

# EPRC MONTHLY NEWSLETTER

JULY 2008

## New electricity and heat retail tariffs

Effective 15 July electricity and heat retail prices will increase by up to 28% and 39%, respectively, per resolution of 30 June of the Energy Regulatory Authority (ERA). The resolution introduced progressive block tariffs for electricity and updated the night time tariff. Nighttime tariffs are lower because consumption at that time is low. The new tariff design rationalized the time-of-use tariffs by increasing the night time tariff up to the minimum or floor price and introduced an additional new tool, progressive electricity tariffs, for energy conservation and demand side management thereby protecting vulnerable consumers from prices they cannot afford.

have exacerbated the already precarious financial situation of these companies.

Current retail electricity and heat tariffs do not cover the cost of service and across-the-board subsidies are used to keep these services running as best as possible. The progressive block tariff recently approved by the ERA keeps tariffs low for lower income consumers but takes steps to bridge the gap of between cost of service provided and what higher income bracket consumers pay. An estimated 60 percent average tariff increase in real terms would be required to cover the cost of service.

ERA's recent tariff rationalization efforts are a part of the Retail Tariff Reform Plan developed jointly by the ERA and EPRC. To be accomplished by 2012, the Plan includes continued rationalization of the retail tariff design through the introduction of demand and customer charges, the conduct of load research, reduction of cross-subsidies, tariff setting at cost recovery levels, revisions of consumer classes and other activities designed to improve the quality of service delivery.

Full details on the progressive tariff block structure by type of consumer, and region are found at the ERA's website: <http://www.era.energy.mn/mon/index.php>.

## Financial Regulatory Commission to issue Mongolian glossary of concepts and terms for mortgage markets

The Financial Regulatory Commission (FRC) has completed a glossary of mortgage-related terms and definitions and will be releasing it in September. The glossary includes concepts, and definitions used in the legal and financial community and their corresponding Mongolian terms.

The brochure is designed to fill a current void in Mongolia of standard lexicon and concepts that are generally accepted in the legal and financial communities and is primarily intended for those involved in the legal and regulatory aspects of the primary and secondary mortgage markets. To foster general understanding of the primary and secondary mortgage market, parties and transactions, the brochure includes explanatory diagrams of typical:

- Primary mortgage market transactions
- Secondary market refinancing
- Mortgage (asset-backed securities)
- European-style covered mortgage bonds

In 2007, the FRC, with project assistance, led the drafting of two securitization laws to create a more favorable legal and regulatory environment for the development of housing finance and capital markets. The draft laws were intended to promote the development of a competitive private sector-led secondary



Under the progressive electricity retail tariff, consumers will pay 60 MNT per kWh used up 150 kWh; 64 MNT per kWh used up to 250 kWh, and 68 MNT per kWh for consumption exceeding 250kWh per month. Equivalent monthly block tariffs for ger residents using the same consumption of electricity are MNT 58, 62, and 66 per kWh, respectively. Thus, ger dwellers using less than 150 kWh per month can expect to pay up to MNT 8,700—2 MNT less per kWh than non-ger residents.

The ERA believes that such a differentiated tariff is justified due to cross-subsidy from electricity to heat. The ERA set lower tariffs for the Trolleybus Company, Altan Taria, Ulaanbaatar Guril, Talkh Chiher and Atar Urgu companies to support the GoM's initiative to protect the general public from soaring inflation.

The current increase in retail prices was an initial step to provide some financial relief to the five combined heat and power companies (CHPs) in the Central Energy System. Recent substantial increases in coal prices—29.6% for Baganur coal, 27.3% for Sharyn Gol coal and 34.1% for Shivee Ovoo coal—and the recent and on-going expansion of electricity service to soums

market, including the secondary mortgage market, by providing the regulation for such financial instruments as collateralized mortgage bonds and asset-backed securities. These would allow banks and other financial institutions to raise longer term and lower cost funding from the capital markets.



Despite the rapid growth of the mortgage market, the specialized terminology and the basic operations of the primary and secondary mortgage markets are generally unfamiliar to policy makers and the general public. The glossary seeks to fulfill this need as well as bring uniformity in the corresponding Mongolian legal terminology and definitions.

The Mortgage Glossary was developed as part of a public education campaign suggested by the lenders and law drafters at a retreat, organized by the FRC in August 2007, on draft securitization laws and similar requests from MPs. Care has been taken to include all legal terms used in the proposed drafts of the Asset-Backed Security Law and the Collateralized Mortgage Bond Law with the intent of making mortgage market operations and its governing laws and regulations easier to understand.

The Mortgage Glossary will be officially released by FRC in September 2008. The brochure will be available to the general public in electronic format on FRC's website: [www.frc.mn](http://www.frc.mn). In the interim, a draft version of the brochure is available in pdf format and can be found at the EPRC project website: [www.eprc-chemonics.biz/](http://www.eprc-chemonics.biz/)

## Proposed new layout for Customs and Inspection Zamiin Uud border area completed

On 1 July representatives from the State Specialized Agency (SSIA), Customs General Administration (CGA), Asian Development Bank (ADB) consultants, and Erchim Co.Ltd, a local partner working on the project, attended a debriefing held at the Customs headquarters on the preliminary engineering for the proposed layout of the Zamiin Uud border customs and inspection area. Mr. Kamal Patel, a facilities engineer supplied through EPRC, led the briefing.



The briefing focused on work performed from 2 June assisting the working group appointed at CGA to develop a new layout and related initial engineering works for the customs and inspections yard in Zamiin Uud. Specific physical infrastructure components of the proposed layout included:

- New cross-border entry road reserved for trucks
- An additional weigh scale
- Expanded and reorganized parking / inspection area
- Platforms for laying out and inspecting freight
- Rerouted traffic flow with designated lanes, including escape lanes
- Dedicated internal road corridor to scanner facility
- Installation of an optional additional scanner.

Due to space constraints and inadequate configuration, the current customs clearance and inspections facilities have become one of the major bottlenecks in the movement of goods by road from Erlian, China, to Mongolia and beyond. In addition, recent roadway improvement projects within the facility have been poorly executed and are rapidly deteriorating.

The new layout seeks to:

- Expand the area for inspections to facilitate inspections and lorry circulation
- Segregate passenger from freight traffic
- Segregate freight traffic by type of load: uniform loads to proceed directly to a scanner; non-uniform loads proceed to the inspections area.

EPRC has been assisting the lead agency to re-structure these facilities, the Customs General Authority (CGA), and the State Specialized Inspection Agency (SSIA). The GoM has allocated 2.5 billion MNT (USD 2.25 million) for CGA in the 2008 budget to

upgrade of these facilities. CGA will issue the tender and supervise construction of the civil works.



At the time of the debriefing and to meet the tight deadline for construction, the international consultant, Mr. Kamal Patel, recommended a design-and-build contract for the engineering works, an unusual practice in Mongolia. Subsequent to the debriefing, CGA found out that issuing of the tender will have to wait until a passage of 2008 budget amendments in Parliament. This will result in a delay in the construction of the new facilities until 2009.

## Financial Regulatory Commission considering new procedures for Initial Public Offerings (IPOs)

On 1 July eighty-nine participants, including all nine officers from the Financial Regulatory Commission (FRC) Securities Department, sixty-five representatives of thirty-eight companies, including the Association of Securities Brokers and Dealers, MICC, BDSec, and fifteen students from the FRC's professional training course attended a presentation on a proposed review the regulations, policies and procedures related to the approval of Initial Public Offerings (IPOs) by the Financial Regulatory Commission (FRC) and their listing and supervision on the Mongolian Stock Exchange (MSE). The presentation provided an opportunity for the industry to discuss the initial recommendations of a review of regulations for initial public offerings (IPOs) which the project is assisting the FRC conduct. Short-term financial markets regulations expert, Mr. Clifford Kennedy, led the discussion.

Existing regulations for the IPO market date from 2006, when the FRC was established and lack general guidelines or instructions to be followed by an issuer interested in publicly selling their shares. As a result, the IPO preparation and review process is time consuming, taking as much as four months to complete. Twelve IPO applications have been under processing at the FRC since early 2008.

The proposed review of IPO regulations and procedures would align them with best international practices such as those embodied in the International Organization of Securities Commissions (IOSCO), the EU Prospectus Directive, and the United States Securities and Exchange Commission (SEC) regulations and written guidance. Current procedures for the approval, listing and supervision are not sufficient to provide

guidance to issuers and underwriters to manage the IPO preparation process. This results in substantial processing time being required by issuers and underwriters to complete IPO applications and prospectuses to obtain FRC approval. A revision of current IPO regulations and procedures is required to attract domestic and foreign investors.



Recommendations discussed during the presentation include:

**Improved disclosure standards.** These should be based on existing disclosure standards of IOSCO, the European Union, and the SEC applicable to equity securities and substantive disclosure principles for documents used in IPOs, secondary public offerings and listings of securities.

**Short Prospectus for potential investors.** It would serve the public interest to require that the issuer prepare a Short Prospectus and make it available for potential IPO investors. The Short Prospectus should be "reader friendly", provide summary information about the issuer, risk factors and other important matters, and be provided to all those filling out an application forms to purchase IPO securities.

**Requirement of Management Discussion and Analysis in Financial Reports.** The inclusion of Management Discussion and Analysis (MD&A) in financial reports has become an international standard. MD&A provides information about the components of a company's earnings and cash flow and helps make sense of complex financial statements and risk factors. Such disclosure of management's assessment of factors and trends which are anticipated to have a material effect on the company's future financial condition and operations enables investors to look at the company through the eyes of management. The revised FRC IPO regulations should consider this requirement.

**Prospectus dissemination.** There is no substantial dissemination of information in a public offering in Mongolia. To address this lack of information dissemination, draft prospectus and the final prospectus could be placed on the FRC's web site and kept there until the offering is completed. In addition, prospectuses should be available from FRC, the MSE, the underwriter, and the company.

**Due diligence.** The conduct and practice of proper due diligence by underwriters needs to be improved. The underwriter must investigate enough to be assured that it has a firm grasp on the business and affairs of an issuer so that it can offer and sell securities with confidence that its customers have been fully apprised of the legal, financial and business position of the issuer. The FRC should take steps to have the underwriter perform such proper due diligence of the issuer.

**Procedural changes.** The FRC should consider extensive use of instructions, circulars, releases and other measures to improve IPO processing at the FRC. The use of a regulatory check list will not be sufficient to increase the efficiency of the IPO review process. Interviews in the financial community indicated that more written guidance, clarification, and streamlining of procedures are required from the FRC.

**FRC staff training.** It is also recommended that FRC establish a formal training program for its professional staff in charge of reviewing IPO applications and prospectuses. To that effect, the FRC should consider development of a procedures manual and a training manual for such staff.

The detailed assessment of current FRC regulations and procedures for the IPO market and recommendations to bring these closer to international best practices are contained in a forthcoming project report.

*This Newsletter is a monthly electronic publication of EPRC project activities. Comments, suggestions, and requests for inclusion or deletion from our mailing list can be forwarded to: Editor, EPRC Newsletter, by e-mail [fbertoli@epc-chemonics.biz](mailto:fbertoli@epc-chemonics.biz) or fax: (976-11) 32 78 25.*