

MIFA

Promoting Microfinance in Asia



MONGOLIA: MICROFINANCE AND FINANCIAL SECTOR DIAGNOSTIC STUDY

FINAL REPORT



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Abbreviations

ADB	Asian Development Bank
BoM	Bank of Mongolia
CRC	Communications Regulatory Commission
DP	Democratic Party
FIFTA	Foreign Investment and Foreign Trade Agency
FDI	foreign direct investment
FRC	Financial Regulatory Commission
GDP	gross domestic product
GNI	gross national income
GTZ	German Technical Cooperation
IBLI	index-based livestock insurance
ICT	information and communication technology
ICTA	Information and Communication Technology Authority
IFC	International Finance Corporation
IT	information technology
MBB	<i>MicroBanking Bulletin</i>
MDF	Microfinance Development Fund
MF	Microfinance
MIK	Mongolian Mortgage Corporation
MIS	management information system
MNT	Mongolian togrog (national currency)
MPRP	Mongolian People's Revolutionary Party
MSME	micro, small, and medium enterprise
MTC	Mongolian Telecom Company
NBFI	nonbank financial institution
NGO	nongovernmental organization
NPL	nonperforming loan
NSO	National Statistics Office
ROA	return on assets
ROE	return on equity
SCC	switch clearing center
SME	small and medium enterprise
UNCDF	United Nations Capital Development Fund
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
WOCCU	World Council of Credit Unions

All dollar amounts in U.S. dollars unless otherwise noted.

Executive Summary

Background

Mongolia has a population of 2.66 million. Ethnic Mongols account for about 85 percent of the population; minority groups include Kazakhs, Buryats, and Chinese. In many regards, Mongolia may be considered a “city state,” as 40 percent of the population lives in the capital city of Ulaanbaatar, where about 60 percent of gross domestic product (GDP) is generated. Poverty is higher in rural areas, especially in the western regions, and there are indications that the poverty gap continues to widen.

Political power is concentrated in the Mongolian People's Revolutionary Party (MPRP) and the Democratic Party (DP).

Macroeconomic Context

After the breakdown of the communist regimes in Eastern Europe in late 1989, Mongolia saw its own Democratic Revolution in early 1990, which led to a multiparty system, a new constitution (in 1992), and the transition to a market economy.

Since the beginning of the 1990s, substantial structural reforms have been introduced, including currency reforms, price and wage liberalization, the privatization of small and medium enterprises (SMEs) and state-owned companies, and the enactment of a substantial number of new laws and regulations to facilitate private sector activities. The privatization process was accelerated when large state-owned enterprises began to be privatized in 2001. The pro-private sector environment in the country was greatly enhanced by the introduction of a flat corporate tax system in early 2008.

The Mongolian economy is centered on agriculture (i.e., agricultural crops, herding, and livestock) and mining (the main hard currency export). The country has experienced GDP growth of over 10 percent per year on average over the past five years, with budget surpluses.

Financial Sector

The financial sector of Mongolia is a two-tier system, comprising the Bank of Mongolia (i.e., the central bank) on one tier, and commercial banks, nonbank financial institutions, and credit and savings cooperatives on the second tier. With one small exception, there is no deposit insurance. The capital adequacy ratio has been 14 and 24 percent since 1999, which is 1.8–3 times higher than the international standard of 8 percent set by the Basel Committee. The central bank law expressly prohibits the government from setting interest rate controls on loans. Mongolian law allows for mortgages and other loan instruments backed by securitized collateral. However, rudimentary systems for determining titles and liens and collecting debts make lending based on local collateral risky. Banks frequently complain that onerous foreclosure rules are barely workable and unfair to creditors.

As of December 2007, there were 16 commercial banks (of which 10 had some level of foreign ownership, but were not controlled by foreign owners), 15 insurance companies, 192 credit unions, 137 finance companies, and 35 securities and/or brokerage firms. Some 82 percent of the total assets of the financial sector are located in Ulaanbaatar. Commercial banks (with foreign ownership) represent 67.5 percent of total assets.

The previous weakness of the financial sector has been a key impediment to national growth—it collapsed outright in the banking crises of 1994, 1996, and again in 1999. Thanks to Mongolia’s ability to rescue itself rapidly from these deep crises in its financial sector, as of September 2008, the banking sector was vibrant and diversified, with a total outstanding loan portfolio of \$2.38 billion—a 35 percent increase over December 2007.

Total loans outstanding grew on average by 81.5 percent each year between 2000 and 2005, then by 42 percent (rising to \$1.05 billion) in 2006, 68.1 percent (to \$1.76 billion) in 2007, and 32.1 percent (to \$2.38 billion) in September 2008. However, total loans outstanding decreased by about \$20 million by September 2008, when compared to September 2007. As of August 2008, private sector loans accounted for only 56.9 percent, or \$1.35 billion, of this volume; and 49 percent of these loans, valued at \$666 million, were in foreign currency. Loans to individuals (which are often used for productive purposes, especially within the informal sector) accounted for 40.9 percent of all private sector lending, with \$542 million targeted at the microfinance sector. Approximately 10.9 percent of this amount, or \$59 million, had been disbursed in U.S. dollars.

The industry’s credit exposure is highly concentrated, with three banks (Khan, Golomt, and Trade & Development) controlling two-thirds of total credit exposure. Credit has been directed primarily towards the construction, manufacturing, and wholesale trade industries. Mortgage lending does not represent a significant share of overall loan portfolios.

Financial sector profitability and interest rate spreads declined in the first half of 2008 because of decreasing numbers of new loans, increased competition, and a large spike in inflation. The devaluation of the national currency (the *togrog*) also increased the instability of the macroeconomic environment of Mongolia.

The central bank—the Bank of Mongolia (BoM)—is responsible for supervising commercial banks. The Financial Regulatory Commission (FRC) is responsible for supervising nonbank financial institutions, including credit unions and nondeposit-taking lenders, capital markets, and insurance companies. The FRC is a newer institution than the BoM and is still struggling with the implementation of systems, as well as staffing, budgeting, and establishing supervisory capabilities. It is also burdened with a much higher number of institutions to regulate than is the central bank (653 versus 16).

Microfinance

In the course of the last ten years the Mongolian microfinance industry has experienced rapid growth and the largest MFIs have generated profits. Taking into account the very low population density of rural Mongolia, a nomadic population, a harsh climate, the seasonality of demand for financial services, high covariance risk, and very poor rural physical infrastructure, the achievements of these MFIs is impressive. Khan Bank, XacBank, and the Mongol Post Bank dominate the microlending market in terms of the number and volume of loans outstanding. In terms of depth of outreach, however, the NBFIs Vision Fund and TransCapital are the leaders.

Contrary to microfinance methodologies used in other countries, the majority of loans in the microfinance sector are individual collateralized loans with terms of 12 months. There are no licensed apex banks in Mongolia. There is, however, a government-led wholesale lending institution, the MicroFinance Development Fund (MDF).

Although nearly every financial institution in Mongolia provides a significant percentage of its services to low-income clients, not all classify these activities as microfinance. Only one commercial bank and three NBFIs *specifically* market themselves as “microfinance” institutions: XacBank, Vision Fund, TransCapital, and Credit Mongol. The typical “microloan” refers more to enterprise loans, which are usually greater in value than the *MicroBanking Bulletin* proxy of 64.9 percent of per capita gross national income (GNI) in Central Asian nations. For example, XacBank reported in its 2007 annual report that its average microloan size was \$19,600.

Microfinance is regulated by the same laws and regulations that govern the mainstream financial system. This means that specific laws do not directly relate to microfinance institutions, their creation, or licensing, nor do specific tax breaks or a regulatory or supervisory regime apply to them. Likewise, there is no specific national policy on microfinance.

A considerable portion of the loan portfolio of the key microfinance players is financed through external borrowing, a large share of which is in foreign currency. Since only part of these foreign currency borrowings can be offset by onlending in foreign currency, these liabilities are a growing concern. With the current turmoil in the financial sector and increased inflation, microfinance banks will not be able to rely on customer deposits as a source of financing.

Microfinance Supply and Demand Gaps

Estimating the potential demand and supply gaps in microfinance in Mongolia is difficult. No empirical quantifiable demand assessment is available. As of early 2009, estimated demand for microfinance credit was about \$877 million, which was covered by an estimated supply of \$715 million, leaving a demand gap of about \$162 million. When estimates were

based on delivery innovations, however, demand was approximately \$965 million, leaving a gap of about \$250 million.

The range of financial products and services available in Mongolia is extensive, with the vast majority available to lower-income households and/or businesses. Consumer lending backed by pensions, savings, salaries, and/or large down payments (i.e., consumer leasing) has become widely available and is often used either as working capital or for small business improvements by microenterprises. While it appears that a large portion of the population (79 percent of households) has access to financing, financial institutions still have scope to move down market to address the needs of the rural poor.

According to statistics from the Credit Bureau of the Central Bank of Mongolia (i.e., the Bank of Mongolia), 560,000 loans were outstanding as of September 31, 2008, an increase of 17 percent over the previous 12 months. Assuming that 15 percent of households have more than 1 loan, an estimated 72.3 percent of households have a loan outstanding. Loan penetration in relation to the total population is thus not only adequate, but potentially reaching saturation.

Priorities for microfinance institutions

- development of mechanisms to improve outreach in rural areas through IT improvements (e.g., mobile phone banking, points of sale, Internet banking)
- improvement of the product mix to increase customer outreach through agency arrangements (e.g., for insurance), noncollateralized loan products, and savings mobilization
- improved risk management systems to monitor and/or hedge foreign currency borrowing
- funding diversification through savings mobilization

Priorities for other financial institutions

- institutional capacity building
- capacity and awareness building regarding the viability of effective services for the poor
- life insurance (bundled with financial institution loans through agent relationships)
- index-based livestock insurance (standalone and bundled with loans through agent relationships)
- financial leasing for herders (e.g., alternative energy, consumer goods, production equipment)
- financial leasing for urban and semi-urban microenterprises that are transitioning to become SMEs

Introduction

Background

Situated strategically between Russia and China, Mongolia has emerged as an important player in the geopolitical landscape. The country's parliamentary republic democratic system has consolidated and matured over the past 19 years, however, with significant instability and downturns. Mongolia has a population of 2.66 million¹ and over 11 political parties; however, political power is concentrated in the Mongolian People's Revolutionary Party (MPRP) and the Democratic Party (DP). The MPRP was formerly the sole party in the country, in power from 1921 to 1996; it was in power again from 2000 to 2004. The DP was the dominant force in the ruling coalition between 1996 and 2000. From 2004 to 2006, the MPRP and the DP formed a coalition with two other parties. Since 2006 the MPRP has been the ruling party, with its domination extending from the Parliament and cabinet to nearly all provincial governorships and provincial parliaments.

Eleven parties, one coalition, and independent candidates took part in the parliamentary elections of June 29, 2008. Due to the riots that followed (the MPRP and the DP both contested the elections due to alleged fraudulent practices),² Ulaanbaatar was placed under four days of martial law. By September 2008, the political disruption had calmed down and the MPRP agreed to share 40 percent of all cabinet positions with the DP (as the main opposition party), forming a coalition government until the 2012 parliamentary elections. The next presidential elections will take place in 2009.

Ethnic Mongols account for about 85 percent of the population. Minority groups, especially Kazakhs, Buryats, and Chinese, are occasionally marginalized in terms of both economic and political opportunities, but the risk of ethnic conflict is low.

Mongolia scores relatively high rankings in terms adherence to international human rights conventions and has a low level of reported human rights violations.³ The nation has a high level of gender equality, with more women in the university system than men. Access to finance for women (including microfinance) is nearly equal to that of men.

Evidence of corruption is widespread in Mongolia. Transparency International 2008 deemed Mongolia a corrupt country, with a score of 3.0

¹ IMF, 2008, *World Economic Outlook: Housing and the Business Cycle* (Washington, DC: IMF). Mongolia is also one of the least populated countries in the world.

² ChinaView (online news service of Xinhua News Agency), 2008, "Riots in Mongolia Subside." July 3, 2008, http://news.xinhuanet.com/english/2008-07/03/content_8485841.htm (accessed September 2009).

³ See UNDP, 2006, "Democratic Governance Indicators: Assessing the State of Governance in Mongolia," UNDP, Ulaanbaatar, Mongolia, http://www.undp.org/oslocentre/docs07/workshop/day3_wed_290807/provided_materials/Mongolia%20DGI%20Assessments.pdf (accessed September 2009).

(out of a best possible rating of 10.0), rating it 104 out of 180 countries.⁴ During the period September 2007–September 2008, 354 individuals were charged as suspects or faced prosecution by the Anti-Corruption Agency. Among those individuals, the majority were government officials and representatives of nongovernmental organizations (NGOs). The total damage caused by the investigated cases amounted to \$29.5 million.⁵ Cases of fraud within the Mongolia banking system are also not uncommon.

Macroeconomic Context

After the breakdown of the communist regimes in Eastern Europe in late 1989, Mongolia saw its own democratic revolution in early 1990, which led to a multiparty system, a new constitution (in 1992), and the transition to a market economy. With international backing, a shock therapy model similar to that applied in Russia was engineered in Mongolia. As a consequence, its status as an industrialized nation almost disappeared and many of its human development indicators were severely affected. The state assets that were broken up were unevenly distributed and a new rich elite quickly emerged.

Since the beginning of the 1990s, substantial structural reforms have been introduced, including currency reforms, price and wage liberalization, the privatization of small and medium enterprises (SMEs) and state-owned companies, and the enactment of a substantial number of new laws and regulations to facilitate private sector activities. The privatization process was especially accelerated after large state-owned enterprises were privatized according to the government's "Privatization Guidelines for 2001–2004." All these reforms have generated significant improvements in the Mongolian economy, which has experienced strong macroeconomic performance in terms of GDP growth (over 10 percent per year on average over the past five years, with budget surpluses).

Mongolia's economy is centered on agriculture (i.e., agricultural crops, herding, and livestock) and mining. Mining has traditionally been the largest source of foreign revenue for the country. In some regards, Mongolia may be considered a "city state," as 40 percent of the population lives in the capital city of Ulaanbaatar, where about 60 percent of GDP is generated. The year-on-year growth rate of GDP remained strong between 2007 and 2008, with 8.7 percent growth as of June 2008 (see table 1). The private sector accounted for 68.4 percent of GDP in 2007, up from 52.6 percent in 2005. Private sector growth in 2007 was primarily driven by growth in manufacturing (32.3 percent) and construction (22.4 percent).⁶ The pro-private sector environment in the country has also been greatly enhanced in

⁴ Transparency International, 2008, *Corruption Perceptions Index 2008* (Berlin: Transparency International).

⁵ Financial Markets Association, 2008, "Annual Report," Financial Markets Association, Ulaanbaatar, Mongolia.

⁶ ADB, 2009, "Private Sector Assessment for Mongolia," ADB, Manila, Philippines, <http://www.adb.org/Documents/Assessments/Private-Sector/MON/PSA-MON-2009.pdf> (accessed September 2009).

recent years, especially since the implementation of a flat corporate tax system in early 2008.⁷

Table 1. Macroeconomic Indicators, Various Years

	2004	2006	2008
% GDP growth	10.6	8.6	8.9
GDP per capita (\$ billions, 2009 prices)	1.8	3.2	5.3
GDP per capita (\$, PPP)	2,378	2,880	3,508
Inflation	7.9%	4.5%	26.8%
Exchange rate (MNT/US\$)	1,185	1,165	1,165
% GDP in agriculture	22.2%	19.5%	18.8%
% GDP in industry, mining, and construction	29.2%	40.4%	38.1%
% GDP in services	48.6%	40.1%	43.1%
% population below minimum living standard (data from 2002)	36.1%	36.1%	36.1%

Sources: EconomyWatch (online reference source), n.d., “GDP Growth (Constant Prices, National Currency) for Mongolia, Year 2008—In Detail,” EconomyWatch.com, Singapore, http://www.economywatch.com/economic-statistics/Mongolia/GDP_Growth_Constant_Prices_National_Currency/ (accessed September 2009); EconomyWatch, n.d., “Inflation Statistics for Mongolia,” EconomyWatch.com, Singapore, http://www.economywatch.com/economic-statistics/Mongolia/Inflation_Average_Consumer_Price_Change_Percentage/; ADB, 2009, “Key Indicators for Asia and the Pacific 2009,” ADB, Manila, Philippines, http://www.adb.org/documents/books/key_indicators/; and UNESCAP, 2008, “Poverty and Inequality,” chapter 7 in *Statistical Yearbook for Asia and Pacific 2008* (Bangkok, Thailand: UNESCAP), <http://www.unescap.org/STAT/data/syb2008/17-Poverty-and-inequality.pdf>. (All URLs accessed September 2009.)

As of late 2008, the poverty rate was officially declared to be 36.1 percent, yet the database for these calculations has not been comprehensively updated since the 2003 survey conducted by the National Statistics Office (NSO). The minimum living standard set by the NSO in September 2008 was MNT 57.25–MNT 64 (\$1.90–\$2.13) per day.⁸ Poverty is higher in rural areas, especially in the western regions, and there are indications that the poverty gap continues to widen.

The severe effects of global warming can already be observed in Mongolia. More than 80 percent of the country’s land area is classified as highly vulnerable to climate extremes. The majority of the population outside urban areas participates in agriculture (i.e., agricultural crops, herding, and livestock), which is subject to extreme weather. This situation makes it much

⁷ MTA (Mongol Tax Authority), 2006, *Law of Mongolia: Corporate Income Tax (Amended Law)*, June 29, 2006, MTA, State Palace, Ulaanbaator, Mongolia, http://www.mta.mn/english/images/stories/tax_files/cit_29_jun_06_eng_official.pdf (accessed September 2009).

⁸ NSO, 2009, *National Statistics Office Yearbook* (Ulaanbaatar, Mongolia: NSO). This report does use a fixed exchange rate. Rather, figures cited in the report reflect the exchange rate provided by the referenced source at the time.

more difficult to improve the general standard of living and reduce poverty in Mongolia.⁹

Statistics of the Mongolian Labor Department showed that as of June 2008, the unemployment rate was 3 percent, a decrease of by 7.8 percent since June 2007. The average monthly salary at that time was \$216 per month, a nominal increase of 65.3 percent since early 2008 (a 168.1 percent increase since 2004). The best paid jobs lie in the financial sector (\$369 per month) and the public sector (\$268 per month).¹⁰

The increase of global prices for major consumption goods and raw materials in 2007 caused the inflation rate to increase 100 percent in less than six months: from 7.1 percent in July 2007 to 14.4 percent in November 2007. There were no published statistics available on the inflation rate again until May 2008, when it showed a dramatic increase to 32 percent, a rate that stayed constant through September 2008.¹¹ Pending strong efforts by the Bank of Mongolia (BoM), inflation is expected to fall again in 2009. According to the International Finance Corporation (IFC), as of July 31, 2006, the Mongolian currency (the *togrog*, or MNT) had a managed floating exchange rate against the U.S. dollar with no predetermined path. As of this writing, the MNT had appreciated by 3 percent since the beginning of 2008, from 1,170 to \$1 to 1,140 to \$1, primarily due to global macroeconomic trends. Although historical data shows that the MNT/USD exchange rate had been relatively stable in the preceding three years, the togrog was devalued against the dollar in December 2008 to 1,240 and continues to fall, with the spread between the official rate and the “curb rate” widening. In early January 2009, the curb rate reached MNT 1,500 to \$1. Bank of Mongolia President Batsukh had at that point resigned and was expected to be replaced by Mr. Purevdorj, a former member of parliament who had worked at the State Property Agency.

As of November 2007, the trade balance of Mongolia had deteriorated to a deficit of \$205 million. After first quarter 2008, this trend accelerated and the country reached a record deficit of \$756 million in September 2008. By late 2008, the mining industry, especially copper—which contributes more than 30 percent of Mongolian GDP—had suffered from falling prices (from \$8,700 to \$4,000 per ton from July 2008 to year-end 2008¹²), directly contributing to the deteriorating trade balance.

Both domestic and foreign investors largely consider the business environment in Mongolia friendly and easy. Foreign direct investment (FDI)

⁹ P. Batima et al., 2005, “Observed Climate Change in Mongolia,” AIACC Working Paper, no.12, Assessments of Impacts and Adaptations to Climate Change (AIACC), SEDAC (Socioeconomic and Data Applications Center), Center for International Earth Science Information Network, Columbia University (Lamont Campus), New York..

¹⁰ NSO, 2009, *National Statistics Office Yearbook*.

¹¹ BoM, 2008, “Monthly Statistical Bulletin,” no. 09 (September), BoM, Ulaanbaatar, Mongolia.

¹² World Bank, 2008, “Mongolia Quarterly (October 2008),” World Bank, Washington, DC, **Fehler! Hyperlink-Referenz ungültig.** (accessed September 2009).

reached \$191 million in September 2008, an increase of 46 percent over the FDI level in September 2007.¹³ In October 2008, it increased by another \$28 million to reach a total of \$209.3 million.¹⁴ According to UNCTAD, Mongolia ranks as one of the best FDI performers among 141 countries globally. At the same time, remittances from Mongolians working abroad are sizable. The flow of inward remittances was \$194 million in 2007 (see table 2), slightly larger than the \$173 million in FDI that same year.

Table 2. Remittances in Mongolia (\$ millions)

	2001	2002	2003	2004	2005	2006	2007
Inward remittance flows	25	56	129	202	177	182	194
Outward remittance flows	3	14	54	49	40	77	--

Source: World Bank, 2008, "Migration and Remittances in Mongolia," in "Migration and Remittances Factbook," Development Prospects Group, World Bank, Washington, DC.

Ratings

As of late 2008, the current credit ratings of Mongolia by Standard & Poor's, Moody's, and Fitch showed the country's outlook as stable (see table 3). According to Standard & Poor's report of December 2008, Mongolia's credit rating had increased from BB to BB+ (positive) in 2007, but was cut again to BB- (stable) in 2008. The 2007 upgrade in its rating reflected the country's fast-improving debt and external liquidity ratios, in conjunction with its solid growth prospects predicated on a burgeoning mining sector. The credit downgrade in December 2008 reflected the influence of the global financial crisis on the national economy.

Table 3. Mongolia Country Credit Ratings

	2006	2007	2008
Standard & Poor's	BB	BB+	BB- (negative)
Moody's	n/a	n/a	B1 (stable)
FITCH-IBCA	B+	n/a	B+ (negative)

Source: Mongolia-Web (online information portal), 2007, "Standard & Poor's Increases Mongolia's Credit Rating," December 17, 2007, Mongolia-Web, Ulaanbaatar, Mongolia, <http://www.mongolia-web.com/component/content/article/1547?format=pdf>; Mongolia-Web, 2008, "Mongolia's Credit Rating has been Downgraded by the Fitch International Credit Rating Agency," December 11, 2008, Mongolia-Web, Ulaanbaatar, Mongolia, http://www.mongolia-web.com/blog/printblog?index_php?view=article&cid=2147&tmpl=component&print=1; and Moody's, 2007 and 2008, "Global Credit Research Rating Action—Company Profile" (April 2007, May 2007, March 2008), Moody's, New York, New York. (All URLs accessed September 2009).

¹³ BoM, 2008, "Monthly Statistical Bulletin," no. 9 (September).

¹⁴ BoM, 2008, "Monthly Statistical Bulletin," no. 10 (October).

Government Priorities

The IMF Article IV Consultation of July 2008, which summarized bilateral discussions to date between the Government of Mongolia and the IMF, included the following policy recommendations:

- Both fiscal and monetary policies needed to be tightened to contain inflation. Authorities were counseled to achieve a modest budget surplus in 2008 by avoiding further wage increases, consolidating welfare programs, and eliminating low-priority capital projects. Monetary policy was urged to aim at containing the growth of reserve money to 12 percent in 2008.
- The real exchange rate was somewhat undervalued. Greater exchange rate flexibility was crucial to help lower inflation and maintain external stability.
- Authorities were advised to move cautiously in tapping nonconcessional sources of external financing. Nonconcessional borrowing was recommended only for projects with clear economic viability that could not be financed from concessional sources, and only when inflation was under control.
- Transparent, stable, and internationally competitive fiscal and investment regimes needed to be put in place in the mining sector to take full advantage of Mongolia's vast mineral wealth.

Addressing the U.N. General Assembly in September 2008, the Mongolian Prime Minister pledged that the country's most important goals were to halve poverty, provide housing, and ensure environmental sustainability—goals that required undivided focus and redoubled efforts.

The government's long-term economic development strategy through 2021—dubbed the "triple 15s"—envisages annual GDP growth of 15 percent to reach an income level of \$15,000 per capita over the next 15 years. The aim of the strategy, adopted in 2008, is to achieve intensive economic growth, boost skills and technology, create new jobs, and develop a private sector based on both exports and domestic markets. This phenomenal growth will depend significantly on the development of the mining sector, which was still largely stalled at year-end 2008.

A stabilization agreement with the Oyu Tolgoi copper and gold mine was still on hold as of January 2009, but was anticipated to be approved during first quarter 2009. The government is negotiating significant co-ownership in the mine, which may either take the form of direct ownership or the sale of equity on the local market. Oyu Tolgoi claims to have reserves of more than 1 billion pounds of copper and 330 thousand ounces of gold. Total investment in the mine is expected to exceed \$3 billion. The successful conclusion of these negotiations is deemed a high priority. At the end of September 2008, a \$74.8 million Canadian mining investment was withdrawn

due to an alleged resolution of the government to nationalize the uranium industry.¹⁵

Furthermore, the government plans to promote large-scale projects, including an oil refinery, coal-to-liquid fuel conversion, natural gas production, and electricity,¹⁶ as well as nuclear energy for use by the mining industry. As of this writing, these projects are primarily at the concept stage and their viability and financing had yet to be fully determined.¹⁷

Private Sector / MSMEs

Overview

Privatization has been at the center of the Mongolian reform process since 1990. The government's "Privatization Guidelines for 2001–2004" aimed to accelerate the privatization process and increase private sector participation in the economy; the guidelines were approved by the parliament in January 2001. As a result of both the privatization of large state-owned enterprises and market liberalization, a micro, small, and medium enterprise (MSME) sector emerged quickly. According to the National Statistics Office (NSO), there were over 32,000 active businesses at the end of 2007, of which 80.1 percent were very small or microenterprises with less than 10 employees. Another 8.8 percent had 10–19 employees, and 9.8 percent had 20–49 employees (see table 4).¹⁸

In terms of the national economy, MSMEs employ over 300,000 people (30 percent of the total workforce) and account for about 40 percent of GDP. MSMEs, moreover, represent almost 99 percent of total business entities in Mongolia. Roughly 51.2 percent of these enterprises are in the wholesale, retail, and household goods sectors; 15.6 percent are in the rental, business advisory, and financial services sectors; and 14.3 percent are in manufacturing and construction.¹⁹ Larger entities are concentrated in urban areas, such as Ulaanbaatar, Darkhan, and Erdenet, while smaller businesses are spread nationwide.²⁰

¹⁵ Elisabeth Behrmann, 2008, "Mongolia Clears Way for Oyu Tolgoi Mine," Market Watch (online information resource), August 26, 2008, Market Watch, San Francisco, California, <http://www.marketwatch.com/story/mongolia-clears-way-for-oyu-tolgoi-mine-2009-08-26> (accessed September 2009).

¹⁶ In September 2008, the government announced a tender for Power Plant #V for the eastern section of Ulaanbaatar (BusinessMongolia.com [online publication], "V Power Plant will be Built in Ulaanbaatar," October 1, 2008, BusinessMongolia.com, Ulaanbaatar, Mongolia, <http://www.business-mongolia.com/mongolia-news/v-power-plant-will-be-built-in-ulaanbaatar/> [accessed September 2009]).

¹⁷ These large-scale projects are not referred to in the 2007 and 2008 memoranda signed between the International Development Association (IDA), the World Bank, and the IMF, and may contradict these same memoranda, which warn against nonconcessional, off-shore borrowing (e.g., such as the proposed sovereign government bond).

¹⁸ The NSO defines MSMEs by the number of employees (NSO, 2009, *National Statistics Office Yearbook*).

¹⁹ Ibid.

²⁰ B. Ganbold, 2008, "Improving Access to Finance for SME: International Good Experiences and Lessons for Mongolia," Visiting Research Fellow (VRF) paper, no. 438 (October), Institute of Developing Economies, Japan External Trade Organization (IDE-JETRO), Chiba, Japan.

Table 4. Number of Registered Businesses in Mongolia, 2004 and 2007

	2004				2007			
	Active	%	Inactive ^a	%	Active	%	Inactive	%
1–9 employees	20,693	81.6%	8,267	28.5%	25,703	80.1%	22,952	47.2%
10–19 employees	1,913	7.5%	324	14.5%	2,830	8.8%	470	14.2%
20–49 employees	1,751	6.9%	211	10.8%	2,351	7.3%	266	10.2%
>50 employees	999	3.9%	60	5.7%	1,221	3.8%	108	8.1%
Total	25,356	100%	8,862	26%	32,105	100%	23,796	42.6%

Source: NSO, 2009, *National Statistic Office Yearbook*.

The SME Law issued in July 2007 provided a clear definition of SMEs in Mongolia for the first time, which should help improve the consistency and effectiveness of government support programs (see table 5). This law tries to set up basic guidelines and policies for SME development, as well as to define the scope of general government measures for promoting SMEs. The government doesn't have a clear definition or policy for microfinance or microenterprises. Nor does comparative data exist to categorize "microloans" or "microenterprises" by household income, expense level, or other livelihood measure.

Table 5. SME Classification in Mongolia

Category	Sector	Number of employees	Annual revenue (in MNT)
Small enterprise	Trade/services	≥9	≥250 million
	Manufacturing/processing	≥19	≥250 million
Medium enterprise	Services	≥49	≥1.0 billion
	Wholesale trade	≥149	≥1.5 billion
	Retail trade	≥199	≥1.5 billion
	Manufacturing/processing	≥199	≥1.5 billion

Source: Government of Mongolia, 2007, *SME Law of Mongolia*, Ulaanbaatar, Mongolia.

Obstacles to Growth

Obstacles to growth in the private sector vary dramatically by enterprise size, geographical location, and sector. There are at times large differences between "perceived" obstacles and "real" obstacles, with a large number of businesses in Mongolia tending to first identify external constraints as barriers before conducting objective, inward-looking analyses of issues related to management, human resources, governance, accounting, management information systems, and corporate culture. There have been a number of striking success stories in Mongolia when companies have prioritized the resolution of internal, institutional factors that constrained business. The financial sector is a case in point. The remarkable turnaround of the nation's financial sector after the collapse of communism—which began in the late 1990s and continues as of this writing—was largely due to a

partnership between the private sector, government, and donors, which together invested significant sums in upgrading human resources and internal systems.

The medium- to long-term prospects for Mongolia's private sector as a whole are highly encouraging, with conservative estimates of GDP growth of 8 percent per annum for the period 2009–2014, and optimistic projections at 15 percent per annum for the same period. Very little practical research has been done to determine the policies and actions that would facilitate access to finance by poor and vulnerable nonpoor people in order to more equally share opportunities for growth. It remains to be seen how the current global financial crisis will impact the Mongolian private sector. Financing to support economic growth might, for example, become an issue if markets seize as a result of the credit crisis.

In many cases, external constraints and barriers are causing undue obstacles to the growth of the private sector. Financial sector constraints of the microenterprise subsector can be categorized as low to medium among well-established microenterprises that possess sufficient immovable assets to pledge as collateral. Though no recent data are available, practitioners and observers frequently comment that people with insufficient immovable assets continue to be marginalized and lack access in large numbers to productive credit. These people include recent migrants to the cities, small herders, and urban and semi-urban dwellers.

However, compared to larger companies, SMEs often find it difficult to finance capital investments and even daily operational needs. Their main impediments are relatively high lending rates, limited market information, and weak capacity for market research and business planning.²¹

Demand for Financial Services

Current Status

As of September 2008, total loans outstanding in the Mongolian banking sector were valued at \$2.38 billion, a 35 percent increase over December 2007. However, as of August 2008, private sector loans accounted for only 56.9 percent, or \$1.35 billion, of this volume; 49 percent of these loans, valued at \$666 million, were in foreign currency. Loans to individuals (which are often used for productive purposes, especially within the informal sector) accounted for 40.9 percent of all private sector lending, with \$542 million targeted at the microfinance sector. Approximately 10.9 percent of this amount, or \$59 million, had been disbursed in U.S. dollars.²²

²¹ IMF, 2008, "Mongolia: Financial System Stability Assessment, Including Reports on the Observance of Standards and Codes on the Following Topics: Banking Supervision and Monetary Policy Transparency," IMF, Washington, DC.

²² BoM, 2008, "Monthly Statistical Bulletin," no. 09 (September).

While the overall increase in credit demonstrates greater financial inclusion, there are discernable regional differences. As of December 2007, Ulaanbaatar accounted for 36.3 percent of all households, yet absorbed 78.3 percent of all lending. The lowest credit coverage was in the Khangai region, where 22.6 percent of the population was receiving only 7.3 percent of total available financing. Interestingly, the western region of the country has the highest rate of poverty, yet the lowest ratio of nonperforming loans, or NPLs (1 percent).

Table 6. Estimate Total Deposits and Outstanding Loans by Region, 2007 (\$ millions)

Geographical region	Households (000s)	HH (%)	Total loans (\$)	Regional %	Total deposits	Regional %	NPL %
Ulaanbaatar	235	36.3	1,376	78.3	976	83.8%	3.8
Khangai region	146	22.6	127	7.3	64	5.5%	1.0
Central region	117	18.1	116	6.6	60	5.1%	2.3
Western region	96	14.9	98	5.6	47	4.0%	0.8
Eastern region	52	8.0	40	2.3	18	1.6%	2.5
Total	646	100	1,757	100	1,165	100%	--

Source: Estimates based on D. Duulal, 2005, “Research on Loan Reports of 2002–2005,” Monetary Policy and Research Department, Bank of Mongolia, Ulaanbaatar, Mongolia, http://www.mongolbank.mn/c/portal/layout?p_l_id=PRI.2.1&p_p_id=20&p_p_action=1&p_p_state=exclusive&p_p_mode=view&p_p_col_id=&p_p_col_pos=0&p_p_col_count=0&_20_struts_action=%2Fdocument_library%2Fget_file&_20_folderId=57&_20_name=RB5.pdf (accessed September 2009).

Similarly, savings mobilization is highly concentrated in urban areas, which have more than 83 percent of total deposits. Current data on the number of savings accounts and average savings per depositor is not available.

Financial Services Demand/Supply Gap

There is no public, up-to-date research available on the supply of microfinance loans or, more specifically, of productive microlending. At the same time, it must be noted that the vast majority of all retail loans in Mongolia are small in size and classified as “consumer loans.” From anecdotal evidence and in light of the fungible nature of household economies in Mongolia, it can be assumed that a significant proportion of consumer loans are used in part, or wholly, for income-generating activities.

According to statistics from the Credit Bureau of the Central Bank of Mongolia (i.e., the Bank of Mongolia), 560,000 loans were outstanding as of September 31, 2008, an increase of 17 percent over the previous 12 months. Assuming that 15 percent of households have more than 1 loan, an estimated 72.3 percent of households have a loan outstanding.

Table 7. Outstanding Loans in Mongolia, 2007 and 2008

	2007	Sept. 2008
Number of households	645,700	658,614
Number of Credit Bureau loans (BoM)	464,800	560,000
Theoretical percentage of households with more than 1 loan	15.00%	15.00%
Retail loan penetration at the household level (%)	61.2%	72.3%
Number of households without access to financing	250,620	182,614

Sources: NSO, 2009, *National Statistics Office Yearbook* (population statistics), and BoM, 2007 and 2008, "Loan Reports," Supervision Department (Credit Bureau Information), BoM, Ulaanbaatar, Mongolia, <http://www.mongolbank.mn/web/guest/statistics/loanrep> (accessed December 2008).

The figures above refer only to formal financial institutions that report to the Credit Bureau of the Bank of Mongolia. However, the number and volume of loans among institutions not reporting to the Credit Bureau is estimated to be less than 3 percent of all lending. Based on the above figures, loan penetration in relation to the total population is not only adequate, but is potentially reaching saturation.

It is estimated that the number of nonvulnerable urban microenterprise borrowers over the next five years will only marginally increase. However, assuming continued GDP growth and inflation, the average loan size requirements among existing borrowers is expected to significantly increase. Demand for rural and start-up microenterprise loans will be disparate, depending on specific geographical conditions. Relatively large growth in demand will be seen in areas close to new mining "boom" towns. There may be a downturn in the total number of microentrepreneurs in specific population areas due to a continued trend of enterprise consolidation (as larger firms overshadow and force out microenterprises) and labor migration to urban centers.

The range of financial products and services available in Mongolia is extensive, with the vast majority available to lower-income households and/or businesses. Consumer lending backed by pensions, savings, salaries, and/or large down payments (i.e., consumer leasing) has become widely available and is often used either as working capital or for small business improvements by microenterprises. Microenterprise clients often cite bureaucratic and collateral requirements of official loans as the driving impetus for using quick, higher-interest consumer loans.

According to the research conducted for this report, among urban and semi-urban microentrepreneurs, borrowing for wholesale and retail commercial purposes is the biggest area of loan activity in terms of both the value and volume of loans.

Estimating the potential demand and supply gaps in microfinance in Mongolia is not only difficult, but complicated by the recent turbulence and uncertainties in the overall economy and, specifically, the financial sector. In addition, no empirical quantifiable demand assessment is available. While it appears that a large portion of the population (79 percent of households²³) has access to financing, financial institutions still have scope to move down market to address the needs of the rural poor. Several products that address the needs of the “bottom of the pyramid,” but are not fully developed, are noncollateralized loans, microleasing, and mortgage lending.

Additionally, products that address specific needs, such as supporting the conversion of public buildings through renewable energy and energy conservation projects, are necessary to further develop the microfinance segment and improve the quality of life for many Mongolians. Most microfinance lending is presently conducted by traditional means (e.g., bank branches and group meetings); access to financing could be improved through technology enhancements, such as mobile phone banking, point of sale banking, and financial counseling.

In order to estimate potential demand and supply gaps, gaps must be identified at the retail and institutional levels:

Gaps at the retail level

Product innovation would increase demand because with enhanced distribution channels, more people would want loans or would want larger loans.

Assessment of microfinance demand

As mentioned earlier, no reports are available that provide an indication of potential microfinance demand. Based on the assumption that the population will increase, on average, by 1.5 percent each year and that average loan sizes will increase according to the expected inflation rate,²⁴ table 8 provides a projection of the anticipated potential demand and supply gap trends for microfinance loans. It is expected that product innovation (e.g., larger loans and new delivery channels) could cause an incremental increase in overall demand for microfinance loans from 10 to 14 percent each year from 2008 through 2013.

As of year-end 2008, estimated demand for microfinance credit was about \$887 million, which was covered by an estimated supply of \$715 million, leaving a demand gap of about \$162 million. When estimates were based on delivery innovations, however, demand was approximately \$965 million, leaving a demand gap of about \$250 million.

²³ Ibid.

²⁴ Estimates based on BoM statistics.

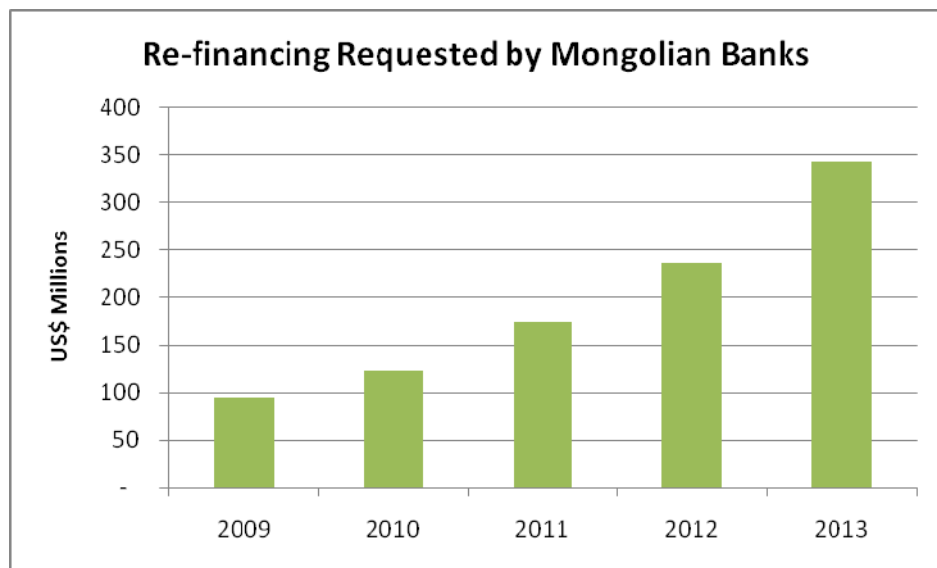
Assessment of SME demand for finance

Based on discussions with XacBank and Khan Bank in late 2008, demand for SME financing is expected to increase significantly over the next few years. However, the average SME loan ranges from \$35,000 to \$40,000, which is outside of the scope of the Microfinance Initiative for Asia (MIFA).

Gaps at the institutional level:

The refinancing gap at the institutional, or supply side, level is equally difficult to estimate. Based on preliminary analysis and brief discussions with key stakeholders in 2008, the estimated need for refinancing for anticipated microfinance portfolio growth (aside from the internal financing resources of MFIs, such as deposit mobilization) is expected to reach \$100–300 million over the next five years. This demand is expected to increase due to both an increase in loan sizes and an expansion of outreach, as well as a decrease in the internal financing resources of MFIs. Key players in the lending arena, moreover, do not distinguish between the microfinance and SME market segments.

Figure 1. Projected Refinancing Demand, 2009–2013



Source: Estimates based on research conducted in 2008.

Table 8. Projected Microfinance (MF) Demand

		Dec 08	Dec 09	Dec 10	Dec 11	Dec 12	Dec 13
Population	Total population	2,660,000	2,699,634	2,739,859	2,780,682	2,822,115	2,864,164
	Total number of poor people	851,200	836,887	821,958	806,398	790,192	773,324
	# of creditworthy poor people	340,480	334,755	328,783	322,559	316,077	309,330
	# "non-poor" benefiting from MF loans	180,880	186,275	191,790	197,428	203,192	209,084
	# of individuals requiring a MF loan	306,432	301,279	295,905	290,303	284,469	278,397
Market Size	Average MF loan amount (\$)	1,800	2,250	2,644	2,932	3,178	3,417
	Total MF demand (\$)	877,161,600	1,096,996,276	1,289,343,184	1,429,989,716	1,549,885,438	1,665,509,569
	Total MF demand (\$) based on innovations	964,877,760	1,217,665,866	1,444,064,366	1,615,888,379	1,766,869,399	1,915,336,004
	Total MF loans outstanding	714,900,000	953,200,000	1,190,010,625	1,397,352,476	1,598,881,756	1,809,260,934
	Supply gap (US\$)	249,977,760	264,465,866	254,053,741	218,535,902	167,987,644	106,075,070

Source: Estimates based on research conducted in 2008.

Financial Sector Overview

Financial Sector Overview

Mongolia's financial sector has undergone vast changes in the last 20 years. In 1989, the system was still a monobanking structure with little experience in modern commercial banking practices, few professionals, and few consumers. The weakness of the banking system was a key impediment to growth, collapsing outright in the banking crises of 1994, 1996, and again in 1999. Thanks to Mongolia's ability to rescue itself rapidly from these deep crises in its financial sector, as of September 2008, the banking sector was vibrant and diversified, with a total outstanding loan portfolio of \$2.38 billion.²⁵

However, Mongolia has not been immune from the global financial crisis that hit in 2008. High inflation rates and a general concern for the stability of the banking system led to a significant decrease in consumer deposits, which in turn dramatically impacted liquidity in the banking system. As of early 2009, it was anticipated that there would be a slowdown in loan portfolio growth. The government has reduced the reserve rate in an attempt to generate liquidity; however, similar to most other banks in the world, Mongolian banks are electing to conserve their capital during these times of financial volatility.

During the expansion of the financial sector in 2007–2008, increased competition put downward pressure on interest rates. However, with the upward trend in inflation (over 30 percent at year-end 2008), financial sector profitability deteriorated. The industry's credit exposure is highly concentrated, with three banks (Khan, Golomt, and Trade & Development) controlling two-thirds of total credit exposure. Credit has been directed primarily towards the construction, manufacturing, and wholesale trade industries.²⁶ In view of this portfolio concentration, the mortgage portfolios of Mongolian banks—although showing significant growth rates—do not represent a significant share of overall lending. Agricultural lending was also declining and individual credit (mainly consumer lending) had almost reached an equal level with credit to the private sector.²⁷

Through September 2008, key figures indicated that the financial system was sound. However, it experienced a precipitous decline in the fourth quarter of that year. Specifically, the drop in copper prices dramatically impacted Mongolia's foreign currency reserves and liquidity in the banking sector evaporated. As of early 2009, the financial system appeared sound and stable. Given the fast growth of credit, high inflation, and the likely slowdown of economic activity due to the fall of copper prices and the world economic slowdown, however, close supervision may be required.

²⁵ BoM, 2008, "Monthly Statistical Bulletin," no. 09 (September).

²⁶ IMF, 2008, "Mongolia: Financial System Stability Assessment."

²⁷ World Bank, 2008, "Mongolia Quarterly Report" (October), World Bank, Washington, DC.

**Table 9. Financial Depth and Outreach of the Mongolian Financial System, 2005–2007
(\$ millions)**

	2005	2006	2007	2008 (September)
Value of total loans	698	1,050	1,759	2,383
% loan growth		50.4%	67.5%	35.5%
Loans as % of GDP	30.4%	32.8%	45.1%	50.7%
Loans to private sector as % of GDP	5.3%	6.8%	11.1%	13.6%
Value of total deposits	801.9	1,160	1,811	1963 million
Deposit growth (%)		44.6%	56.2%	8.4%
Deposits as % of GDP	34.9%	36.2%	46.4%	41.8%
Loans as % of deposits	87.0%	90.5%	97.1%	121.4%
Cash as % of total deposits	4.9%	5.2%	4.5%	3.8%
Loans per 1,000 people	250,084	370,658	595,832	795,484
Deposits per 1,000 people	287,306	409,451	613,510	655,242

Source: BoM, 2008, "Monthly Statistical Bulletin," no. 09 (September).

Note: The table uses the following exchange rate for the period 2005–2009: MNT/USD: 1233 (2005), 1165 (2006), 1169 (2007), 1140 (2008) (BoM, 2007, "Monthly Statistical Bulletin," no. 9 [September]).

The financial sector of Mongolia is a two-tier system, comprising the Bank of Mongolia (i.e., the central bank) on one tier, and commercial banks, nonbank financial institutions, and credit and savings cooperatives on the second tier. As of December 2007, there were 16 commercial banks (of which 10 had some level of foreign ownership, but were not controlled by foreign owners), 15 insurance companies, 192 credit unions, 137 finance companies, and 35 securities and/or brokerage firms. Most financial services are concentrated in Ulaanbaatar, where approximately 82 percent of the total assets of the financial sector are located.²⁸ Nonbank financial institutions (which include insurance companies, financial companies, securities firms, and brokerages) account for about 3 percent of total financial sector assets. Credit unions contribute another 1 percent of total financial sector assets. Commercial banks (with foreign ownership) represent 67.5 percent of total assets (see table 10).²⁹

²⁸ IMF, 2008, "Mongolia: Financial System Stability Assessment."

²⁹ IMF, 2007, "Mongolia: Financial System Stability Assessment."

Table 10. Financial Institutions in Mongolia, 2005–2007

		2005	2006	2007
Commercial banks	Domestic	na	na	6
	Foreign	na	na	10
	State-owned	1	0	0
NBFIs	Insurance companies	na	19	15
	a) life insurance	na	na	0
	b) non-life insurance	na	na	15
	Finance companies	122	122	137
	Securities/brokerage firms	na	na	35
	Credit unions	400	955	192

Source: IMF, 2007, “Mongolia: Financial System Stability Assessment.”

Under the current legislative structure the supervisory responsibilities for commercial banks fall within the legal ambit of the Bank of Mongolia (BoM) and NBFIs are regulated by the Financial Regulatory Commission (FRC) of Mongolia.

Banks

Credit grew, on average, 81.5 percent annually between 2000 and 2005, by 42 percent in 2006, 68.1 percent in 2007, and 23.5 percent during the first half of 2008. This growth was primarily driven by economic recovery, a more competitive financial market structure, and foreign capital inflows. Considering the size of Mongolia, its financial infrastructure can be considered sufficient. By the end of August 2008, the system had 1,558 retail offices that provided financial services, with Khan Bank and the Mongolia Post Bank the leaders. In the 24-month period, 2006–2007, banks opened an average of 10.5 new branch offices nationwide per month. Aggressive expansion continued in 2008, with the Post Bank adding an additional 40 offices and Khan Bank, 22.

The large number of banks, NBFIs, and credit unions has been both positive and negative for the development of the sector. Beginning in the late 1990s, the growing number of institutions and outlets resulted in greatly accelerated competition, an increase in the savings rate, a lowering of lending rates, enhanced customer service, and a greater degree of product diversification. These positive results have been more recently offset, however, by confusion in the market, dilution of a limited human resource pool, increased incidence of predatory behavior, cross-indebtedness of microfinance clients, customer and employee fraud, an undue burden on regulatory authorities, and, in some cases, sector inefficiencies.

The government policy of continually increasing the minimum capital requirements for banks has not had the intended effect of encouraging bank mergers and acquisitions. Market data, paired with anecdotal evidence, points to a situation where the significant presence of banks is no longer resulting in deepening and broadening outreach, but instead has resulted in greatly increased competition for the same customers. This is particularly true for SME and corporate clients. If the mining sector generates expected value chain benefits, however, the situation may reverse itself in the medium term.

Nonbank Financial Institutions

The nonbank financial sector is comprised of a plethora of different types of institutions with varying degrees of importance and varied contributions to the economy. On the whole, such institutions are relatively unimportant in the Mongolian financial sector. As of 2007, there were 137 registered finance companies, of which 102 were engaged in lending—comprising less than 2 percent of all financial system assets. These NBFIs are widely mixed in corporate culture, capabilities, and depth and breadth of outreach. Portfolio quality and return on assets in both credit unions and NBFIs range from excellent to technically insolvent. Core target markets for both of these types of institutions vary from highly privileged clients to poor and vulnerable nonpoor clients. One NBFIs of particular importance for micro- and rural finance is Credit Mongol, which was founded by four local NGOs. The institution has received most of its capital from donor agencies, especially the European Union.³⁰

Microfinance Institutions

In the course of the last ten years the Mongolian microfinance industry has experienced rapid growth and the largest MFIs have generated profits. Taking into account the difficult circumstances in the country, namely, very low population density in rural areas, a nomadic population, a harsh climate, the seasonality of demand for financial services, high covariance risk, and very poor rural physical infrastructure, the achievements of these MFIs should be viewed highly favorably.

Although nearly every financial institution in Mongolia provides a significant percentage of its services to low-income clients, not all classify these activities as microfinance. Only one commercial bank and three NBFIs *specifically* market themselves as “microfinance” institutions: XacBank, Vision Fund, TransCapital, and Credit Mongol.³¹

A few other projects and institutions are engaged specifically in microfinance lending, including government projects and NGOs. However, these entities operate outside of the law (in the case of NGOs) or work within the framework of unsustainable project agreements with the government. At the

³⁰ ADB, 2006, “Rural Finance in Mongolia,” in “Beyond Microfinance.”

³¹ Other major providers of microfinance, such as Khan Bank and the Mongol Post Bank, do not brand or market microfinance as a core product or identify it as an essential element of their organizational cultures.

same time, with the exception of the Microfinance Development Fund (MDF), none of these unlicensed entities are of noteworthy significance in terms of either the volume or monetary value of their lending activities.

Given that hardly any financial institution markets itself as a microfinance institution, categorization of the institutional supply of microlending is open to debate. Using the simple industry benchmark of loan size as 64.9 percent of per capita gross national income (GNI), more than 80 percent of Mongolia's 341 banks, credit unions, and NBFIs can be categorized as microfinance lenders.³² When considering additional criteria, such as institutional culture, engagement with social investors, and the design and offer of specific microfinance-tailored products, the range of institutions narrows. For example, there are only one bank and five NBFIs whose mission statements include a mention of either microfinance or poverty.

It is estimated that the three commercial banks most engaged in the microfinance sector (the Mongol Post Bank, Khan Bank, and XacBank) are servicing 69.7 percent of the existing market for both micro and SME lending.

Every bank in Mongolia provides savings, credit card services, and transfer services to the low-income population. Only one company currently provides financial leasing for smaller enterprises (XacLeasing); only one regulated institution specializes in non-collateralized, group solidarity lending (Vision Fund Mongolia); and only one NBFIs specializes in rural finance innovation (Achid Finance).

As previously mentioned, Khan Bank, XacBank, and the Mongol Post Bank dominate the microlending market both in terms of the number and volume of loans outstanding. In terms of depth of outreach, however, the NBFIs Vision Fund and TransCapital dominate the market.

All but the first two institutions in table 11 offer loans well above the MBB benchmarks, indicating a potential discrepancy in the classification of "microfinance" in Mongolia.

³² The *MicroBanking Bulletin* (MBB) reports that the benchmark for microfinance institutions in Central Asia and Europe is currently 64.9 percent; 60 percent for institutions using individual lending methodology (MBB, no. 16 [Spring 2008]). The percentage is based on benchmarks for 340 institutions throughout the world.

Table 11. Microfinance Providers in Mongolia as of December 2007

	Type of institution	Approach to microfinance	Number of loan clients	Average loan size (US\$)	Loan size as % of per capita GNI
Vision Fund	NBFI	Poverty	3,576	\$286	22.2%
TransCapital	NBFI	Access	2,253	\$541	42.0%
MDF	Apex	Poverty	6 wholesale	\$1,055	81.8%
XacBank	Bank	Access	60,719	\$1,666	129.2%
Khan	Bank	Access	282,681	\$1,733	134.4%
Mongol Post	Bank	Access	68,300	\$2,337	181.2%
Credit Mongol	NBFI	Access	1,445	\$2,518	195.2%
Xac Leasing	NBFI	Access	28	\$11,683	905.7%

Sources: Research conducted in 2008 (Vision Fund, MDF, Mongol Post Bank); MixMarket, 2007, “Microfinance in Mongolia,” MixMarket, Washington, DC, <http://www.mixmarket.org/mfi/country/Mongolia> (accessed September 2009) [TransCapital, Credit Mongol]; and 2007 annual reports of Khan Bank, XacBank and Xac Leasing.

According to the research conducted for this report, the MBB depth-of-outreach benchmark is difficult to faithfully apply in Mongolia, primarily because (i) microfinance does not comprise more than 40 percent³³ of the portfolio of any Mongolian bank, and (ii) reporting on gross portfolio amounts often does not distinguish between loan product by purpose or term. In addition, it is assumed that the average loan sizes in table 11 refer to individual (consumer) loans, which actually comprise the majority of microfinance loans. The typical specified microloan refers more to enterprise loans, which are usually greater in value than the MBB proxy. For example, XacBank reported in its 2007 annual report that its average microloan size was \$19,600.³⁴ As per the MBB definition, this loan would not fall under the category of a microfinance loan.

In the microfinance sector overall, the proportion of loans with terms of more than one year has dramatically increased over the past three years. Nearly 53 percent of all loans are term loans; but less than 10 percent have terms of more than five years. The vast majority of all microlending is still under 12 months. Predominately these loans are disbursed as individual (consumer) loans.

³³ Research conducted for this report in 2008.

³⁴ Using the exchange rate provided by Oanda.com (www.oanda.com, accessed September 12, 2008).

A reliable snapshot of average terms and conditions specific to microfinance is illustrated by data provided by the MicroFinance Development Fund (MDF). The analysis in table 12 is based on reporting by the MDF's 16 current and past financial institution borrowers (7 NBFIs and 9 banks).³⁵

Table 12. Analysis of Financial Institution Borrowers

Average length of loan	7.8 months
% of borrowers below poverty line	7.6%
Average loan outstanding	\$1,055
Portfolio at risk	3.2%
% of loans backed by immovable property collateral	80%

Source: Data provided by MDF at a meeting with the institution in June 2008. Collateral percentage derived from ADB and World Bank, 2005, *Country Gender Assessment: Mongolia*.

Contrary to microfinance methodologies used in other countries, the majority of loans in the microfinance sector are individual loans that are collateralized.

Challenges and Trends in Microfinance

As of early 2009, the challenges faced by the microfinance industry were:

- How to reach larger number of clients who represent bankable demand, in particular, how to expand and serve bankable clients in rural Mongolia in a sustainable manner.
- How to maintain the high rate of loan recovery in an environment that has become increasingly competitive, as indicated by declining lending interest rates and spreads.
- How to diversify, innovate, and introduce new financial services, such as index-based livestock and crop insurance and leasing, that could reduce the transaction costs and risks of both MFIs and their clients.
- How to address the potential over- and cross-indebtedness of clients and the resulting potential market saturation.
- How to consolidate smaller, nonregulated microfinance providers through mergers and acquisitions.
- Foreign currency borrowing and lending.

³⁵ Data provided by MDF at a meeting in June 2008. Collateral percentage derived from ADB and World Bank, 2005, *Country Gender Assessment: Mongolia* (Manila, Philippines: ADB and World Bank), <http://siteresources.worldbank.org/INTEAPREGTOPSOCDEV/Resources/Mongolia-Gender.pdf> (accessed September 2009).

Leasing Companies

In June 2006 a Law on Financial Leasing was adopted that positively impacted the growth of the Mongolian leasing industry. The total volume of new leases in 2007 was \$90 million, representing 1.6 percent of GDP. As of June 2008, the number of lease providers had rise to 48 from 13 in 2005.³⁶

Two leasing companies specialize in financial leasing in Mongolia: Mongol Leasing and XacLeasing. Mongol Leasing was the first leasing company in Mongolia. It was established in 2002 and has extensive experience in the field. XacLeasing was established in May 2007 with the purpose of providing financial leasing to SMEs. Mongol Leasing is licensed as an NBFIs, while XacLeasing was established as a limited liability company.

The lease conditions offered clearly indicate an interest in supporting SMEs. However, due to limited funding resources, leasing companies are highly selective in their clients. Only clients with a previous credit history with the companies' respective banks were offered financial leasing; the average term is up to 60 months, with a down payment of 10 percent and a flexible payment schedule. Interest rates of 1 to 1.8 percent are also lower than those of banks and NBFIs.

The repayment rate on leases was well over 90 percent in 2007, with payments overdue by 90 days representing only 1.4 percent of the total value of outstanding lease amounts—reflecting a situation where the supply of credit is far lower than demand.³⁷

Insurance Companies

As of year-end 2008, there were 15 insurance companies and one life insurance company in Mongolia, down from 21 in 2004 (see table 10).³⁸ There are no longer any state-owned insurance companies. Government holdings in the insurance sector were fully divested in 2003 with the sale of “Mongol Daatgal,” the biggest insurance company then on the market.

In 2007 the insurance industry as a whole recorded a profit of MNT 633.6 million (\$541,538).³⁹ It also increased the reserve fund by MNT 5.6 billion to MNT 17.8 billion (a 45.9 percent increase over the previous year), and made reinsurance agreements worth MNT 4.5 billion.

As of year-end 2007, total assets of the insurance sector amounted to MNT 28.4 billion, an increase of 7.6 billion MNT (or 36.5 percent) over 2006. The asset structure of insurance companies remained largely unchanged, with 80 percent of total assets comprised of current assets. The latter consisted of

³⁶ Data provided by the FRC at a meeting in June 2008.

³⁷ IFC and Government of Japan, 2008, “Mongolia Leasing Industry Survey,” IFC, Washington, DC.

³⁸ Ibid.

³⁹ According to Oanda.com, the average exchange rate for 2007 was US\$1 = MNT 1,170. See <http://www.oanda.com/convert/fxhistory> (accessed September 2009).

67.6 percent cash and cash equivalents, 12 percent short-term investments, 9.4 percent accounts receivable, and 11 percent other current assets. While the industry took an accumulated loss of MNT 594.2 million in 2006, this figure decreased significantly in 2007 to MNT 303.4 million.

The biggest insurance companies in Mongolia in terms of market share (i.e., premiums collected) are Mongol Daatgal (37.0 percent), Bodi Daatgal (25.3 percent), MIG Daatgal (7.8 percent), Prime General Daatgal (6.4 percent), and Nomin Daatgal (5.4 percent). The remaining 10 companies accounted for an average market share of 1.8 percent each, indicating that the insurance market is dominated by the big companies and lacks competition.⁴⁰

In the Mongolian economy, the agricultural sector plays a central role, contributing around one-third of national GDP. Livestock provides rural households with an important source of income, jobs, and food security, as well as a means for investing and storing wealth. In recent years the importance of livestock to the livelihoods of poor rural households has increased. These households are particularly vulnerable to extreme climatic events that cause high rates of livestock mortality.

Given these conditions, insurance is a logical complement to ongoing pastoral risk management activities. Traditional approaches to livestock insurance proved inappropriate in the Mongolian context, so a new and highly innovative insurance approach, index-based livestock insurance (IBLI), was designed.

A pilot project for such insurance was initiated by World Bank and several other donor institutions in September 2005 and was implemented successfully in three aimags (provinces). Due to its great success there are plans to scale up the program to all other aimags of Mongolia.

Pension Funds and Social Welfare

There are no pension funds in Mongolia beyond a government-guaranteed pension. Government pension payments to retired people significantly increased on a per person basis during the period 2004–2007. At the same time, the number of people eligible for and receiving social benefits rose from only 6.1 percent of the population in 2004 to nearly 45 percent in 2007. There have been discussions regarding the creation of private sector-led pension funds, yet there have been no actual results to date.

⁴⁰ FRC, 2008, “Annual Report 2007,” FRC, Ulaanbaator, Mongolia, 13–22.

Table 13. Pension Funds in Mongolia, 2004 and 2007

	2004	2007
Number of beneficiaries		
Social welfare benefits	155,500	1,176,600
Pension funds	270,400	294,200
Benefits Paid		
Social welfare benefits	\$9,359,090	\$72,200,473
Pension funds	\$5,963,516	\$13,450,099
Average payment		
Social welfare benefits	\$60.2	\$61.4
Pension funds	\$22.1	\$45.7
Population		
% of population receiving social benefits	6.1%	44.6%
% receiving pensions	10.7%	11.2%

Source: NSO, 2009, National Statistics Office Yearbook.

Credit Unions

The first credit unions in Mongolia were established during the early days of the nationalist revolution in the 1920s. A new and modernized credit union movement began in the early 1990s when two new credit unions were established. With government and donor support, the credit union movement has experienced a nearly 18-year period of unfettered growth nationwide. By 2007, approximately 192 cooperatives were operating.⁴¹

For many years, credit unions, whose target markets are often microborrowers, were self-regulated (with only a fleeting degree of monitoring from the Bank of Mongolia). Quite often these institutions engaged in pyramid schemes and speculative deposit taking and/or lending practices. By the time the Financial Regulatory Commission (FRC) was established in the mid-2000s and began regulating the sector, a credit union crisis was already advanced that led to massive forced closures. However, during this time a number of both urban and rural credit unions adopted WOCCU international standards of good practice. These cooperatives continue to exist today. At end December 2007, these 192 credit unions accounted for approximately 22,000 members, MNT 18 million in loans, and MNT 36 million in assets.⁴²

⁴¹ IMF, 2008, "Mongolia: Financial System Stability Assessment."

⁴² IMF, 2008, "Mongolia: Selected Issues and Statistical Appendix," IMF, Washington, DC, 32.

Informal Finance In Mongolia, as in other countries, informal financial arrangements are widespread, perhaps far more widespread than generally recognized. Especially in rural areas, informal financing is still very important. The full extent of its importance and the possible lessons it could provide formal financial institutions have not yet been adequately explored.⁴³

Market Structures

Financial Sector and Microfinance Liabilities

In recent years, the role of banks in intermediation in the Mongolian economy has expanded. In 2007, current accounts increased by 75.7 percent to \$605.6 million and deposits, by 46.0 percent to \$1.3 billion. The increase in deposits and loans from banks resulted in an increase in total banking sector assets by 51.2 percent to \$2.9 billion, which represented 71.9 percent of GDP in 2007. This percentage was 3.5 times higher in 2007 than during the banking crisis of 1996–1998. As the assets of the banking sector have risen, loans and financing to the private sector have also steadily increased. In 2007, loan activities of banks intensified, and the share of loans in total assets was 64.5 percent, an increase of 7.5 percent over 2006. As a result, the proportion of cash in total assets declined to 24.6 percent.⁴⁴

Total loans outstanding grew on average by 81.5 percent each year between 2000 and 2005, then by 42 percent (rising to \$1.05 billion) in 2006, 68.1 percent (to \$1.76 billion) in 2007, and 32.1 percent (to \$2.38 billion) in September 2008. However, total loans outstanding decreased by about \$20 million by September 2008, when compared to September 2007.⁴⁵ In August 2008 private sector loans as a proportion of all loans stood at 56.9 percent of total lending (of which 49 percent was in foreign currency).

As mentioned previously, total microfinance assets are difficult to establish since most commercial banks also provide services to typical low-income, that is, microfinance, clients. The five largest commercial banks that are involved in microfinance have approximately 43 percent of total assets of the sector. Banks are entitled to mobilize savings; however, this appears to be a funding source that is still not really used to its full extent, indicating that the major funding sources remain equity and external borrowing.

⁴³ ADB, “Rural Finance,” 174.

⁴⁴ BoM, 2008, “Annual Report 2007.”

⁴⁵ BoM, 2008, “Monthly Statistical Bulletin, no. 10 (October).” In October, only Golomt, Capital, Xacbank, National Investment Banking, and Chinggis Khaan Bank did not report decreasing numbers of outstanding loans.

Table 14. Financial Market Structure, 2007 (\$ millions)

Type of financial institution	Number	Deposits	Loans	Assets	% Assets
Private commercial Banks	16	1,810.9	1,758.8	2,805.0	95.7%
Domestic	6	n/a	n/a	827.2	28.2 %
With international shareholders	10	n/a	n/a	1,977.8	67.5 %
Nonbank financial institutions	379	n/a	n/a	125.7	4.3%
Insurance companies	15	Not allowed to accept deposits	n/a	24.0	0.8 %
a) Life insurance	1		n/a	0	0.0 %
b) Non-life insurance	15		n/a	24.0	0.8 %
Financial companies	137		n/a	56.5	1.9 %
Securities firms/brokerages	35		n/a	13.7	0.5 %
Credit unions	192	n/a	n/a	30.8	1.0 %
Total financial system	395			2,930.7	100 %

Source: IMF, 2008, “Mongolia: Financial Stability Assessment.”

While there is limited data available, it is estimated that a high percentage of the loans extended by private commercial banks are denominated in U.S. dollars. This fact is primarily due to limited interbank lending activity in Mongolia. The rapid depreciation of the togrog against the dollar is therefore likely to put pressure on profitability, as banks make loan repayments.

Performance

Financial sector

Generally, the financial performance of banks improved over the three-year period, 2006–2008. In 2007, the capital of banks increased by 27.6 percent, mainly as a result of increased profits and subordinated debt.⁴⁶ The capital adequacy ratio has been 14–24 percent since 1999, which is 1.8–3 times higher than the international standard of 8 percent set by the Basel Committee.

Competition among banks has increased and the use of available funds has been enhanced, as a result of which the capital adequacy ratio fell to 14.2 percent in 2007.⁴⁷ In 2007, return on assets (ROA) was 2.5 percent in the sector, and return on equity (ROE), 20.8 percent—relatively high rates compared to other developing countries. While the interest margin to gross income was 28.3 percent, noninterest expenses to gross income declined to

⁴⁶ BoM, 2008, “Annual Report 2007.”

⁴⁷ Ibid.

46.5 percent (a drop of 8.9 percent since 2006), which indicated an improvement in operational efficiency (see table 15).⁴⁸

Table 15. Financial Performance Indicators for the Banking Sector, 2004–2007

	2004	2005	2006	2007
Growth of loan portfolio	37.1 %	41.7%	42.2 %	68.1 %
Capital adequacy rate	20.0 %	18.2 %	18.1 %	14.2 %
NPLs to gross loans	6.0 %	5.6 %	4.7 %	3.2 %
ROA (after tax)	2.5 %	2.2 %	2.7 %	2.5 %
ROE (after tax)	12.3 %	12.1 %	14.3 %	20.8 %
Interest margin to gross income	31.5 %	30.9 %	27.8 %	28.3 %
Noninterest expenses to gross income	58.8 %	54.3 %	55.4 %	46.5 %

Source: BoM, 2008, “Annual Report 2007.”

Although the absolute number of NPLs increased by 13.8 percent in 2006 and 14.8 percent in 2007, the proportion of NPLs among total loans fell to below 2.8 percent as of August 2008. This proportion was a far cry from the 41 percent of 1998 and is perhaps due to strong growth of the total loan portfolio (which increased by 42.2 percent in 2006 and by 68.1 percent in 2007). The measures adopted by banks to strengthen their credit and risk management in the past years also contributed to improved asset quality to some degree.

Financial sector profitability and interest rate spreads declined in the first half of 2008 because of decreasing numbers of new loans, increased competition, and the large spike in inflation. The devaluation of the togrog also increased the instability of the macroeconomic environment of Mongolia. Since a significant share of external borrowing is in foreign currency, even though such obligations are partly offset through onlending in foreign currencies to end customers, the recent devaluation is a concern.

In October and early November 2008, rumors abounded regarding a possible financial sector crisis, resulting in sudden, large cash withdrawals. While these withdrawals could not be termed a run on the banks, they were a cause of general concern in both the financial sector and among policy makers.

Appropriate risk management, especially in times of financial sector crisis, is crucial. Banks have differing levels of sophistication in risk management. The need for improvement in this area is often commented on by international rating companies, such as Moody’s 2007 report on Khan Bank.

⁴⁸ Ibid.

Microfinance Sector

Among commercial banks involved in microfinance, Khan Bank and XacBank have experienced the fastest growth in loans outstanding in recent years, from \$66.7 million in 2004 to \$564.0 million in September 2008 (Khan Bank) and from \$16.5 million to \$136.5 million (XacBank). Meanwhile, the market share of Khan Bank increased from 13.25 percent to 23.67 percent, and for XacBank, from 3.3 percent to 5.7 percent. The ROA and ROE of both banks were also higher than the average rate of the banking sector as a whole in 2007(see table 16).

A considerable portion of the loan portfolio of the key microfinance players is financed through external borrowing, a large share of which is in foreign currency. Since only part of these foreign currency borrowings can be offset by onlending in foreign currency, these liabilities are a growing concern. They will potentially have an impact on the profitability and/or liquidity of these institutions as a result of the current financial crisis.

Additionally, the banking sector has not yet priced inflation into banking products. Specifically, the margin charged is between 18 and 25 percent, which is substantially lower than the inflation rate of approximately 30 percent. Additionally, due to high inflation there are less deposits, pushing banks to increase interest rates on deposits to over 15 percent. Both factors will put additional pressure on bank profitability.

Table 16. Performance Indicators of the Five Largest Mongolian Banks with Microfinance Portfolios, 2007–2008

	Market share (% of total loan portfolio)		Size of loan portfolio (\$ millions)		Capital adequacy %	Total equity (\$ millions)	Deposits (\$ millions)	Total Assets (\$ millions)	ROA	ROE
	2004	Sept. 2008	2004	Sept. 2008	2007	2007	2007	2007	2007	2007
Khan	13.35%	23.67%	66.7	564.0	9.63 %	49.4	422.0	513.8	4.10 %	42.87 %
Zoos	6.26%	6.70%	31.3	159.6	10.18 %	23.9	92.4	235.0	1.39 %	13.68 %
Post	6.76%	6.26%	33.7	149.1	n/a	14.4	na	251.8	na	na
XacBank	3.30%	5.73%	16.5	136.5	9.22 %	11.3	66.7	122.7	2.43 %	23.39 %
Capitron	3.43%	3.16%	17.1	75.2	9.14 %	8.8	66.9	96.2	0.48 %	5.27 %
Total	33.10%	44.52%								

Source: BoM, 2008, “Annual Report 2007”; MIX, 2007, “Microfinance in Mongolia”; and the 2007 annual reports of Zoos Bank, Xacbank, and Capitron Bank.

Note: na – not available.

Financial Infrastructure

Capital Market

The capital market in Mongolia is led by the stock market; the bond market has not yet played a big role. The Mongolia Stock Exchange (MSE) was established in 1991 as a vehicle to implement the government's privatization of large state-owned enterprises. It is regulated by the Mongolian Stock Exchange Commission and the Securities Law of Mongolia (published in 1998). As of year-end 2007, there were 384 listed companies and 30 brokerage companies (see table 17).

With the influence of the global financial crisis, the “top 20” average index of the MSE was 6,274 points on November 24, 2008, a decrease of 3,985 points since the beginning of 2008. During October 2008, the index decreased by 1,777 points compared with September, and the total market capitalization of listed companies decreased dramatically.

Table 17. Mongolian Stock Exchange, 2004–2008

	2004	2007	July 2008
Number of listed companies	395	384	n/a
Daily average trading value (\$)	2,150 ^a	209,920 ^b	197,384
Annual trading value (\$ millions)	0.5	53	n/a
Brokerage companies	25	30	30
Top 20 index closing	586	10,710	6,274 (24 Nov.)
Total market capitalization (\$ millions)	25	612	667

Source: MSE, 2008, “Annual Report 2007,” MSE, Ulaanbaatar, Mongolia.

Notes: According to the source above, the exchange rate for 2004 was \$1 = MNT 1,209 and for 2007, \$1 = MNT 1,169.97.

Specific needs for improved institutional capabilities of MSE members include: (i) improving the clearing and settlement systems and adopting new technologies, (ii) enhancing the knowledge and skills of employees, (iii) organizing public education on bond market issues, (iv) strengthening disclosure requirements for bond issuers, and (v) setting prudential limits on individual exposures.

Once further improvements to the enabling environment are enacted, new financial instruments and products could include asset-backed bonds, inflation-indexed bonds, floating interest rate bonds, and infrastructure bonds. Secondary liquidity markets might include instruments such as futures, swaps, and repurchase contracts.

Payment Systems

The BoM ensures the operation of interbank payment systems. All banks are required to have a settlement account with the central bank. Each bank is then responsible for its own interbank indebtedness and can settle its own

account. The BoM guarantees the availability of funds for settlement, thus eliminating the liquidity and credit risks associated with the settlement assets of system participants.

The Switch Clearing Center (SCC) of the BoM is the core mechanism of the entire payment system for both high- and low-value payments. The SCC is an automated clearinghouse system in which the processing of payments is fully automated and only electronic payment instructions are accepted and processed.⁴⁹

The Bank of Mongolia is presently working to improve the interbank payment and clearance system—upgrading it to become fully real time. Discussions are underway to implement the necessary infrastructure for such a system for foreign currency and bonds, which would be functional in real time and fully compliant with international systems.

Nearly all commercial banks in Mongolia issue debit cards and many, but not all, provide credit card services. These cards are increasingly being used for a variety of purposes, including the payment of salaries and utilities. As of year-end 2007, there were 538,900 cardholders in Mongolia who collectively conducted 4.4 million transactions valued at \$475.75 million. The clearing of card transactions is conducted through two banks (Trade & Development Bank and Golomt Bank), which has caused inefficiencies and confusion. Thus, the Bank of Mongolia is also working toward the creation of a unified, centralized bank card clearing network.

The amount of remittances from Mongolians working abroad is enormous (\$194 million in 2007). The partner banks of the three biggest money transfer companies are listed in table 18.

Table 18. Partner Banks of the Leading Money Transfer Companies

Money transfer Companies	Western Union	MoneyGram	Coinstar Money Transfer
Partner banks in Mongolia	Zoos Bank	Trade and Development Bank	Capital Bank
	Agricultural Bank	Anod Bank	
	Golomt Bank	Capitron Bank	
	XacBank		

Source: Web sites of Western Union, MoneyGram, Coinstar Money Transfer (accessed November 2008).

⁴⁹ BoM, 2007, “The Bank of Mongolia’s Policy on Payment System” (July 21), document no. 307, BoM, Ulaanbaator, Mongolia.

Deposit Insurance With the exception of a small private effort (between one bank and one insurance company), Mongolia does not provide deposit insurance. Discussions have been underway between the central bank, parliament, and the financial sector for many years, with no tangible results to date. A draft deposit insurance law has been presented to parliament. The draft includes provisions that the system will be compulsory for all commercial banks and funded ex ante. Premiums are envisaged at a flat quarterly rate of 0.08 percent of a bank's total deposits, with coverage of household deposits up to MNT 1.5 million (\$1,262, around 80 percent of per capita GDP in 2007). In addition, emergency financing from the government is envisaged, especially during crisis situations. In the absence of deposit insurance, the government quietly but firmly backed depositors during the 2007 fraud at the Savings Bank and, through a parliamentary decree, is backing up to \$28.5 million in savings and loan cooperative losses.⁵⁰

**Accounting Standards/
Audit and Legal
Services**

Commercial entities in Mongolia follow generally accepted international accounting standards and are required to engage licensed auditing firms. Auditors of financial entities must obtain a special license. Auditing of large banks is generally conducted by offshore auditors, such as KPMG and Price Waterhouse Coopers. The quality and depth of accounting and auditing of NBFIs and credit unions in Mongolia varies widely and no generalizations can be made. Credit unions utilize a variation of the World Council of Credit Unions (WOCCU) system, PEARLS,⁵¹ to track reporting on prudential norms. The banking sector is largely in compliance with all Basel accords. Information disclosure in the audited financial statements of banks is largely based on international financial reporting standards and auditors' notes often, though not always, provide statements of compliance. A Web review of the online availability of reports by the largest banks and MFIs is shown in table 19.

Table 19. Online Availability of Bank Financial Reports, as of November 2008

	BoM	TDB Bank	Golomt Bank	Khan Bank	Post Bank	Xac Bank
Annual report	No	No	Yes	Yes	Yes	Yes
Audited statements 2007	No	No	Yes	Yes	Yes	Yes
2008 updates	Yes	No	Yes	No	Yes	No

Source: Official Web sites of each bank listed above (accessed November 2008).

⁵⁰ IMF, 2008, "Mongolia: Financial System Stability Assessment."

⁵¹ PEARLS is a financial performance monitoring system designed to offer management guidance to credit unions and other savings institutions.

The mandatory provisioning requirements for nonperforming loans (NPLs) have been modified by the BoM so as to allow for internal credit rating systems. A random review of bank provisions and reserves in relation to NPLs conducted for this report found a mostly adequate system. Provisioning by credit unions and NBFIs is occasionally inadequate.

Ratings and Credit Information

The BoM has worked with the leading rating agencies—Fitch, Moody’s, and Standard & Poor’s. Most larger and some smaller banks (such as XacBank) have had institutional ratings conducted by Moody’s.⁵² The Trade & Development Bank and Khan Bank have also had ratings conducted based on their international bond offerings. Planet Finance conducted “Planet Ratings” of both Khan Bank and XacBank in 2006. TransCapital (an NBFIs) was rated by MicroFinanza in early 2008. There are no rating agencies in Mongolia, either domestic or international. The second-tier apex institution, the Microfinance Development Fund (MDF), is currently considering grant financing to establish a Mongolian microfinance rating agency.

The only credit information bureau in existence in the country is housed in the BoM. The importance of a functional credit bureau is of great significance to the microborrower, as the current system of credit checks can be slow and cause clients undue cost and time burdens. In addition, functional credit bureau systems allow microborrowers to establish a credit history, which may make it easier to enhance the range of financial service options as the number of these borrowers grow.

In its current state, the BoM credit bureau does not provide information on a borrower’s credit history or performance, but instead merely tracks the names, amounts, and locations of current outstanding loans of all banks and NBFIs (mandatory), as well as those of other financial institutions (voluntary). The system has proven inefficient and inadequate, not only due to internal limitations inherent in the central bank, but also due to purposeful lack of on-time reporting and/or full disclosure by banks. The management information system (MIS) of the credit information bureau has been upgraded in recent years, but still has obvious limitations. A draft credit bureau law is under discussion, although the time line for ratification is not clear.

The annual meeting of the Mongolian Banker’s Association (MBA), held at the end of September 2008, discussed the establishment of a private credit bureau sponsored by the MBA. If a private credit bureau is established, the rights, protections, and needs of microborrowers (which comprise the vast majority of all borrowers in Mongolia) will need to be carefully considered. The means of transparency and accountability by the bureau owners would also require careful attention. Furthermore, beyond the obvious need for

⁵² XacBank received a rating from Moody’s on March 28, 2008: BA2 and stable.

sustainability, technology and a legal framework for reporting and access by financial institutions that are not members of the MBA will be needed.⁵³

Apex Banks

There are no licensed apex banks in Mongolia. There is, however, a government-led wholesale lending institution, the MicroFinance Development Fund (MDF). The MDF is a subcomponent of the Sustainable Livelihoods Program of the government and the World Bank. The goal of the MDF is to expand the outreach of sustainable microfinance services to poor and vulnerable low-income individuals, households, and microenterprises throughout Mongolia. Its strategy has been to provide wholesale lending facilities to commercial banks and NBFIs that subsequently onlend to MDF-targeted clients. Savings and loan cooperatives, NGOs, and other microfinance-related retail entities are excluded as clients of the MDF.

The wholesale funding institution has grown from its initial World Bank capitalization of approximately \$3.0 million to nearly \$5.0 million in late 2008. Over the four-year period 2005–2008, the MDF disbursed 30,251 loans collectively valued at approximately \$27 million. During 2008, the average loan size of the MFIs that received MDF funding was \$1,160, with an average term of 9.6 months. The MDF is planning for further growth by increasing its loan fund to more than \$13 million in the short term through a variety of funding sources. Due to delays in the new funding cycle, MDF activities in 2008 were at a low point, with loans active only to four banks and two NBFIs.⁵⁴

Discussions have been underway for a number of years regarding the creation of a development bank in Mongolia. These discussions have been especially active among certain members of parliament. However, to date the government has not received support from the international community for such an initiative.

Financial Industry Associations

Nongovernmental agencies that represent subsectors of Mongolia's financial industry include the MBA (established in 2005, with 19 members as of late 2008), the Mongolia Leasing Association, the National Association of Insurance Companies, and the Mongolian Confederation of Credit Unions. Mongolia is also a member of the Asia Pacific Banker's Association, the Asian Confederation of Credit Unions, the MicroFinance Centre, the Association of Development Financing Institutions in Asia and the Pacific, the World Savings Banks Institute, and the Microfinance Information Exchange (MIX).

⁵³ The MBA represents the interests of the 16 banks in Mongolia and 3 of the 131 NBFIs. None of the 202 credit unions are members or affiliates of the association.

⁵⁴ Information provided by the MDF, October 2008.

It should be noted that associations and institutions representing civil society and the private sector, while quite numerous in Mongolia generally, tend to suffer from problems of ineffective governance, leadership, and disunity. Industry associations are still very much on the learning curve with respect to their ability to differentiate between competitive self-interest and shared common interests. Association activities are therefore often less a response to the pro-active needs and strategies of members and more a response to the availability of donor funds.

Training, Education, and Consulting

The larger banks in the country have strong in-house training capabilities and have in recent years significantly increased their staff development budgets. Smaller banks, NBFIs, and credit unions are constrained both by a lack of in-house capabilities and the difficulty of competing with larger banks in terms of salary levels and the “status” of positions.

The MBA established a new and modern training facility, the Bank Training Center (BTC), in 1993. However, it failed to adopt a business model, which did not allow for anything but ad-hoc trainings and rental of space.⁵⁵ Jurisdiction of the BTC was placed under the Bank of Mongolia in 1997, but its training activities continued in an ad-hoc fashion.

As of this writing, the BTC was making efforts to strengthen its activities and improve the efficiency and quality of its trainings and seminars. In cooperation with German Technical Cooperation (BMZ), a project was started in 2005 that aims to create a viable business plan for BTC.

A large number of private and quasi-private sector institutions exist in Mongolia that provide demand-driven technical assistance, training, and consulting services to the financial sector. Outsourcing of such services by financial institutions has become quite common and their willingness and ability to pay competitive fees for such services has vastly improved. There is only one company that markets itself as a specialist in financial sector strengthening (Achid.Org), yet many others provide similar services. The subsector leaders include the MIS industry, auditing firms, law firms, advertising and/or marketing companies, and management training providers.

Within the national university system, the School of Banking and Finance graduates the largest number of financial sector professionals. A number of other private and state universities also provide specific and sector-related training. The first lawyer with an advanced, specialized degree in banking law will graduate abroad in 2009. Unsurprisingly, the higher the level of

⁵⁵ GTZ, n.d., “Förderung von Finanzdienstleistern,” (German-language report on support for financial services providers in Mongolia), GTZ, Eschborn, Germany, <http://www.gtz.de/de/weltweit/asien-pazifik/mongolei/17004.htm> (accessed September 2009).

education, the greater the average monthly salary in both the private and public sectors.

Specific training for microfinance-related activities is also ad hoc in nature. The MDF has organized a number of microfinance trainings at both the national and rural level on a number of occasions, the most recent of which was cosponsored by the FRC. Led by XacBank, Mongolian MFIs hosted a high-profile, well-attended international conference on microfinance in July 2008. Other high-profile international microfinance events have previously been held in the country, including an international donor's conference organized by the United Nations Capital Development Fund (UNCDF). Mongolia has also become a focus for exposure tours by other countries, several of which have been hosted by XacBank. Discussion has been underway for a number of years to institutionalize microfinance training with no tangible results so far. A previous effort to introduce a microfinance curriculum into the national university system faded after initial enthusiasm.

Technology

Since 2005, the information and communication technology (ICT) sector in Mongolia has developed thanks to a favorable regulatory framework and policies, the institutional set-up of the sector, and the commitment of private software, hardware, and infrastructure development companies that provide ICT services to citizens.⁵⁶

ICT development was promoted when the government established the Information and Communication Technology Authority (ICTA) under the direct supervision of the Prime Minister of Mongolia. In addition, the initiation and implementation of the “e-Mongolia” national program (which required changes to the legal and regulatory framework for ICT), together with cooperation and coordination with local and international companies, organizations, and donors,⁵⁷ has supported ICT development. An important decision regarding ICT infrastructure was to separate services from networks. The Mongolian Telecom Company (MTC) has been divided into two companies: the service provider (ServCo) and the network maintenance company (NetCo). This decision created an environment in which service companies use the network infrastructure on a competitive basis.

Big challenges remain for the ICT sector in Mongolia. First, draft laws on ICT are still subject to discussion. Second, ICT has to be integrated into public sector reforms. Third, the ICT capabilities of the population need to be strengthened, with new curricula adapted at the secondary and tertiary education levels. Fourth, the digital gap between the rural and urban populations needs to be closed. (ICT penetration in rural areas is much lower than in urban areas.) For example, the 7,726 rural users of fixed-line

⁵⁶ This section is based on Felix Lobrero and Patricia B. Arinto, eds., 2007, *Digital Review of Asia Pacific 2007–2008*, 3rd edition (Los Angeles: Sage/ IDRC (International Development Research Centre)/Orbicom).

⁵⁷ Among the donors are the World Bank, the Asian Development Bank, the U.S. Agency for International Development, and the International Development Research Centre of Canada.

telephones represent only 6.4 percent of total telecommunications service users.⁵⁸ Moreover, 86 percent of ICT businesses are concentrated in the major cities of Ulaanbaatar, Darkhan, and Erdenet. Given that the majority of the population lives in rural areas, this concentration is worrisome. As of 2007, there were only 5 computers per 100 inhabitants, 42 persons in 1,000 used the Internet, and 1 person in 500 was a broadband subscriber.⁵⁹

Given Mongolia's low population density, mobile phone banking seems to be a promising option, offering wider access and more cost efficiency, as well as increased speed and reliability. Khan Bank was the first bank to introduce mobile phone banking (in December 2007). Its mobile banking annual service fee is MNT 3,000. There are no fees or commissions for transactions conducted via mobile banking, but 40 units (or MNT 40) are charged by Mobicom, the partner institution of Khan Bank, for encrypted messages sent from a mobile phone.⁶⁰

XacBank was planning to launch a mobile banking service in 2009 that was expected to benefit 300,000 Mongolians. CGAP is supporting XacBank with technical assistance and funding. The new service will enable people living in rural areas to make cash deposits, withdrawals, and transfers, as well as to receive loan disbursements and send remittances. Under the service, cash-handling services will be provided by merchants.⁶¹ Mongol Post Bank does not offer mobile phone banking services.

The positive impacts of mobile phone banking on the lives of the rural population are hampered by the severe limits of these services. As of this writing, four mobile phone service providers were in operation in Mongolia: Mobicom, Skytel, Unitel, and G Mobile.⁶² Some 33 percent of inhabitants of the country are mobile phone subscribers and roughly 41 percent of population has mobile signal coverage.⁶³

Consumer Financial Education

Consumer financial education programs have been neither designed nor tested in Mongolia for any segment of society. Discussions about the need for such services increased in 2008. The apex institution MDF has allocated grant funds to such projects in its budget and the BoM has mentioned it in

⁵⁸ ICTA, CRC, Intec, and MIDAS/MONITA, 2006, "White Paper on ICT Development in Mongolia—2006," Ulaanbaatar, Mongolia.

⁵⁹ Lobero and Arinto, 2007, *Digital Review of Asia Pacific 2007–2008*.

⁶⁰ See the Khan Bank Web site, <http://www.khanbank.com/> (choose "Business," then "Internet banking service"; accessed September 2009).

⁶¹ CGAP, 2008, "Mobile Phone Banking to Reach Rural Mongolia," press release, July 21, 2008, CGAP, Washington, DC, <http://www.cgap.org/p/site/c/template.rc/1.26.3005/> (accessed September 2009).

⁶² CGAP, n.d., "Technology Blog: Archive for Mongolia," CGAP, Washington, DC, <http://technology.cgap.org/category/geography/east-asia-pacific/mongolia/> (accessed September 2009).

⁶³ Lobero and Arinto, 2007, *Digital Review of Asia Pacific 2007–2008*.

its business planning documentation, but to date no concrete actions have been taken.

The lack of adequate consumer financial education has resulted, among other things, in low savings rates among poor people, a high rate of mismatch between loans and actual needs, misinformed choices regarding financial institution selection, predatory lending practices, and uneven dissemination of information on lending and savings rates. While research has neither qualified nor quantified the negative consequences of a lack of financial education, anecdotal evidence, together with the losses that have occurred in Mongolia as a result of failed credit unions and pyramid schemes, points to a national need for consumer financial education.

Legal, Regulatory, and Policy Framework

Regulation and Supervision

The Bank of Mongolia (BoM) is the entity responsible for supervising commercial banks. The Financial Regulatory Commission (FRC) is responsible for supervising nonbank financial institutions, including credit unions and nondeposit-taking lenders, capital markets, and insurance companies.⁶⁴ There is no supervisory authority responsible for leasing (including financial leasing).⁶⁵ A Financial Stability Board was formed in 2007 to coordinate policy between the BoM, the FRC, and the Ministry of Finance.

Both the BoM and the FRC are under the direct supervision of the parliament and are known for their autonomy from the government. The central bank is well staffed and funded, and its staff is highly skilled. Certain governance deficiencies exist, but are in the process of being improved. The FRC is a newer institution than the Bank of Mongolia and is still struggling with the implementation of systems, as well as staffing, budgeting, and establishing supervisory capabilities. It is also burdened with a much higher number of institutions to regulate than is the central bank (653 versus 16).

Both the Bank of Mongolia and the FRC have in certain cases not taken requisite remedial action regarding low-performing financial institutions. The central bank has not taken an interventionist role with respect to commercial banks since the banking crises of the late 1990s. The FRC, backed by parliamentary probes and a high-level government commission, forced all credit unions to re-apply for their licenses following the 2006 credit union debacle. This requirement led to the withdrawal of licenses from more than

⁶⁴ Nyamaa Togtokhbariul, 2007, "Microfinance Regulation and Supervision in Mongolia," BoM, Ulaanbaator, Mongolia.

⁶⁵ This situation may change with the enactment of a revised financial company leasing law, which is currently under discussion.

600 institutions. The FRC has also temporarily and/or permanently suspended the licenses of a number of NBFIs.⁶⁶

Banking laws specifically prohibit the government from engaging in lending activities. Multilateral agreements and a specific provision of the central bank law provide specific loopholes that allow the government to engage in direct intermediation of financial services under certain conditions. Government involvement in the secondary housing market and socially targeted micro and SME lending thus continues, yet at a substantially lower level than in previous years. The central bank law expressly prohibits the government from setting interest rate controls on loans.⁶⁷

When assessing the adherence of Mongol banks to the “Basel Core Principles for Effective Banking Supervision,” the IMF found that banking supervision in Mongolia is relatively well developed compared to other countries at the same stage of transition. The IMF concluded that the BoM has built the necessary expertise for effective banking supervision.⁶⁸ Gaps in the legal and regulatory framework that need to be addressed include the fact that legislation does not allow for supervision to be conducted on a consolidated basis. A legal definition of “connected parties” is also needed in order to better monitor large exposures. In addition, the legal requirements relating to the prior experience and background of bank managers and board members need to be strengthened and legal protections provided for BoM supervisors who carry out their duties in good faith

⁶⁶ In 2007 the FRC suspended the licenses of 14 NBFIs and revoked the licenses of 7 more (IMF, 2008, “Mongolia: Financial System Stability Assessment.”).

⁶⁷ According to the research conducted for this report, in most countries, political and social pressure for government-backed low-interest loan programs is evident, yet in most cases these pressures have been successfully resisted by key policy makers in Mongolia.

⁶⁸ IMF, 2008, “Mongolia: Financial System Stability Assessment.”

Table 20. IMF Recommendations on the Regulatory Framework, 2008

Central bank core principle	Recommendation
CP 16. Interest rate risk in the banking book	Require all banks to implement the interest risk methodology commensurate with their activities.
CP 17. Internal control and audit	Ensure that implementation of the Corporate Governance Principles for Banks, issued in 2006, is completed by first quarter 2008.
CP 18. Abuse of financial services	Allocate additional human resources to the Financial Intelligence Units and train supervisors more fully in this area.
CP 21. Supervisory reporting	Issue guidelines on how to conduct consolidated supervision.
CP 22. Accounting and disclosure	Increase the frequency of contacts with outside auditors.
CP 23. Corrective and remedial powers of supervisors	Review and increase the schedule of fines.
CP 24. Consolidated supervision	Introduce an amendment to the banking law on consolidated supervision.
CP 25. Home-host relationships	Prepare regulations and guidelines in the banking law for the eventuality that Mongolian banks seek to operate internationally and vice-versa.

Source: IMF, 2008, "Mongolia: Financial System Stability Assessment."

Note: CP – Core Principle.

The continued resistance by many of Mongolia's largest companies to introducing sound principles of corporate governance contaminates public trust in capital markets. Nevertheless, it is expected that the Financial Regulatory Commission, together with the Ministry of Finance and the parliament (together with international donor support), will continue to enhance the legal and regulatory framework with respect to corporate governance, information disclosure requirements, and the protection of investor rights. The lack of adequate protection of the rights of minority shareholders has been identified as a constraint to stock market development by both international agencies and certain government specialists.

A 2008 review by the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) noted that the legal and regulatory environment of the country would be further enhanced through (i) adoption of the Principles of Securities Regulation of the International Organization of Securities Commissions; (ii) implementation of international reporting standards, (iii) enactment of further improvements to accounting and auditing standards, (iv) amending the Law on Securities Market and the Company Law, (v) adoption of a law on mortgage-backed securities, and (vi) introduction of regulations and mechanisms for the participation of insurance companies in the bond market.

Microfinance is regulated by the same laws and regulations that govern the mainstream financial system. This means that specific laws do not directly

relate to microfinance institutions, their creation, or licensing, nor do specific tax breaks or a regulatory or supervisory regime apply to them. Likewise, there is no specific national policy on microfinance, nor has there been one in the past.⁶⁹

Legal Environment The general legal environment has made great strides over the past 18 years. The system primarily follows Germanic law, with a civil code and court rulings based on interpretation versus precedence. The legal environment is open towards foreign investment, with few cases of discrimination towards foreigners. (Chinese citizens in particular had previously faced discrimination.⁷⁰) The agency representing foreign investors (FIFTA) is also known to be helpful and efficient.

For both the borrower and the lender, the pledging of collateral (whether movable or immovable assets) can be highly burdensome. The immovable property registry continues to improve (with significant online and committed donor support), yet is still plagued by inefficiencies. The court system is painfully slow in the settlement of debt claims (especially between individuals and smaller financial institutions) and the enforcement of court rulings can be even more burdensome. Significant improvements in the skill level of judges, particularly in commercial law, have been observed.

The Mongolian tax code is one of the world's most friendly, with a flat corporate tax and deduction opportunities for corporate investment. Key agencies involved with tax enforcement, including the Customs Office, are still woefully lacking skills, plagued by inefficiencies, and often accused of corruption. The agencies involved in business inspections and certifications are also known to be inefficient and corrupt.

The Mongolian government employs a limited regulatory regime for controlling foreign exchange, maintaining exceptionally liberal policies for investment remittances.

Mongolia's bankruptcy provisions and procedures for securing the rights of creditors still need improvement. Mongolian law allows for mortgages and other loan instruments backed by securitized collateral. However, rudimentary systems for determining titles and liens and collecting debts make lending based on local security risky. Banks frequently complain that onerous foreclosure rules are barely workable and unfair to creditors. Due to the inefficiencies of these systems, Mongolian lenders risk lending based on collateral that a debtor may not actually own, or which may have already been offered as security for another debt. The legal system provides for foreclosure, but this process has proved exceptionally onerous and time consuming. Court cases have been known to take up to five years to fully

⁶⁹ Togtokhbariul, 2007, "Microfinance Regulation and Supervision in Mongolia."

⁷⁰ U.S. Department of State, 2007, "Mongolia: Country Reports on Human Rights Practices," U.S. Department of State, Washington, DC.

settle. In addition, enforcement of court decisions is expensive and can be exceptionally difficult.

Dispute resolution as an alternative to the court system is still in its infancy and not widely accepted. The Mongolian Chamber of Commerce is the only entity active in this area. However, at least three international arbitration cases have been resolved, all of which favored Mongolia.

An anticorruption law has been enacted and the National Anti-Corruption Council became functional in 2006, yet the full effect of its work has yet to be felt. A National Commission on Human Rights was established in 2001.

Important legislation directly related to the financial sector is at various stages of discussion, including laws on mortgages, a universal bank, deposit insurance, and savings and loan cooperatives (the latter has been stalled since 2005), as well as modifications to the current NBF law.

Corporate Governance

As the majority of commercial banks have foreign ownership, corporate governance systems are generally robust and productive, with several international members on their boards.

Gap Analysis

Summary of Gaps

Mongolia has made great strides over the last ten years in financial system intermediation so that it can provide financing to people at the bottom of the pyramid. However, there is still room for improvement and growth, opportunities for which are outlined below. It cannot be overstated that the main issue facing the Mongolian microfinance sector is access to financing in local currency. With the turmoil in the financial sector and increased inflation, microfinance banks will not be able to rely on customer deposits as a source of financing.

Microfinance Institutions

- development of mechanisms to improve outreach in rural areas through IT improvements (e.g., mobile phone banking, points of sale, Internet banking)
- improvement of product mix to increase customer outreach through agency arrangements (e.g., for insurance), noncollateralized loan products, and savings mobilization
- improved risk management systems to monitor and/or hedge foreign currency borrowing
- funding diversification through savings mobilization

Other Financial Institutions

- institutional capacity building
- capacity and awareness building regarding the viability of effective services for the poor
- life insurance (bundled with financial institution loans through agent relationships)
- index-based livestock insurance (standalone and bundled with loans through agent relationships)
- financial leasing for herders (e.g., alternative energy, consumer goods, production equipment)
- financial leasing for urban and semi-urban microenterprises that are transitioning to become SMEs

Financial Sector Infrastructure

- institutional improvements to rating and research services that better monitor financial institution performance related to such issues as impact on the environment, depth of outreach, and contributions to productivity
- establishment of secondary markets for insurance, including the institutionalization of index-based livestock reinsurance, and reinvigoration of the secondary market for mortgage lending
- establishment of deposit insurance
- institutionalization of microfinance training
- establishing a privatized credit bureau that would balance the needs of the financial industry, consumers, policy makers, and smaller financial institutions
- IT improvements to better enhance the information technology services of financial institutions (e.g., point-of-sale and mobile phone banking, especially in rural areas)

Donor Activities

The list of investors in Mongolia is long, but the five major development partners of Mongolia are the Asian Development Bank (ADB), World Bank, the United States, Japan, and Germany. These five donors account for about 87 percent of overseas development assistance to the country. Other multilateral donors active in Mongolia include the IFC, European Union, the European Bank for Reconstruction and Development (EBRD), KfW, GTZ (German Technical Cooperation), and various U.N. agencies.⁷¹

⁷¹ Government of Mongolia, 2007, "Mongolia: Response to the Questionnaire of the Co-chairs," U.N. General Assembly, 61st Session, Environmental Governance: Statements during Informal Consultations in January 2007, UN, New York, New York, http://www.un.org/ga/president/61/follow-up/environment/statementsJan07/Mongolia_response_to_questionnaire.pdf (accessed September 2009).

IFC. Mongolia has been an IFC member since 1991. The IFC's integrated advisory and investment strategy in Mongolia, delivered through its office in Ulaanbaatar, focuses largely on four broad areas: the financial sector, natural resources, infrastructure, and the development of the industrial and agribusiness sectors.

The IFC's work includes investments to support banking consolidation, increase lending volumes to target underserved segments, expand product and service offerings in the market, as well as to promote institutional strengthening, together with advisory services on improving risk management and best practice lending standards. The IFC has completed several financial sector transactions, including debt and equity investments in Mongolian banks. With support from the Japanese government, it has also committed funds to a project that seeks to develop a leasing market in the country by creating an enabling legal and regulatory environment and opportunities for local and foreign leasing investment.

KfW. On behalf of the German federal government, KfW Development Bank has provided assistance to Mongolia since 1991 in various sectors, including energy, telecommunications, financial services, infrastructure, and health services. KfW established an office in Ulaanbaatar in 2006.

Within the financial sector, KfW promotes the development of the private sector and the financial system through various lending programs for SMEs. In the microfinance sector KfW is supporting Credit Mongol and XacBank.

KfW, together with GTZ, became involved in housing finance through a private sector initiative—the Mongolian Mortgage Corporation (MIK)—that is backed by banks, the BoM, and the Ministry of Finance.

Other donor activities. The Asian Development Bank (ADB) is providing technical assistance to a capital markets development program and a Financial Regulation and Governance Program. Support for the latter program, which also includes a loan, is aimed at creating a broad-based financial sector with alternative channels of financial intermediation.

The **World Bank** has two active projects related to Mongolia's financial sector: the Index-based Livestock Insurance Project (which continues until June 2011) and the Financial Capacity Development Project (which supports institutional capacity building of banking institutions to reduce systemic risks and enhance financial intermediation). The second program was initiated in June 2002 and will last through June 2009. The World Bank also provides ongoing funding to the MDF.

USAID does not have an assistance program with a special focus on finance. Nonetheless, the rural development initiative GOBI is trying to establish rural business linkages to the financial services sector.

The ***EBRD*** accepted Mongolia as a country of operations in 2006. Among its strategic priorities are the enterprise, natural resources, infrastructure, and financial sectors. EBRD activities are aimed at overcoming limited access to finance. The Bank finances micro and small enterprises through credit lines to commercial banks and microlending institutions and is planning to roll out a Trade Facilitation Program to local banks. Additionally, it assesses opportunities for loans and equity participation and supports the development of the nonbanking financial sector.

Other investors and donors that are providing technical assistance in Mongolia, whether via loans and/or equity and/or other debt instruments, include Dexia, Oxfam, Novib, MicroVest, MerciCorps, ShoreCap, Triodos Bank, Triodos Fair Share, FMO, Blue Orchard, Morgan Stanley, Deutsche Bank, Credit Suisse, Calvert Foundation, Symbiotics, OikoCredit, ADRA, VetNet, World Vision, and Habitat for Humanity.

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