



# **LEGAL REGULATION OF PUBLIC OFFERING AND SALES OF SECURITIES**

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## INTRODUCTION

One of the alternative ways to attract investment and expand one's business is the public offering and sales of securities. As of 2021, there are 314 joint-stock companies (hereinafter the "JSC") registered in Mongolia, and securities worth MNT 1.4 trillion (app USD 452.09 million) were traded on the market which is 21.6 times higher from 2020 and increased results by 64.3 percent from 2017. Out of the total trade, 74.1% accounts for corporate bonds, 4.0% for units of investment funds, 0.3% for asset-backed securities, and 21.6% for shares, respectively. Further, in terms of the trade level of shares, it reached a total of MNT 304.9 billion (app USD 98.4 million) in 2021, an increase of 3.9 times compared to 2017, and 5.7 times compared to the previous year. Moreover, corporate bond trade increased 103.2 times compared to the same period in 2017 and 180.1 times compared to the same period in 2020, reaching MNT 1,048.2 billion (app USD 338.4 million) (Financial Regulatory Committee, 2021).



With the capital market growth, companies increasingly tend to use the issuance of securities to attract investment instead of high-interest loans from commercial banks. In this regard, regulations and requirements on issuing securities for the raising of capital are outlined in this legal alert.

## SECURITIES, ITS PUBLIC OFFERING

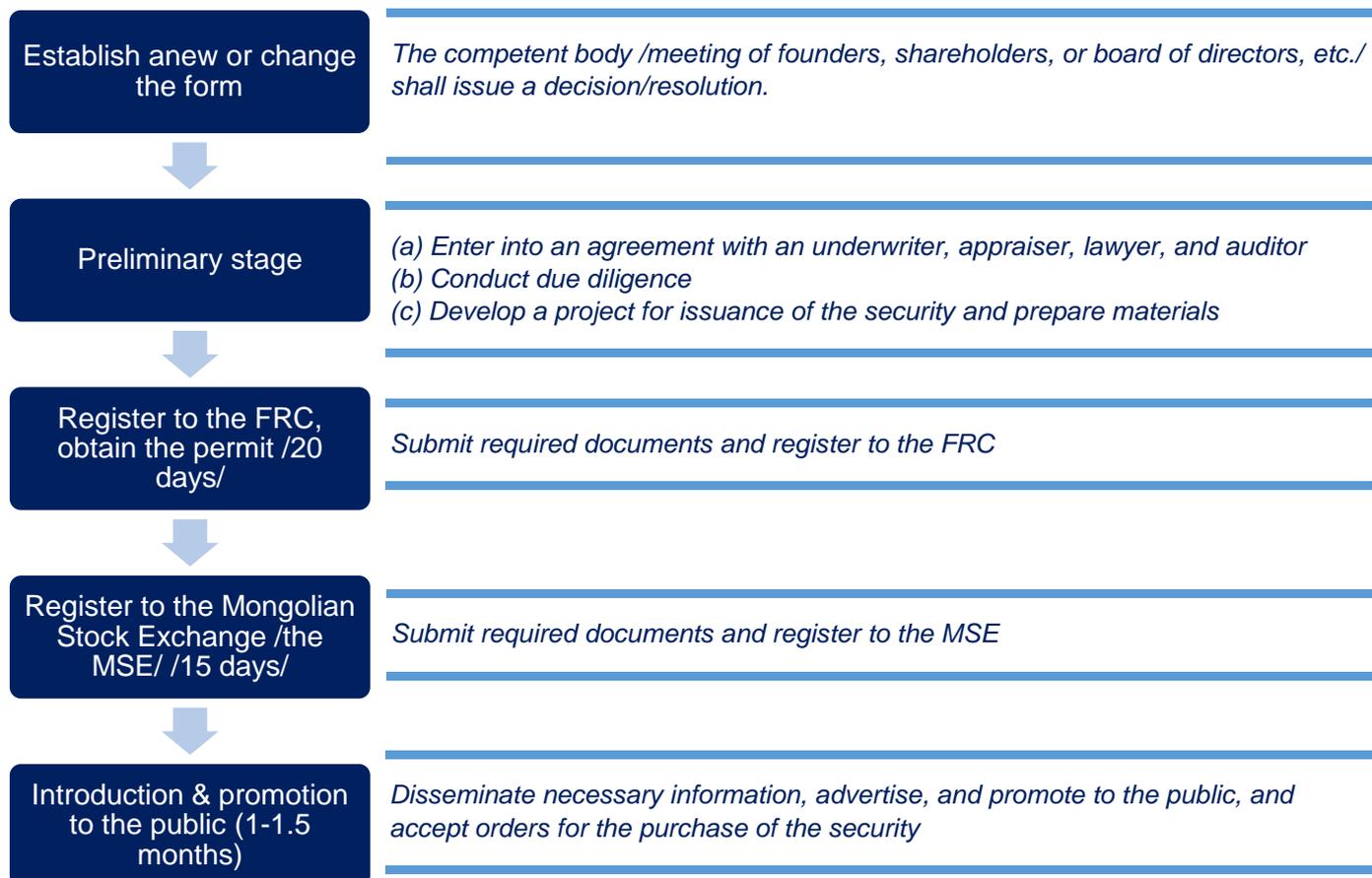
The Law of Mongolia on Securities Market regulates the relations in connection with public offering and sales of securities in Mongolia. Under this law, securities include financial instruments such as company shares, debt instruments, shares or units of investment funds, asset-backed securities, etc. In addition, "public offering" means an offering of securities to 50 or more investors by introducing and promoting. In the course of the offering of securities,

companies must comply with regulations established by the Financial Regulatory Commission of Mongolia (hereinafter the “FRC”).

Companies must get the security that is being offered and issued to the public registered to the FRC and obtain a permit to offer to the primary market.

## SECURITIES ISSUING PROCESS

### i. Shares



### Details on the preliminary stage of issuance of shares

Company share is one of the financial instruments that can be offered and sold to the public. It can be carried out by establishing a new company or changing the form of a limited liability company to a joint-stock company. A new company shall be established upon the offering of a project on such a matter to the public or a few investors and acceptance of their orders. In either case, a decision/resolution by the Shareholders’ Meeting /the SM/ and Board of Directors’ Meeting /the BoDM/ shall be issued. In the case when the form of the company is being changed, its charter shall be revised as well.

Furthermore, the legal, audit, and appraisal service providers, and the independent expert which whom the company enters into an agreement must be duly registered to the FRC. The underwriter shall not be an affiliate of the company.

## **Registration to the FRC**

The company shall submit the following documents to register to the FRC, including:

1. Application form;
2. Prospectus of the security /to be prepared by the underwriter/;
3. Minutes of meeting and decision/resolution on the issuance of shares by the SM and the BoDM;
4. Financial statements certified by an audit firm for the last 6 months and a reference letter from the audit firm;
5. Due diligence report by the legal service provider;
6. An agreement made with the underwriter and a reference letter from it;
7. Evaluation and conclusion of the independent expert /if any/;
8. Reference from the trading organization;
9. Draft of the revised charter of the company;
10. Receipt of payment of service fee and state stamp duty.

The request and the prospectus of the security shall be signed and stamped by the chairman of the Board of Directors (the BoD), the Executive Director (the CEO), Chief Accountant (the CA), and the CEO of the underwriter.

The FRC shall resolve the request within 20 business days from the receipt of such request and the required documents. The resolution states whether to allow the sales of the share that is being offered and issued to the public on the primary market.

### **Role of a legal entity that provides legal services in the course of the preliminary stage**

As specified in article 10.6 of the Law on Securities Market, a legal entity that provides legal services reviews and issues a conclusion on the accuracy and validity of the information contained in the prospectus. This conclusion is an integral part of the prospectus and plays a crucial role in decision-making by investors.

Law firms conduct due diligence and issue a professional opinion ascertaining whether the company is free of any financial debts and is secure. Having this opinion prepared and attached to the prospectus is of great importance that investors are likely to have more confidence, as well as the company can be always ready for their questions. In other words, it will resolve doubts and build trust between the company and investors.

In a nutshell, law firms carry out the following tasks:

- Check whether the information in the prospectus are accurate
- In case of any breaches or omissions are identified, provide guidance or recommendation to eliminate such breaches or omissions prior to finalization of the prospectus
- Attach a conclusion stating that there is no objection to making the legal opinion made public together with the prospectus. It shall be an integral part of the prospectus. Lastly, evidence showing that the firm is free of conflict of interest and is competent to issue such opinion is required as well.

## **Works to be performed by law firms within the due diligence**

### Legal status of the company:

- First and foremost action is to determine whether the company to be invested is duly incorporated and registered in accordance with the law. Under the Company law of Mongolia, information on shareholders and charter of any companies must be mandatorily registered to the state registration. It will be checked whether the state registration certificate of the company is duly issued and extended, whether it includes appropriate changes, and whether the current status of the company has no breach according to the charter.

### The company's shares and shareholders, and any restrictions on them:

- It will be checked whether investors are able to purchase additional shares, the shareholders are registered to the state registration and have paid in full, and whether there are any prohibitions or restrictions on the issuance of additional shares or transfer of shares to a third party.

### Ownership of the property:

- It will be ascertained whether any intellectual properties, immovable properties, and equipment of the company are duly registered under its name, whether the intellectual property rights would be expired in the near future, the type of ownership of the tools and equipment, whether leasing or loan payments /if any/ are settled, and whether there are any existing leasing agreements.

### Future liabilities including any debts and loans:

- Within this work, it will be checked whether there are any existing and future liabilities in the form of any assets and other forms.

### Lawsuits and other disputed matters:

- It will be determined whether the company, in fact, is involved or potential to be involved in any legal proceedings as a defendant.

### Compliance with the laws and regulations:

- It will be determined whether the company has received any notices and official letters regarding the violation of the laws and regulations.

### Labor disputes:

- It will be inspected whether there has arisen any situation where key employees are in a position to resign.

After the due diligence carried out within this framework, the law firm issues its opinion in a written report with which the purpose and scope of the analysis and a list of used documents are attached thereto.

## Registration to the MSE

Companies must comply with the following requirements in terms of economic indicators (including sales revenue, profits, capital-output ratio, etc.), market cap, and dispersion of the shares.

Criterion and requirements for registration by the MSE:

No	Criterion	General requirement	Special requirement
<b>Shares</b>			
1	Share capital	more than MNT 10.0 million (app USD 3,229.2)	more than MNT 10.0 million (app USD 3,229.2)
2	The amount of non-current assets in the value of the security to be registered	at least 10 percent	at least 20 percent
3	The number of shareholders	at least 50	at least 50
4	Percentage of common shares being offered to the public	at least 30 percent	at least 10 percent
5	The number of years operated	at least 1 year	at least 3 years
6	Profit margin	To have operated profitably, otherwise the loss to not have exceeded 30 percent of the equity	No requirements

The following documents are required for registration to the MSE:

1. Application;
2. Notice by the company;
3. Notice by the underwriter;
4. Decision/resolution by the competent body /the SM, the BoD, etc./;
5. Prospectus of the security or the share;
6. Due diligence report;
7. Appraisal report;
8. Audit report;
9. Report by the independent expert or professional /if any/;
10. Receipt of payment of service fee.

The MSE shall review and resolve the request within 15 business days from the receipt of the application and the supporting documents. If necessary, this term may be extended by up to 15 business days.

### Final stage or introduction and promotion to the public

The underwriter places and sells the new issues of shares on the primary market in the manner specified in the prospectus of the registered security or the shares. The following timelines apply to this activity:

# Term

Introduction & promotion of the prospectus to the public – **10 business days**

registration of the order of the shares - **5 business days**

## EXPENSES REQUIRED IN THE ISSUANCE OF SECURITIES:

- ✓ **For registration to the state registration:**  
State stamp duty – MNT 10 000 (app USD 3.2)
- ✓ **A service fee for underwriter, appraiser, law firm, and auditor:**  
Service fee shall be fixed upon an agreement between the respective parties.
- ✓ **A service fee for the FRC:**  
For registration of a security anew – MNT 200 000 (app USD 64.5)
- ✓ **Admission fee for the MSE:**  
At least MNT 500 000 (app USD 161.4) and more /under certain scales/ as per the “Procedure for registration of securities”
- ✓ **Other:**  
It is advisable to have accumulated necessary funding for the preliminary stage of public offering of securities.

## Issuance of securities in Mongolia by foreign companies

Legal entities listed on foreign stock exchanges may issue securities in Mongolia provided that they have registered to the Mongolian Stock Exchange and the Financial Regulatory Commission.

Further, the legal entities must meet the following criteria:

- To have incorporated and been operating as a legal entity in accordance with the legislation of its resident country;
- A securities market regulatory authority of the resident country, or the country where the security of the legal entity is registered and traded, and of the resident country of the securities trading organization to be a member of the International Organization of Securities Commission;
- The foreign securities trading organization at which the initial registration was carried out to be one of the organizations in the list issued by the FRC;
- To have officially notified of secondary registration of the security in Mongolia to the foreign securities trading organization and the securities market regulatory authority at which the initial registration of the security was carried out;

- To have appointed a person or legal entity that has a capacity to communicate and exchange information with the FRC and a securities trading organization, and represent the legal entity in Mongolia;
- The securities trading organization of Mongolia to have provided a proposal supporting the request for dual listing.

The legal entity listed on the foreign stock exchange may simultaneously apply for registration of its security being issued in Mongolia to the FRC and the securities trading organization. Yet, the legal entity must have registered to the FRC prior to offering of its security to the public.

The foreign legal entity shall submit the following documents for registration to the FRC:

1. Application for registration of its security;
2. Profile of the legal entity;
3. Receipt of payment of the service fee and state stamp duty;
4. Decision/resolution by the competent body /the SM, the BoD, etc./;
5. Copy of state registration certificate of the legal entity;
6. Audited financial statement of the legal entity for the last year;
7. Due diligence report issued by the legal service provider.

The following documents are required for registration to the MSE

1. Application for registration of the security;
2. Prospectus of the security;
3. Copy English versions of the prospectus and supplementary prospectus of the security that is registered to the foreign regulatory authority and the securities trading organization, and other relevant attachments, and their brief summary translated into Mongolia.

## **ii. Debt instrument /bond/**

Companies must meet the following criteria to issue bonds:

1. Private joint stock company & limited liability company /LLC/:
  - a. To have been established for at least 3 years;
  - b. To have actively operated for the last 3 years prior to applying to the FRC.
2. To be free of any overdue or court-ordered debts;
3. To fulfill its legal obligation to investors;
4. If it has issued bonds before:
  - a. Not to have deferred and interrupted the payment of interest and principal payment of the bonds.
5. To be a joint-stock company, if offering a convertible bond;
6. Sales revenue for the last year = >MNT 5,000,000,000 /five billion/ (app USD 1.6 million), net profit = >MNT 500,000,000 /five hundred million/ (app USD 161,000);
7. Authorized persons to have appropriate experience to conduct activities;
8. To have no changes in the executive management or in 2/3 of the executive management team within the last 2 years, and no major changes in the structure of controlling shareholders within the last 1 year;
9. To comply with domestic and international principles of corporate governance;

10. To have entered into an underwriter agreement;
11. The underwriter not to be an affiliate of the company.

### Registration of the bond to the FRC

Companies must submit the following the documents to the FRC for registration:

1. Official request and application;
2. A bond prospectus;
3. An agreement made with an underwriter company and reference letter from it;
4. A reference letter from an auditor /an auditor who has audited the financial statements for the last 6 months/;
5. Collateral, guarantee, and surety agreements /if any/;
6. Receipt of payment of the service fee and state stamp duty.

In case of registration to the FRC of a bond that is going to be issued by a legal entity registered to the FRC, or to be issued by a public JSC in a private placement, the following documents are required:

1. Official request and application;
2. A decision/resolution by the competent body;
3. A decision/resolution by the competent body and agreements on collateral, guarantee, and surety /if any/;
4. A decision by a professional association on registration of securities that are allowed to be traded on the Over-the-Counter market;
5. Receipt of payment of the service fee and state stamp duty.

### Registration of the bond to the MSE

The same documents required for the registration of shares are needed for the registration of a bond to the MSE.

In order to issue bonds, companies must meet the following requirements of the MSE.

Bonds			
1	Share capital	more than MNT 10 million (app USD 3,229.2)	more than MNT 10 million (app USD 3,229.2)
2	Amount of immovable properties in total assets	at least 20 percent	at least 30 percent
3	The number of securities for registration, its price	more than 50.0 thousand units, MNT 500.0 million (app USD 161,000)	no requirements
4	The number of years operated	have actively operated for at least 3 years, and have been profitable for the last year	have actively operated for at least 5 years
5	Guarantee	to have provided collateral and guarantee	

## **GENERAL OBLIGATIONS OF SECURITIES ISSUERS:**

- Provide accurate information and reports related to the securities trading in accordance with relevant methodology and forms, submit them to the FRC and make public within the established period;
- In case of any changes in the implementation of the project specified in the securities prospectus, notify the public and shareholders from time to time;
- Immediately notify the public of resolutions of the SM, and submit the relevant documents and information to the FRC and the stock exchange within the 3 business days after the meeting;
- Immediately notify the public of any circumstances that may have a significant impact on the price or trade volume of the securities.

## **ISSUANCE OF SECURITIES ON THE OVER-THE-COUNTER MARKET:**

The FRC has adopted a “Procedure for over-the-counter market” in 2020 which enabled companies to issue debt instruments on the over-the-counter market (hereinafter the “OTC market”) in an expedited and swift way and raise long-term financing without having to meet the sky-high requirements established for registration of securities.

The Mongolian Association of Securities Dealers (hereinafter the “MASD”) is in charge of organizing the operation on the OTC market. Companies must submit the following documents to the registration committee of the MASD:

1. Request for registration of securities;
2. Reference from the securities issuer;
3. Reference and opinion from an underwriter;
4. Decision/resolution on the issuance of the security by the competent body;
5. Securities prospectus;
6. Audit report;
7. Receipt of payment of service fee for the registration.

Companies must meet the following requirements in order to issue securities on the OTC market:

1. Fully comply with relevant laws and regulations, and its own legal documents;
2. Members of BoD, executive management, and influential shareholders meet the requirements stipulated in the law;
3. Competent persons have the knowledge and experience necessary for conducting of the company’s business;
4. Have been conducting its business in the field for at least 1 year;
5. Comply with domestic and international principles of corporate governance, and if not, provide a statement.

Sources:

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6. “Procedure for registration of securities in the over-the-counter market” by the MASD /2021/ - [http://masd.mn/upload/durem8%20juram/otc/2.otc\\_burtgel\\_juram\\_21.06.29.pdf](http://masd.mn/upload/durem8%20juram/otc/2.otc_burtgel_juram_21.06.29.pdf);
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8. Mendsaikhan T., Contract Law., UB, 2021

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