Law July 2013

On 24 May 2013, the Parliament of Mongolia approved an amended version of the Securities Market Law ("**Revised Securities Law**"). The Revised Securities Law replaces the current Securities Market Law enacted on 12 December 2002 ("**Securities Law**"). The official version of the Revised Securities Law was published in the State Gazette on 24 June 2013.

An amendment to the Securities Law had been pending for several years and was hoped to create an enabling regulatory environment for further development of the securities market. This follows the adoption of the revised Company Law in 2011, which introduced international standard corporate governance regulations to Mongolia.

INTRODUCTION

In Mongolia, public trading in securities only commenced in 1995 and capital-raising opportunities are limited. Industries are still heavily reliant on conventional debt financing.

The Mongolian Stock Exchange ("**MSE**") has over 300 listed companies, the majority of which are former state-owned enterprises. Total market capitalisation of the top 20 companies is around US\$ 713,000,000, but shares are heavily concentrated with majority shareholders. Average daily trading volumes are approximately between MNT 30 to 150 million, which represents only a handful of securities. Only two forms of securities are publicly offered and traded, being open joint stock company shares and bonds. Although provided for in prior legislation, dual-listing of Mongolian-listed companies has not taken place in actual fact, and depositary receipts are not permitted.

The absence of an enabling regulatory framework restricts capital-raising opportunities for Mongolian companies, especially those who are engaged in capital intensive mining activities. The Revised Securities Law seeks to overcome the limits and shortcomings of the existing Securities Law and introduce international standard market regulations. In doing so, the

monitoring and regulatory authority of the Financial Regulatory Commission ("**FRC**") is increased in order to counter-balance the increased accessibility of the market.

The Revised Securities Law will enter into force on 1 January 2014, following a phase-in period. To support the Revised Securities Law and facilitate its implementation, Parliament has also amended other laws, including the laws on advertising, licensing, and personal and corporate income taxes. Further, it is expected that the Company Law and the Criminal Code will be amended to provide a compatible regime.

KEY FEATURES

1. Introducing a distinction between legal and beneficial ownership

Mongolian law does not distinguish between nominal legal and beneficial ownership, which is an important and established concept in common law jurisdictions. To overcome this, the Revised Securities Law expressly introduces the concept of beneficial and nominal ownership of securities.

A "nominal holder" of securities is defined as a regulated entity who is registered as depositor/custodian of a given security and who is not the beneficial owner of such security. By contrast, "beneficial owner" is defined as the "real" owner of the security who is entitled to enjoy the rights and benefits attached to such security.

2. Towards increased liquidity and capital raising opportunities

The Revised Securities Law increases the range of tradable securities to include derivatives, depositary receipts and warrants. Further, over-the-counter trading of securities is expressly permitted.

While the Securities Law recognised the concept of derivatives, the offering and trading of derivatives has

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not been a feature of the Mongolian market to date. Under the Revised Securities Law, derivatives are defined as options or futures agreements as well as such other financial instruments that are permitted to be traded on the regulated market. The FRC and the MSE will issue implementing regulations to govern the trading of derivatives, and securities dealers will only be able to trade derivatives with professional investors.

Depository receipts

The Revised Securities Law provides a basic regulatory framework for the issue of depository receipts. The law recognises both global and Mongolian depository receipts, issued by Mongolian-listed and foreign-listed companies respectively. Depository receipts are defined as securities that are issued by depositors for the purpose of trading on foreign securities markets, with the underlying securities to be held by a custodian. The law briefly sets out the process for issuing depository receipts - detailed regulations will be issued by the FRC.

Dual-listing

Although the Securities Law referred to the possibility of dual-listing, it did not provide detailed regulations. The Revised Securities Law specifically allows for the dual-listing of Mongolian-listed companies abroad as well as the listing of foreign-listed companies in Mongolia. The FRC will be in charge of approving and monitoring such dual-listing.

3. Towards protecting investors during IPOs and takeovers

The Revised Securities Law provides detail on the IPO procedure and imposes stringent requirements on issuers and their advisors in terms of disclosure requirements, update obligations, and sanctions for non-compliance.

The Revised Securities Law distinguishes between the primary and secondary securities market and the FRC is authorised to approve trading on the secondary market in the event an IPO is successful.

Disclosure during IPOs

The Revised Securities Law enhances IPO disclosure requirements, stipulating that prospectuses now must

include detailed financial information, lists of related parties, a business plan for the capital raised by way of public offering and risk management plans. Further, the issuer and its "governing persons"¹ will be liable for losses resulting from any misinformation. Information contained in a prospectus must be verified by authorised auditors and legal professionals.

The Revised Securities Law requires the FRC's consent for any amendment/update to the prospectus. Such amendments will be compulsory in the event of changes in market conditions or to the issuers themselves which could change an investor's decision.

Takeover regulations

The Revised Securities Law shortens the takeover offer period from 6 months to 1 to 3 months. The law places increased disclosure and reporting obligations on parties acquiring a controlling block or all the shares in a listed company and sets out minimum requirements relating to the offer. The offer price must not be less than the market price, which will be calculated on the basis of a methodology to be issued by the FRC.

4. Towards increased monitoring and enhanced regulation of market participants

Under the Revised Securities Law, at least 14 activities will require an FRC-licence including securities trustee services, securities registrars, custodial and credit rating services. Further, property valuation companies, audit companies and law firms may only provide services to listed companies upon registration with the FRC.

The FRC will be authorised to monitor and regulate professional participants. Any dealing in certain regulated entities will require the FRC's consent.

Further, the FRC will issue a package of regulations/rules concerning regulated activities, which cover matters including the issuance, extension, and termination of licences, requirements for regulated participants, risk management, service fees, advertisements, customer issues, reporting to the FRC

¹ A governing person is defined under the *Company Law of Mongolia* (enacted on 6 October 2011) as being, in essence, the executive management of a company and those shareholders with over 20% of the issued shares of the company.

and the appointment of governing persons, who must be "appropriate", i.e. have the relevant qualifications and satisfy certain criteria which are to be determined by the FRC.

In general, the Revised Securities Law seeks to impose stricter liabilities and obligations on market participants and to protect investors' interests and rights.

5. Towards preventing insider dealing and market abuse

To protect investors' interests, the Revised Securities Law expressly prohibits insider dealing and market abuse.

Insider dealing

Insider information is defined as such information not publicly available which may influence the price of certain securities. Holders of insider information are influential shareholders (holding 5 per cent or greater), competent officials, employees of the relevant company and their related parties, as well as those individuals who obtained insider information in the course of performing their official duties, or negotiating or preparing transaction documents.

Holders of insider information are prohibited from trading in the relevant securities, inducing others to trade, and from disclosing insider information other than when required.

Market abuse

The Revised Securities Law expressly prohibits market abuse which includes fraudulent trading, artificial pricing, and misleading clients in order to promote/prevent securities trading.

6. Towards increasing market transparency and reporting/disclosure requirements

The current Securities Law is limited in its scope of disclosure requirements – the annual reports and financial statements of listed companies are often not publicly available.

To increase transparency and ensure adequate levels of disclosure, the Revised Securities Law shifts the onus of compliance to listed companies and the

MSE. The scope of disclosable information for each entity is provided by law. Issuers must disclose within 1 business day of the occurrence of certain organisational changes, changes in shareholding structure affecting influential shareholders and such other information that may influence share prices. Immediate disclosure is required in certain circumstances.

The MSE must facilitate the disclosure of certain information relating to listed companies through its website.

Professional market participants will owe reporting and disclosure obligations to their customers and the FRC, and the FRC is also obliged to make certain information publicly available.

7. Towards increased monitoring and efficient regulation

The FRC

Under the current Securities Law, the key regulator is the FRC, who is authorised to exercise the state authority in regulating, monitoring, and ensuring the sound operation of the securities market.

Under the Revised Securities Law, main authority is still vested in the FRC, but with increased monitoring and regulatory powers.

The FRC has wide regulatory and monitoring authority, including issuance of implementing regulations, licences, recommendations and instructions, and the monitoring of professional participants. The FRC now may issue binding "instructions" to licensed market participants, issuers or self-regulating bodies, instructing them to take or refrain from taking certain actions for the purpose of implementing securities legislation or protecting investors. The Revised Securities Law strengthens the powers of the FRC's inspectors to carry out ad hoc investigations/monitoring, and allows the FRC to bring claims on behalf of investors against offending entities.

Self-regulating bodies

In order to raise professional standards and delegate certain monitoring powers, the Revised Securities Law introduces so-called self-regulating bodies, which include associations comprising of licensed market

participants and licensed individuals, the MSE, the securities settlement organisation and the central securities depository. It becomes compulsory for a professional participant to become a member of the relevant self-regulating association/body, whose mandate is to increase professional standards and ethical discipline and to protect the interests of its members.

Dispute resolution body

The Revised Securities Law introduces a dispute resolution body at the FRC to resolve disputes among regulated entities, issuers, investors and/or customers. This introduces a non-judicial dispute resolution mechanism which may offer benefits in terms of efficient and fast dispute resolution determined by experienced market professionals.

Enhancing regulatory enforcement

As is customary with Mongolian laws, the Revised Securities Law imposes administrative sanctions on offending persons, expressed in financial penalties. The Revised Securities Law significantly increases these fines by 200 to 300 times the existing levels to a maximum of MNT 86,400,000 (approximately US\$ 59,000).

CONCLUSION

The adoption of the Revised Securities Law is certainly a welcome development for the strengthening and improving of the current regulatory regime and market practices. It provides a general regulatory framework within which the FRC, the MSE and the self-regulating bodies have the authority to issue implementing regulations and rules. It will be important for regulators to involve relevant market participants in adopting implementing regulations so as to ensure efficient implementation of the law.

Both the FRC and the MSE have been assigned the task of promoting and effectively implementing the new legislation, and this may prove a challenging exercise. Thus it remains to be seen to what extent the new regulatory environment will advance the development of the Mongolian securities market and capital-raising opportunities for Mongolian companies.

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