

ONE. INTRODUCTION

In order to develop the legal environment of the Mongolian capital market in line with international standards, as well as to develop and introduce an appropriate regulatory structure, support the activities of professional participants in the market, and build staff competences, the Financial Regulatory Commission (FRC) announced 2007 as the year for capital market development. Within this framework, the main objective of the FRC was to implement tasks indicated in the Action Plan of the FRC.

The FRC has completed the following tasks in order to achieve its goals and objectives: the Commission has developed an appropriate organizational structure for the FRC and job descriptions for each department; strengthened staff capacity; standardized all forms of activities; created and maintained a good quality working environment; ensured public awareness of the activities and functions of the newly established FRC; promoted expansion of both foreign and domestic cooperation; regularized supervisory activities to ensure compliance with relevant standards imposed on entities under FRC regulation; and improved efficiency of both off-site and on-site supervision.

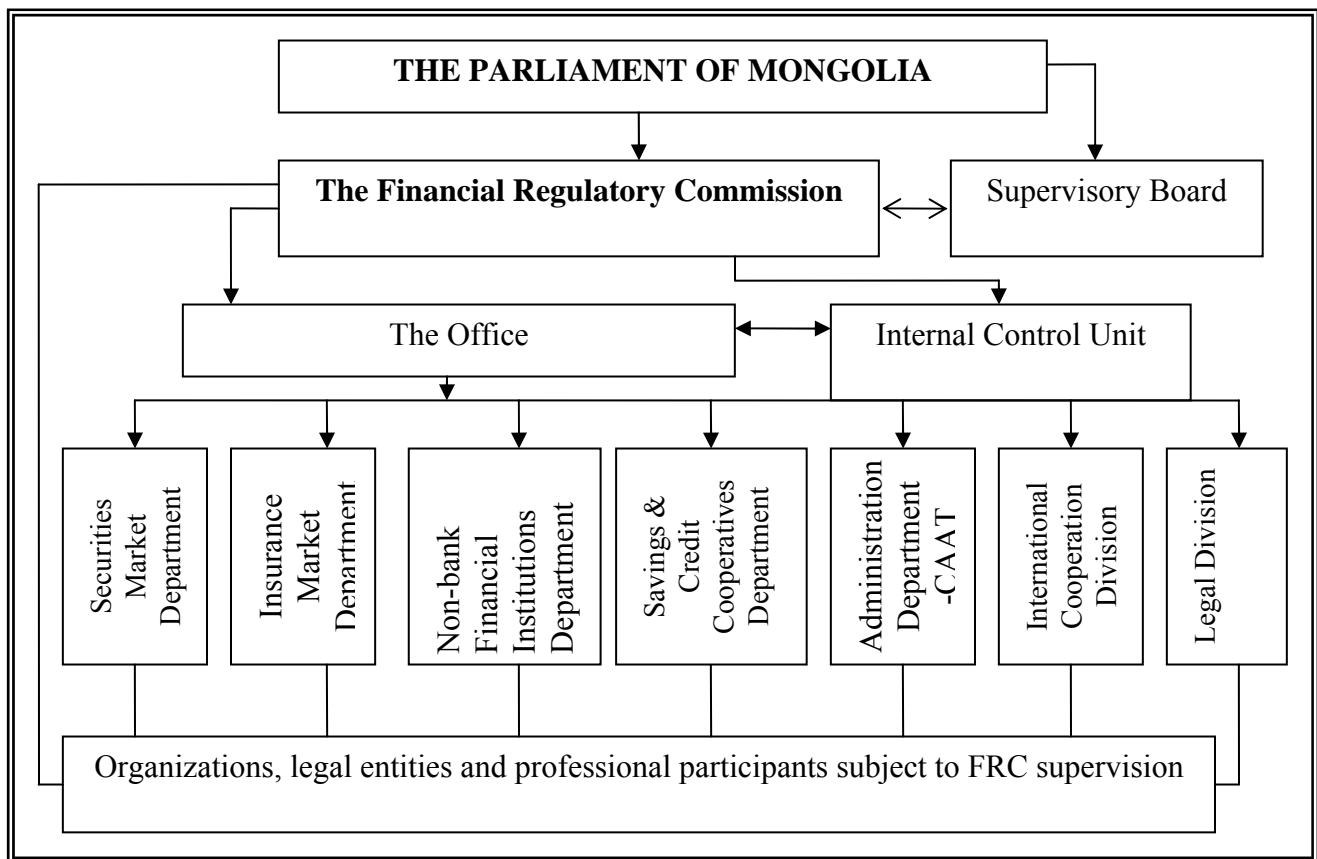
During the reporting year, the Commission convened 18 meetings; discussed and made decisions on 238 urgent matters; issued 215 resolutions and 18 notifications; imposed supervision on implementation procedures, and produced quarterly performance reports. The total number of matters discussed and decided during the year doubled compared to 2006.

The Commission received 4398 official letters and facsimiles from both domestic and foreign individuals and organizations, and provided responses accordingly. Out of 866 complaints filed to the Commission, 836 were resolved through detailed examinations.

The Commission, with the guidance of experts from the Capacity Building for Financial Sector Reforms project funded by the Asian Development Bank (ADB), implemented some structural changes considering the models of best organizational structures of international counterparts, and reorganized each department based on a sectoral model which includes a total of 7 units: Securities Market Department, Insurance Market Department, Savings and Credit Cooperatives Department, Non-Bank Financial Institutions Department, Administration Department, Legal Division, and International Cooperation Division.

The Internal Control Unit was established with functions to ensure prompt execution of Office activities, ensure compliance with resolutions and decrees, monitor budget expenditures and provide advice to executives. The Unit worked under the direct supervision of the Chairman of the Commission with the purpose of strengthening and expanding the Unit's capacity and ensuring its independence.

The revised organizational structure of the FRC



A performance agreement was established between the General Manager of the FRC and the General Budget Administrator, and a product delivery report was created and submitted to the relevant authorities by the General Manager.

The Commission developed and approved its mid-term action plan and its implementation agenda for 2008-2010. Each department of the Commission formulated their annual and monthly work plans consistent with the mid-term action plan, and activities were carried out according to the plan.

Considering the inadequacy of the Commission's office premises, the ownership of the annex of Government building IV was transferred to the Commission at its request.

The annex was originally built in the 1960s for the purpose of holding conferences and seminars. Since then, the quality of the building has deteriorated and no longer satisfies the working safety code requirements of the relevant professional organizations. Following submission of an official request to the Government and the Parliament to construct a consolidated training center for financial education as a replacement of the annex, financing was approved and allocated in the state budget.

The Commission has exerted efforts to expand its cooperation with foreign counterparties in the context of exchanging information and knowledge in order to strengthen the infrastructure of the

non-bank financial sector, enhance its regulatory system, provide competent staff members, and develop the non-bank financial sector in line with international standards in the short term. Moreover, within budget limitations the Commission has always been active in participating in important events organized by both securities and insurance international organizations, thereby fulfilling its membership role.

Becoming a member of the International Association of Insurance Supervisors on 19 September 2007 has established recognition of the Commission in the international arena, and established a basis to broaden the scope of its cooperation with other insurance regulators.

The Commission, with 10 other organizations, jointly organized specialized training sessions and seminars aimed at restoring confidence between the regulator and professional participants, determining their common goals, and promoting cooperation in achieving their common goals for further development.

The Commission has taken steps to build a closer relationship with foreign and international financial development organizations, as well as to resolve many pressing issues in the scope of its powers entrusted within the Law by means of implementing projects and programs.

Within the scope of the objective initiated by the International Organization of Securities Commissions (IOSCO) under which all member countries of IOSCO must sign the IOSCO MOU by 1 January 2010, a request was made to the ADB to include the FRC in the ADB-funded program implemented in the Asia Pacific Region through which the Commission was granted 30000 US dollars for an international expert to prepare a diagnostic study of the FRC's compliance with the IOSCO MOU.

The FRC-related tasks of ADB TA project 4737-MON "Capacity Building for Financial Sector Reform" have been successfully carried out and completed.

The European Bank for Reconstruction and Development made a resolution on providing a technical assistance grant worth 30000 EUR for the purpose of enhancing insurance regulation in Mongolia. Further cooperation was established with the embassies of Japan and Turkey, as well as with Korean International Cooperation Agency, Japan International Cooperation Agency, and United States AID in the context of training of employees on the financial market, providing advisory services, and providing opportunities for FRC employees to participate in various training programs and seminars being held in foreign countries by means of giving financial assistance.

Assignments were carried out within the scope of trilateral and bilateral memoranda of understanding among the FRC, Ministry of Finance, Bank of Mongolia, Ministry of Urban Development and Construction, Mongolian Chamber of Commerce and Industry, "XAC" bank, and the implementation unit of the "Index Based Livestock Insurance Project".

TWO. THE SCOPE OF ENSURING STABILITY OF THE FINANCIAL MARKET

Financial Market Stability is mainly determined by the level of the implementation of interconnected objectives such as ensuring public confidence in the financial market, raising public

awareness on the financial market, protecting the legal rights of financial market participants, and minimizing financial crimes and breaches. These objectives have been reflected in the mid-term policy documents.

1. CAPITAL MARKET

The “Capital Market Development Year” initiative was aimed at raising both public and Government awareness on the development of the capital market, improving corporate governance, strengthening the capacity building of the professional participants, establishing an appropriate regulatory regime, encouraging investors, and promoting the reliability of public information.

A. Promoting Public Confidence in the Financial Market

Improving the legal environment of the capital market has been a priority for the FRC. This is becoming more important as a new flow of products rapidly comes into the market. In this sense, the regulations on IPOs, Consolidated Database for the Securities Market, Service Fees Collection from License Holders, Inheriting Security Backed Ownership Rights, and regulation on registering the securities of Mongolian companies seeking to be listed overseas, have been developed and amendments were made.

Substantial amounts of mining and mineral resources in Mongolia are becoming the main attractions for foreign investors, as expected. The strategic mining sites as well as the possibilities of issuing securities with no less than 10 percent of the capital through the Stock Exchange have resulted in the exploration of opportunities for listing of Mongolian stocks on foreign markets, and trading of foreign securities on the Mongolian market. In relation to this, the draft amendment to the Securities Market Law and related regulations were developed in order to establish a regulatory mechanism for the changing market.

With the purpose of enhancing housing financing, and establishing the legal environment for the secondary mortgage market development, the draft Mortgage Law was formulated with the help of relevant organizations and was submitted to the Parliament for passage. In addition, the concept paper and draft Law on Mortgage Backed Bonds and Law on Asset Backed Securities were developed accordingly with the help of international consultants provided by USAID as well as other relevant organizations, and have been handed to the Ministry of Justice and Internal Affairs. Additionally, the failure to define some types of financial crimes in the Criminal Law, has resulted in proposals being made to relevant authorities and gained their approval to add the following provisions to the law: Notaries and State Right Registrars violating owner’s rights; Violating the Law on Savings and Credit Cooperatives; Violating the Law on Activities of Non-bank Financial Institution; and Violating the Insurance Law.

It is becoming increasingly crucial to introduce internationally recognized corporate governance principles that establish mechanisms to ensure that investors and shareholders are fulfilling their responsibilities, sanctions are improved and investors are provided with material facts in a timely manner. Therefore, the Commission, based on the above principles, has developed and approved the “Corporate Governance Code” which is not restricted to joint stock companies only, but also is designed to promote business management and social responsibility for any corporation.

With the view of solving many critical issues in this market that require resources, specialized expertise and knowledge within a short period of time with the united effort of the Government along with international banks, donor organizations, the public, and professional organizations, drafting of the “Capital Market Development Program 2008-2011” has been completed and is now ready for submission to the Parliament for approval.

The stability of market participants and their regulatory standards are the most important means for any market development. The Commission has given priority to, and provided comments on, the amendments of the regulation on trading and listing of securities approved by the Mongolian Stock Exchange, which is the only securities trading institution in Mongolia.

A new “E-clearing house” system was launched at the Securities Clearing and Settlement House and Central Depository (SCSHCD) which safeguards securities and assets worth 1 billion MNT owned by approximately 600 thousand citizens and legal entities.

During the reporting year, the Commission renewed the licenses of the Mongolian Stock Exchange, the SCSHCD, and 15 Brokerage and Dealer companies, and granted licenses to 9 new companies such as “Bats”, “Global Asset”, “Ci Ci Pi”, “Frontier”, “Bloomsbury Securities” which increased the number of Brokerage and Dealer companies to 36, of which 8 began to offer underwriting services. A total of 8 companies were granted additional licenses, among which 2 companies offer investment advisory services, and 2 engage in broker and dealer activities respectively. Also, 5 of the 8 licensed companies received investment from Japan, South Korea and the United States of America.

The Commission has placed high importance on assisting investors and encouraging new types of instruments coming into the market aimed at restoring market activities as well as speeding up market development. In this context, there were 6 companies, namely “Tuul-Songino Usnii Nuuts”, “Hi Bi Oil”, “Olloo”, “Nako Tulsh”, “Monfresh Juice” “Moninjbar” which filed their documents with the Commission to launch IPOs and were granted licenses to issue 145.8 million securities valued at 123.6 billion MNT and 100 million bonds valued at 2.2 billion MNT.

B. Promoting Public Financial Education

Promoting public financial education is becoming increasingly important to the development of the capital market. The reason is that, during early 1990, there were many citizens who were given vouchers to own shares, and because of their lack of knowledge and experience in the capital market, never opened their personal accounts with the SCSHCD. Further, those who opened their accounts never managed or looked after their accounts.

The Commission, using its resources to the extent possible, published and disseminated brochures and pamphlets to the public about the nature of the capital market, its further outlook, and its instruments and mechanisms, and has taken specific measures to coordinate and finance those activities. For example,

- “Shareholders’ Day” was jointly organized with the Mongolian Stock Exchange aimed at raising public awareness on the capital market.

- The FRC announced an academic contest titled “Capital Market Development” among scholars and students, and published 3 volume books which consisted of academic works written by 36 students and 22 scholars. 5 students and 4 scholars won the contest and were awarded accordingly.
- The FRC organized a fair titled “Capital Market Development-2007” for the first time in Ulaanbaatar city, as well as in all provinces. The fairs were open to the general public. A total of 7 thousand citizens attended the fairs. During the fair at the Sukhbaatar Square in the city, approximately 589 people received advice, and brochures and leaflets were disseminated and 394 people opened their accounts with SCSHCD.
- Objectives and Principles of Securities Regulation published by IOSCO was translated into Mongolian, and Principles of Corporate Governance issued by the OECD was translated and published in Mongolian based on which the “Corporate Governance Code” was developed and approved by the Commission.
- The FRC broadcast and publicized measurements implemented by the FRC, as well as capital market related information to the general public through radio stations, televisions and newspapers.

As the market develops at its accelerating pace, it necessarily requires regular capacity building of staff of the Commission as well as of market intermediaries. The Commission ensures that its staff receives comprehensive training and seminars organized by both domestic and foreign organizations. Still this is insufficient for the staff to perform their duties effectively.

During the reporting year, training for the securities market participants to issue licenses was held twice and 176 people participated, of which 132 received their licenses to run a business on the capital market. In the scope of cooperation, the Commission organized joint seminars with Mongolian National University, Russian Economics Academy named after Plehanov, Bloomberg, Reuters, Asian Development Bank, Taiwan Securities Exchange, and Financial Services Commission of Korea, and the Commission staff actively participated in those seminars.

C. Protecting the Legal Rights of Financial Market Participants

During 1990-2000, embezzlement of customers’ shares allocated during the privatization period and other illegal behaviors were common among the market intermediaries. During this period, there were many market deficiencies such as an inadequate regulatory framework, lack of sanctions, poor conduct of market intermediaries, and a low level of public financial education. The impact of this misconduct was tremendous, causing investor distrust and difficulties for state organizations.

The majority of the complaints filed by citizens were related to this specific issue. Resolving these complaints required a lot work hard work, research and gathering of evidence. By decisions of the Commission, a total of 23 securities transactions involving 3.9 million securities worth 614 million MNT, which were owned by 24 citizens, were revoked. In order to protect investors’ legal rights, the Commission has taken part in the court for administrative cases and defended the inspectors’ positions on prosecution for embezzlement and misuse of clients’ assets of 23.1 thousand securities worth 90 million MNT.

When a joint stock company goes private, there is a potential risk that small investors’ rights are being violated. This year, the Commission delisted 1.3 million shares of 11 companies that filed

their request to change their status which was owned by 3926 citizens, and 29.2 million MNT of shares were placed in 3839 shareholders' accounts at the SCSHCD.

Those who own controlling shares of a publicly traded company must make a tender offer according to the Company Law if they wish to purchase voting shares of the company. This is particularly important in ensuring the protection of small shareholders' rights. In the framework of ensuring compliance with this requirement, the Commission made legal orders and conducted enforcement actions on tender offers. As a result, controlling shareholders of 7 publicly traded companies filed their statements for tender offers, and resolutions were made accordingly. Currently, there are 4 tender offers expired, and during the tender offer period, 7.4 million shares were acquired.

In accordance with the Government resolution #155 of 2006, 57870 clients were compensated with 45.8 million MNT for the losses incurred due to failure of custodian banks which was accomplished with the help of SCSHCD.

D. Fighting Against Financial Fraud and Misconduct

The Commission conducted on-site supervision during the first half of 2007 with respect to listed companies as well as market intermediaries, to ensure compliance with the "Securities Market Law" and the "Company Law". 202 of 251 publicly traded companies in provincial areas, and 126 of 132 publicly traded companies in the capital city totalling 309 publicly traded companies as well as 25 broker and dealer companies have been involved in this process.

The investigation result shows that there are properly operating 151 publicly traded companies, poorly operating 62 publicly traded companies and 146 insolvent companies. 67 percent of these insolvent companies' capital was misused, or the companies are incapable of carrying out further operations. This shows that it is already time to strengthen the MSE's listing standards in compliance with international standards, ensure that investors are given fair access to market facilities, and develop the securities market structure, and to bring it up to an internationally recognized level.

During the on-site supervision of Broker and Dealer companies, it was revealed that 4 companies failed to meet minimum capital requirements in accordance with the "Securities Market Law" and 13 companies failed to comply with "Regulation on Capital Adequacy for Market Intermediaries and Loss Provisions for clients".

The following are some of the common misdeeds Broker and Dealer companies engaged in:

- Failure to register with State Registration Office whenever amendments are made to the Company Charter;
- Failure to approve and comply with their Company Charter;
- Failure to provide investors with material information, and underperformance of their duties in terms of examining and resolving client complaints and requests in a prompt manner;
- Failure to distribute dividends and capital gains in a prompt manner
- Failure to disclose their financial data, disseminate relevant information to investors and clients, and file reports of their shareholders meetings to the Commission.

Additionally, misconduct of some of the Brokers led to suspension of licenses, and many clients' assets were transferred from the Brokers' accounts to other Brokers accounts that are compliant with relevant regulations. However, these Broker companies appeared to be negligent towards these accounts because of their insufficient capacity to oversee all the accounts they are entrusted with.

The Broker and Dealer companies that are responsible for providing services to Dornod, Sukhbaatar, Tuv, Bulgan, Hentii, Bayan-Ulgii, and Uvs provinces as well as Baganuur district operate properly and provide services according to their schedule. However, there is no accessibility for the citizens in Gobisumber and Huvsgul provinces for B&D services since there are no existing B&D companies that provide services to clients in those areas such as checking account balances, and making orders to buy or sell shares.

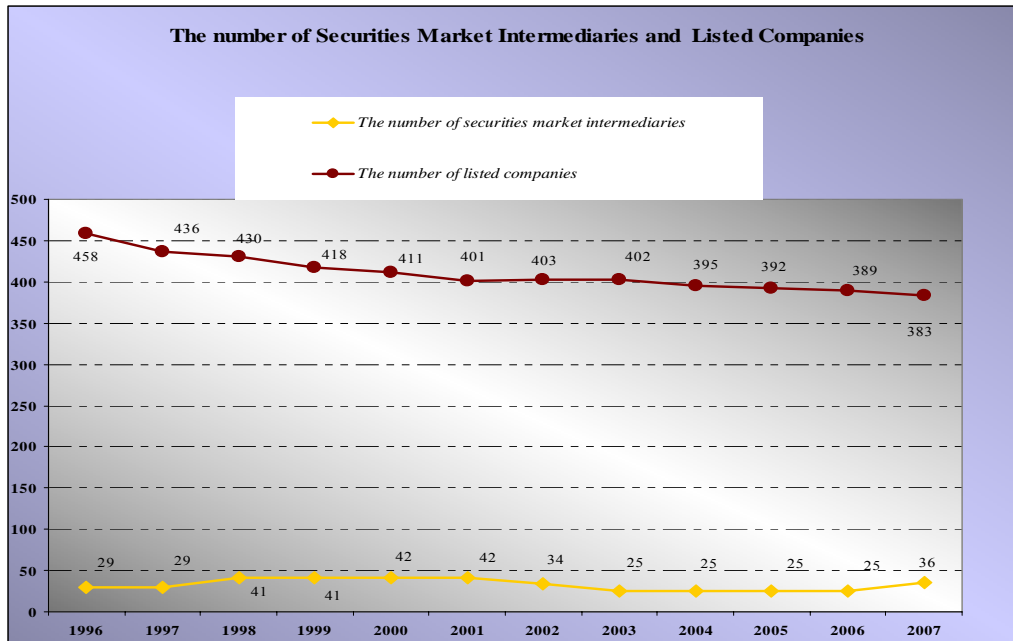
On the other hand, it is evident that B&D companies, an important group of securities market intermediaries, face challenges of being financially sound as well as being profitable from their operations. During 2006, 14 out of 25 B&D companies lost 60 thousand to 5.6 million MNT and 10 lost 42.3 thousand to 47.2 million MNT.

Measures taken against misconduct uncovered during the supervision process included administrative sanctions and fines for 1.5 million MNT to individuals and companies that violated related legislations.

E. The Current Situation of the Market

Following the rapid growth of the economy, positive signs are evident and the main indicators of the market are showing some dramatic growth.

1. Market Intermediaries

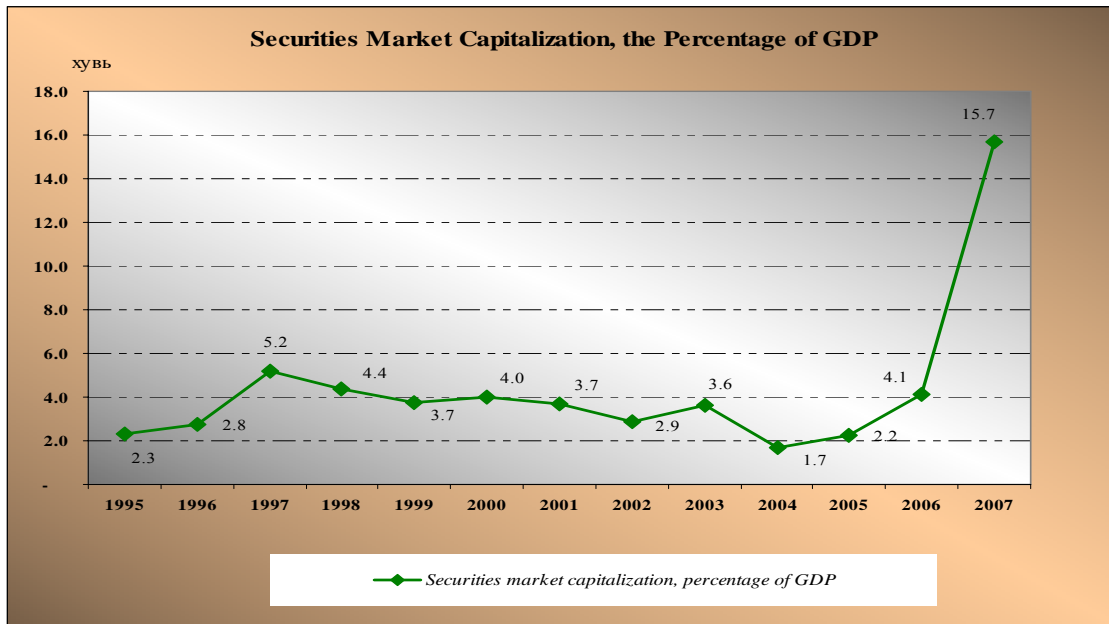


The decreasing trend of listing of shares on the MSE is related to the ending of the accumulation process of securities, as well as the growing interest of shareholders who hold controlling shares of a publicly traded company to change their company status to a private company. Only 10 percent of a total of 2.5 billion shares of 383 listed companies are being actively traded on the MSE, which makes it necessary to revise the MSE listings and establish listing categories on the MSE.

During the years of inactive securities trading, the number of B&D companies stayed unchanged until the market has become more active, and national companies started offering IPO's which increased the total number of B&D companies by 11 new companies that are offering broker, dealer and underwriting services.

During 2007, 119 joint stock companies held their shareholder meetings, 138 joint stock companies submitted their financial statements to the Commission, and 28 joint companies distributed dividends for 7.4 billion MNT.

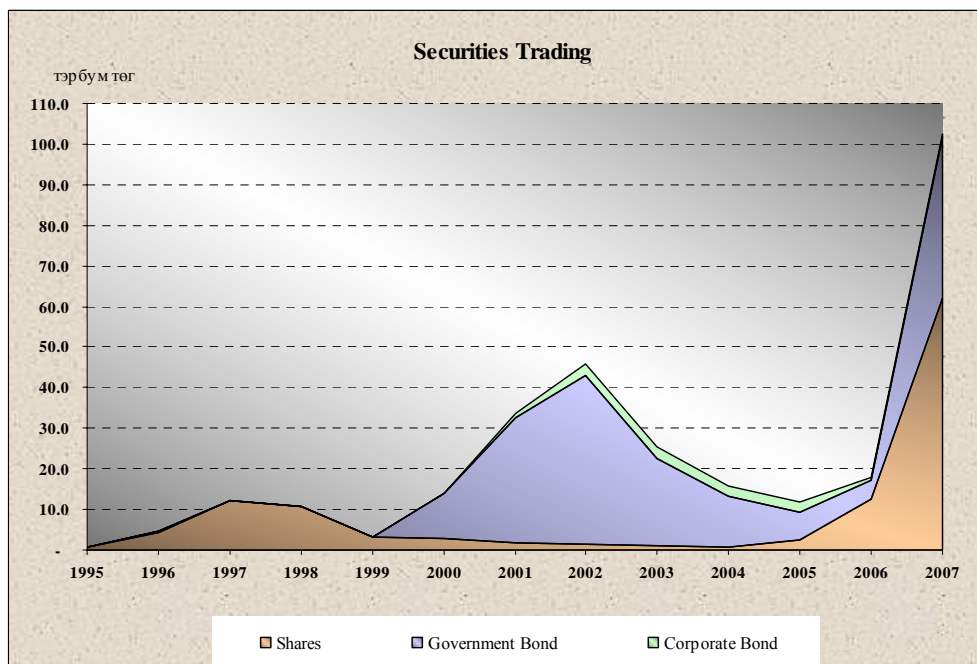
2. Market Capitalization, Percentage of GDP



During the reporting year, market capitalization increased to 716.6 billion MNT from 131.9 billion MNT in the last year, which indicates that market capitalization grew by 585.7 billion MNT which is 5.4 times as large as the previous year.

During the last 10 years, market capitalization has averaged 3.2 percent of GDP. However, during the reporting year, the value of stock market capitalization increased by 11.6 percent of GDP due to increased prices of actively traded securities as well as the growing number of IPO's.

3. Trading of Shares

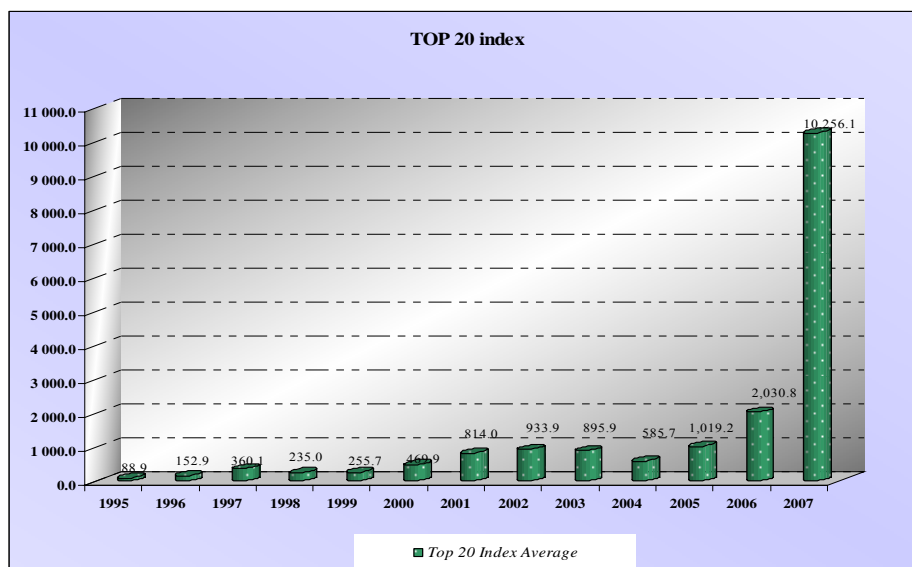


During 2007, there were 253 trading days, and 116.1 million shares and 542.8 million bonds of 307 companies were traded. The total trading value was 102.6 billion MNT.

62.1 billion tugrug of share trading accounted for 60.7 percent, and 40.5 billion tugrug bond tradings accounted for 39.9 percent, of the total trading value.

The total trading value of securities rose by 49.5 billion MNT, which is 4.9 times higher than the previous year. The total trading value of bonds rose by 35 billion MNT, which is 7.5 times higher than 2006.

4. Top 20 Price Index Dynamic

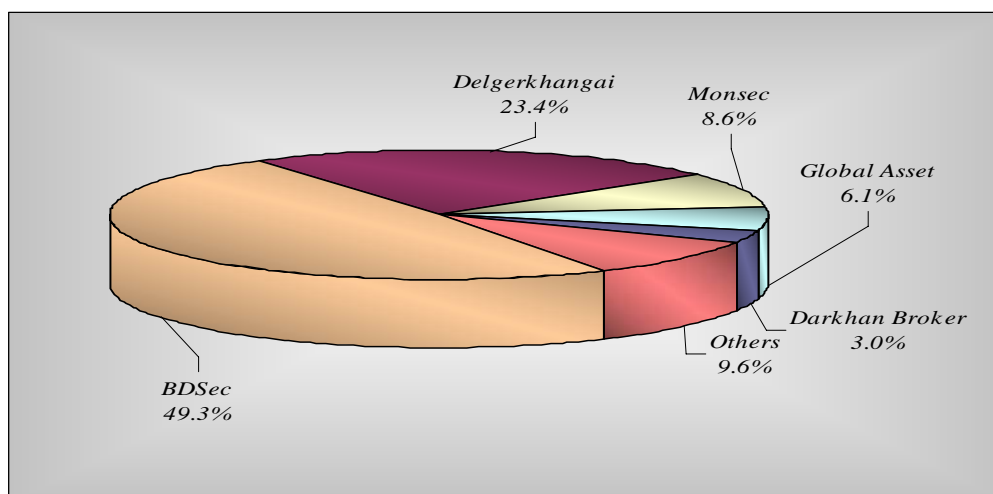


Since the end of 1999, the Top 20 index has been calculated based on a portfolio of 20 securities selected using various indicators in order to illustrate the change in the securities market.

Because the general outlook of market development is largely determined by the increase and decrease of the index, regular calculation of the index and implementation of regulatory measurements are critical.

As of 31 December 2006, the top 20 index was 2030.8 points, and as of 29 December 2007 it jumped to 10256.1 points. The peak reached 13676.9 points during the reporting year, which indicates that the index rose by 5.1 times compared to the previous year.

5. Market Shares of Broker and Dealer Companies



According to an estimate that calculates the percentage shares of the B&D companies of the market, based on their overall transactions, 90 percent of the total transactions were handled by 5 large B&D companies. The remaining 31 B&D companies each handled only 0.3 percent of the total transactions.

This indicates that the management of B&D companies, as well as their staff competency and financial capacities, is low. This might lead to a lack of competitiveness among the B&D companies.

Therefore, it is necessary to promote mergers of B&D companies, as well as the strengthening of their governance and management by a way of imposing stricter terms and conditions for B&D companies.

F. The Further Implementation of the Policy Measures

Given the fact that the development of the capital market is one of the pathways to economic growth, we need to constantly learn from international best practices, make practical evaluations, and draw conclusions on current situations. We need to establish our future outlook in order to regain our strength in the marketplace. The following measures must be taken in order to solve many issues we face on a continuing basis.

- With the purposes of strengthening the legal environment of the capital market, it is necessary to make amendments to the Company Law, Securities Market Law, Law on Investment Funds, Law on Trusts, and finalize drafts for submission and further approval
- With the purposes of developing the capital market and developing and implementing state integrated policy, it is necessary to submit the FRC-developed “Capital Market Development Program 2008-2011” to the parliament for passage.
- Develop regulations on IPOs in line with roles and responsibilities of the securities market participants, recognizing that IPOs involve major risks such as financial, economical, as well as social risks.
- Raise the business conduct requirements for the securities market participants, promote high standards of integrity as well as strengthening the disciplinary arrangements, along with improving capital adequacy standards for Broker, Dealer companies.

- Promote Brokerage and Dealer services in rural areas and ensure that citizens in rural areas are given access to market facilities through the establishment and implementation of service standards.
- Privatize the MSE and enhance the organizational structure of the Securities Clearing House and Central Depository in an appropriate form that is consistent with international standards and which promotes positive impacts on the market development.
- Strengthen the listing requirements in compliance with international standards and assist investors to manage the risks of share price decrease by revising listing standards and delisting unqualified securities.
- In order to provide investors with full disclosure of material information, create possibilities for conducting risk assessment, and improve supervision of market participants. It is necessary to establish an integrated database by solving both hardware and software issues.
- By means of monitoring the trading activities on the MSE, as well as effectively implementing the regulatory system, there should be an effective mechanism that addresses price manipulation, insider trading, misuse of client assets and any other fraudulent and deceptive practices.

2. INSURANCE MARKET

Main objectives in 2007 were to develop insurance related rules, regulations and instructions within the scope of the “Law on Insurance” and “Law on Insurance Intermediaries”, to build fundamentals prior to introducing life insurance and a compulsory insurance system, to improve the state supervision of the insurance market, and to study and introduce new mechanisms to protect insureds.

A. Promoting Public Confidence in the Financial Market

Although the overall insurance legal environment is considered to be formed comparably well, not all the rules, regulations, and instructions which should be passed with regard to the “Law on Insurance” and “Law on Insurance Intermediaries” are in place. By passing and enforcing 22 rules, regulations and instructions such as “Instruction on Content and Form of Additional Financial Statements of Insurers”, “Instruction on Defining Insurance Related Parties”, and “Regulation on Reinsurance Plan Requirements for the Insureds and its Compliance and Supervision”, the market met international standards on operation of professional market participants and their financial reporting, endorsed a methodology to establish the state supervision system, established fundamentals for life insurance, and upgraded the supervision system for reinsurance. Furthermore, the adoption of a “List of Voluntary Long Term Insurance”, “Requirements for the Entities to Conduct Long Term Insurance Business and List of Documents of Application for Licensing” is considered to be the foundation of legal environment for life insurance.

By considering the formed preconditions for an increase in new insurance products, and their penetration of the market, the FRC drafted the “Law on Drivers’ Compulsory Liability Insurance” and participated actively to draft the “Law on Deposit Insurance” in order to develop the legal environment as quickly as possible.

Studies and research have been conducted on mortgage insurance legislation in cooperation with relevant organizations.

Translation of the 4th International Accounting Standards chapter “Insurance Policy” was adopted by National Standardization and Measurement Council. This is considered to be as an action of introducing international standards in the Mongolian market.

Some pressing issues have been solved to an extent, such as to develop industry infrastructure, to provide professional participants with specialized staff, and to train auditors on insurance auditing. 15 companies were licensed to run 220 types of insurance activities by aggregate number. The licenses of companies such as “Capital Daatgal”, “Chin Uils Daatgal”, “Mongoliin Undesnii Daatgal”, and “Erel Daatgal” were revoked in 2007 due to their failure to comply with the requirements of the Law on Insurance and to establish appropriate reserve fund levels.

The licenses, suspended pursuant the the report of inspections made on “Gan Zam Daatgal” and “Ard Daatgal” companies, were reinstated after relevant flaws were remedied.

The FRC identified insufficient access of insurance intermediaries and agents nationwide, which had a negative influence on the market. Measures were taken accordingly to resolve the situation. Two companies which passed the inspection and met other qualifications are licensed out of four applications to conduct activities on the market as insurance intermediaries. 286 individuals, who attended insurance agents’ training and passed the examination, are licensed as insurance agents.

Granting power to the Commission to license insurance auditors, by a new provision in the Law on Insurance, has been considered as an important regulation in terms of protecting insurants’ rights. 18 auditors were licensed in 2007.

An international tender for the “Project on Upgrade and Enhancement of Insurance Regulation” to be financed by the European Bank for Reconstruction and Development (EBRD) Technical Assistance has been processed and evaluated.

By introducing eighths method which calculates and distributes total premiums consistently and concurrently through the reporting period, accounting of insurance companies’ financial statements and profitability, in particular premium income, and calculation of reserve funds, have been updated to the international standards.

B. Promoting Public Financial Education

Failing to stress the importance of being insured and the significance of insurance market industry to the public, will also have a negative impact on the development of this sector.

Therefore, first steps have been taken in response to the urgent need to form developed mechanisms to ensure a quality information dissemination system, in order to promote transparency, fairness, timeliness, public focus, and informative and advisory functions of the insurance market.

First of all, a blueprint to develop the information system of the insurance market was written by the project team of Asian Development Bank TA #4737 MON with assistance of the FRC. And in this way, the basis for the insurance sector database system was established.

The FRC disseminated, through mass media, and its website, news and information about its approved policy, actions, rules and instructions, which were intended to improve insurance market regulation in order to ensure transparency. Also, information was disseminated about licensed insurers, and licensed auditors of professional insurance participants. In necessary cases, as a response to requests, the information was provided through official letters.

Two live broadcasts on television were organized regarding insurance market challenges, and a publication titled “For Insurants Attention” was published in order to improve insurants’ education and knowledge about the insurance market.

Due to importance of staff proficiency and capacity building of regulatory body, professional participants and for the financial market development, several training programs were conducted, such as:

- two programs for insurance agents;
- two programs for insurance company accountants;
- a program for life insurance regulation and on actuarial matters with the Korean Financial Supervisory Services;
- a program on life insurance regulation and its supervision with cooperation of the Indian Insurance Regulation and Development Authority and Mongolian “National Life” LLC;
- programs which covered three provinces and licensed agents who will involve herdsmen in index based livestock insurance with the team of “Index based Livestock Insurance Project”;
- Licensing training program for actuaries, conducted in cooperation with the Association of Mongolian Insurers and with funding from the Luxembourg Government.

C. Protecting the Legal Rights of Financial Market Participants

Insurants started to realize that protecting the rights of financial market participants is one of the main functions of the FRC. The number of applications and complaints to the FRC addressing abuses of rights are increasing. In 2007, 28 complaints were received, investigated and resolved according to laws and regulations, and 247 official letters and inquiries were received and responded in the legally prescribed timeframe.

Some transportation and insurance companies were collecting compulsory insurance fees by automatically adding to ticket fees. This was a common practice while the liability insurance of passengers and drivers was voluntary. Such malpractices and breaches of relevant laws caused frustration among the public. The companies involved in this activity were penalized with relevant sanctions.

Advisory services related to the insurance market legal system and market regulation have been provided by the FRC upon request from individuals and entities.

D. Fighting Against Financial Fraud and Misconduct

In the course of re-licensing insurance companies, all the insurance companies examined the schedule to verify whether they are operating in compliance with laws, rules, regulations and instructions passed by the FRC.

The following are widespread violations and breaches by the companies:

- Paying agent fees to individuals without licenses;
- Misplacing of reserve funds, and using reserve fund assets for other investments, despite the Commission requirements;
- Fail to register with the State Registration Office the changes in companies' charters;
- Some voluntary insurance have been forced to be compulsory through relevant regulatory agencies which violates the Insurance Law.
- People often get frustrated because of the bureaucratic actions of insurance companies in the process of paying indemnities, because of unclear wording and definitions in insurance policies.

Penalties in the total amount of 20 million MNT were imposed on the insurance companies, which were found guilty according to the examinations, were allocated to the state budget. Orders were issued by the state inspectors addressing the companies to cease the violations and to rectify the flaws. Implementation of the orders was monitored by the FRC. Introduction of history logs for each company breaches, violations and incompliances is considered to be an effective practice for supervision.

Carrying out financial analyses of financial institutions through off-site supervision assists to identify policy definitions to improve risk management; moreover it becomes the basis of database statistics.

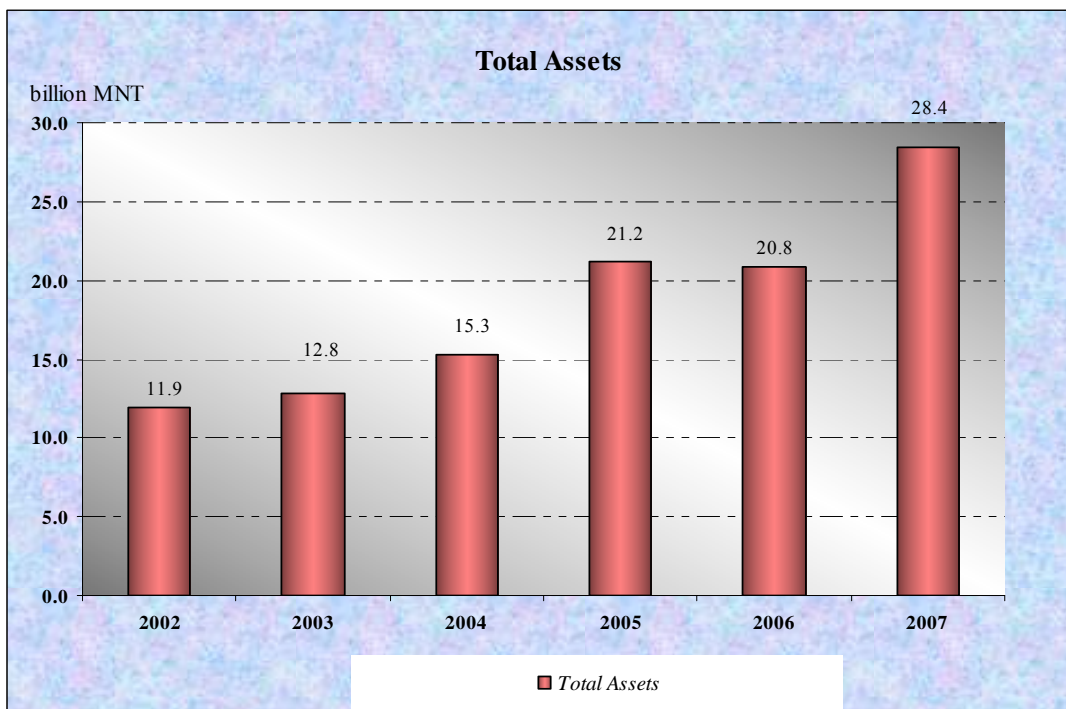
The analysis and compilation of financial statements on 15 insurance companies has been done on a quarterly basis. Basically, all the licensed companies operating in the insurance market meet the prudential ratio on solvency, set out from the FRC to protect the domestic insurance market from financial risks and to stabilize activities.

Insurers' solvency improved since the insurance market reserve fund volume increased and reached 17.8 billion MNT as a result of enforcing the "Regulation on Building Insurance Reserve Fund, its Distribution and Control" which was passed in order to increase the reserve fund amount, the main prudential indicator for insurers.

E. The Current Situation of the Market

During the reporting year, the insurance industry as a whole recorded a total profit of 633.5 million MNT, increased the reserve fund by 5.6 billion MNT (45.9%) to 17.8 billion MNT, and made reinsurance agreements worth 4.5 billion MNT.

1. Total Assets

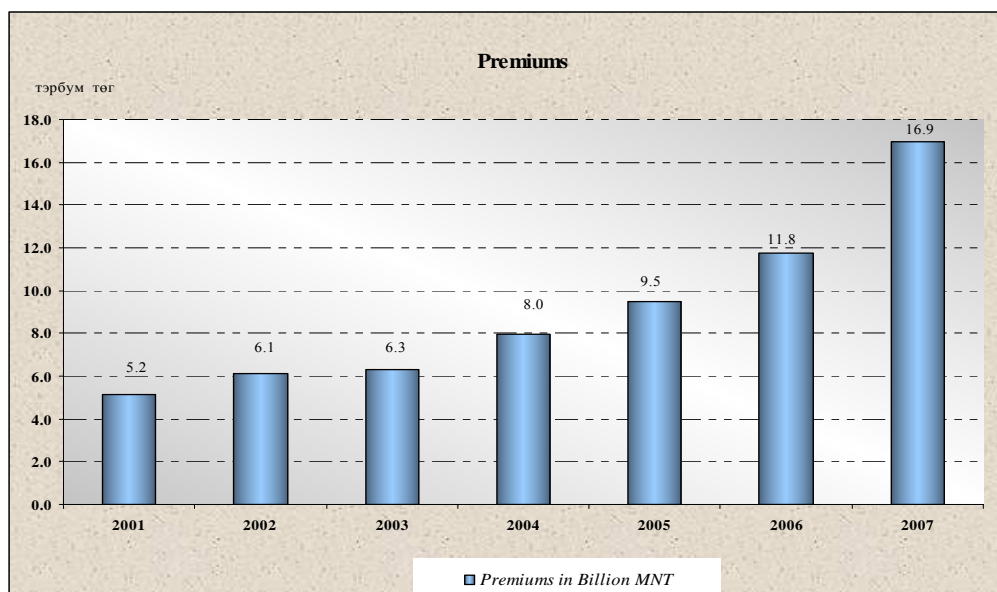


Total assets of insurance companies reached 28.4 billion MNT, which gives a rise of 7.6 billion MNT or 36.5% increase compared to 2006.

No significant change has been recorded in asset structure. 80% of total assets are composed of current assets, of which 67.6% is cash and cash equivalents, 12.0% is short term investments, 9.4% is accounts receivable, and 11.0% is other current assets.

The accumulated loss of 303.4 million MNT in 2007 is lower than the accumulated loss of 594.2 million MNT in 2006, a decrease of 2.9 times was observed. This shows the positive results of introducing the new eighths method of reserve fund establishment, which was started from second half of 2007.

2. Premiums Income

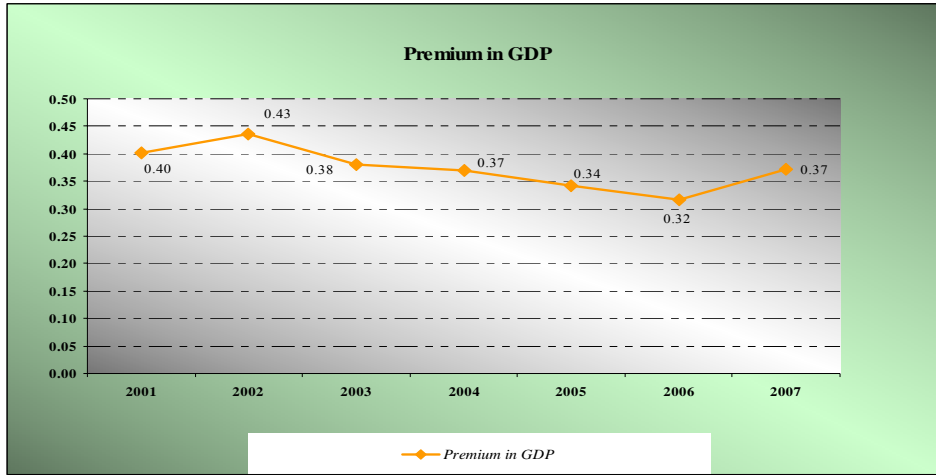


While insurance premiums have been steadily increasing with an average amount of 1.9 billion MNT within the last few years, a sharp increase was observed in 2007 when growth reached 5.1 billion MNT or 43.2%. This increase resulted from the introduction of new insurance products to the market and the improved public awareness about the advantages of insurance services in order to prevent potential risks. The evidence for this observation is that 84.8% of the increase was premiums collected from property and liability insurance products.

Comparison of premiums by insurances type, in 2006 and 2007:

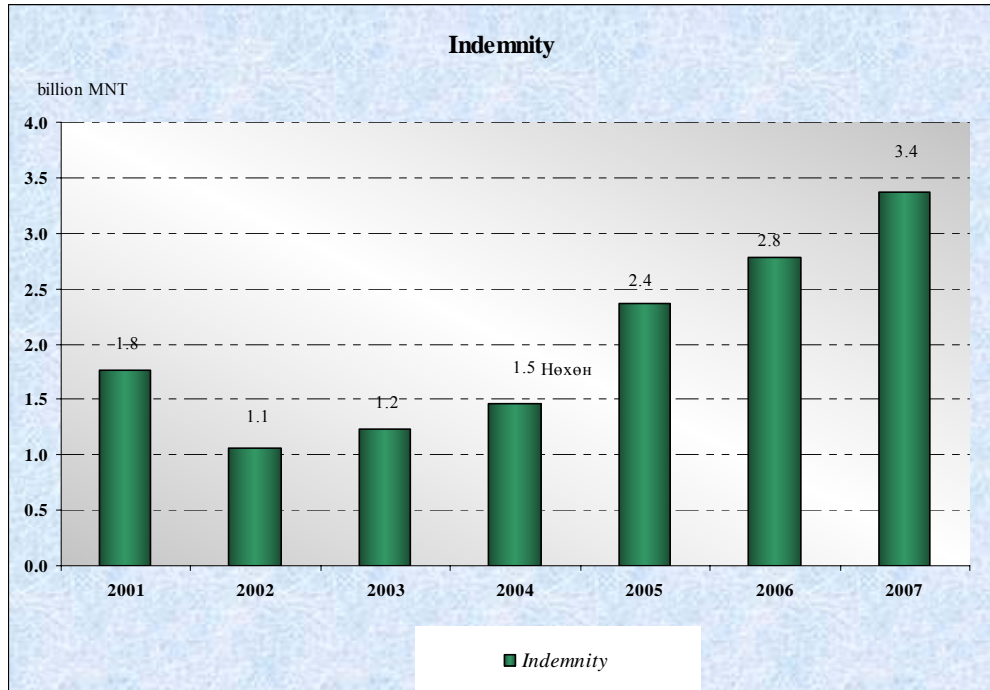
Insurance subclass	2006	2007	Growth	
			MNT in ml.	Percent
1. Interest, and Health Insurance	1 048.4	1 495.0	446.6	42.6
2. Property Insurance	8 051.4	10 534.7	2 483.3	30.8
3. Liability Insurance	2 679.3	4 566.4	1 887.1	70.4
4. Financial Insurance		333.0	333.0	
Total	11 779.1	16 929.1	5 150.0	143.7

3. Total Premiums as Percentage of GDP



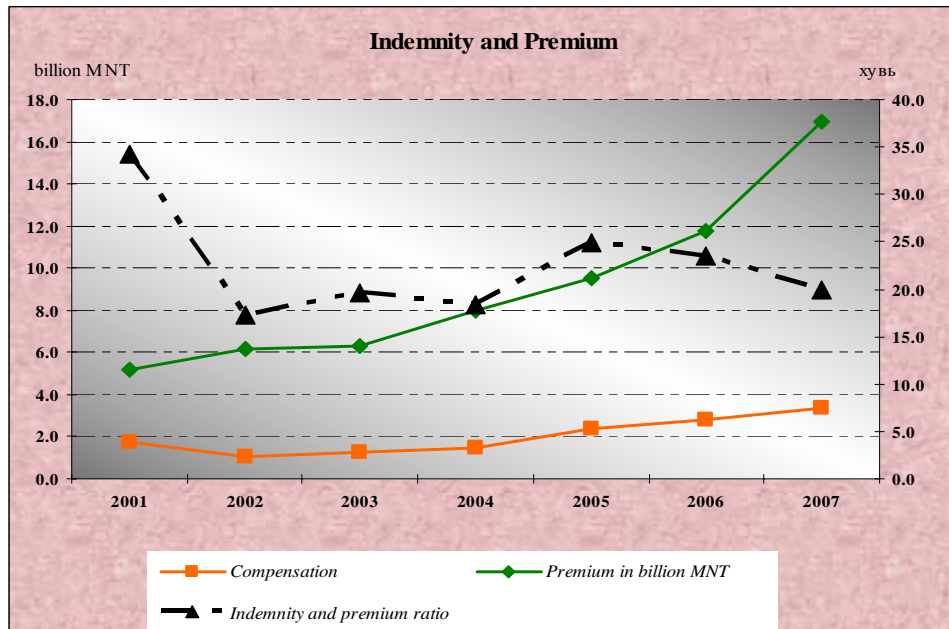
The downward trend of insurance premiums as a percentage of GDP observed during the last few years changed in 2007, when 5.2 billion MNT or a 0.05 percent increase was recorded. This indicator equals about 10% in developed countries. Therefore, 0.4 percent in Mongolia shows that insurance market can develop further. It is necessary to carry out measures to improve public knowledge, and to introduce new types of life and compulsory liability insurances.

4. Indemnity



During the reporting period, the indemnity level reached 3.4 billion MNT, which constitutes a 21.6% increase compared to the 2006 level. The increase of indemnity in 2007 was mainly influenced by a 37.3% rise in property insurance indemnity and a 35.3% rise in liability insurance indemnity.

5. Loss Ratio

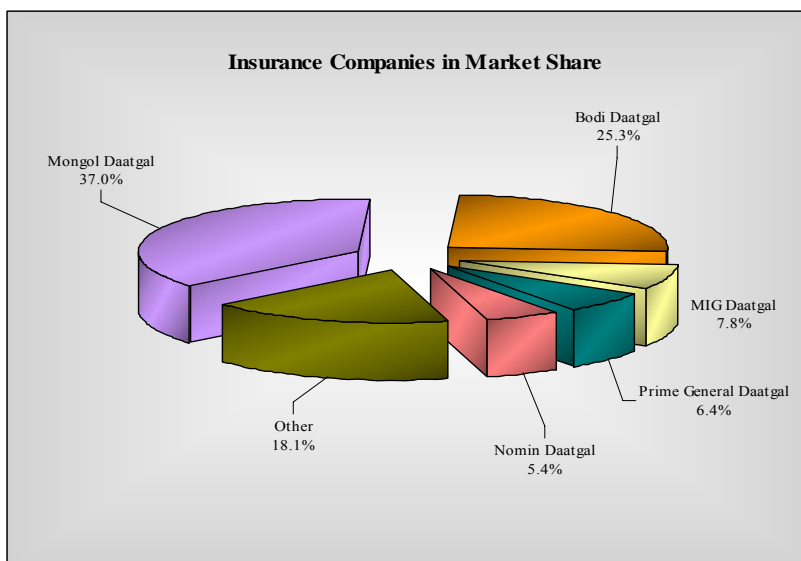


The graph shows the changes in insurance premium and indemnities for the last 7 years. The annual increase of the collected premiums was almost 5 times higher than the indemnities payout. This

trend sharply increased in the last 2 years, and may cause a decrease of the public trust in insurance and result in negative effects to the insurance market development.

One of the main indicators of insurance sector in Mongolia was the loss ratio, calculated by dividing total indemnities to premiums. According to this calculation the ratio was 19.9% in 2007. However, the international practice which calculates this ratio by dividing total indemnities to income accounted premiums. After the corrected calculation in 2007, it is now indicating 48.57% which is close to the developing markets average of 50%. The loss ratio shows how many MNT is compensated back to the insureds from every 100 MNT of premium.

6. Market Shares of Insurance Companies



In regard to the market shares of insurance companies based on premiums collected, five companies shown on the above chart occupy 81.9% of whole market. In other words, the remaining 10 companies each take 1.8% in average, which indicates that the market urgently needs an increased competitive environment and companies with high solvency potential and proper management.

F. Further Implementation of the Policy Measures

Specific attention should be paid to the following challenges to be solved in the near future:

- Considering the nascent stage of insurance market development, it is necessary to introduce new long term and life insurance products as well as compulsory liability insurance products for persons such as notaries, attorneys, doctors, food manufacturers, and persons who work with substances which may endanger the environment. Also, it is important to set out and ensure compliance of rules, regulations and instructions in relation to new products and services;
- It is necessary to implement policies to increase the Mongolian insurance market's competitiveness through expanded financial capacity of insurance companies, and by

enhancing governance and management competence; to integrate and expand smaller companies by increasing minimum capital requirements of paid-in capital and reserves, instead of increasing the number of insurance companies; and to create opportunities for insurance companies to make short-term investments in other financial markets.

- Increasing interest of foreign investors to establish insurance companies, or attempts to purchase local companies creates pressure to form and adopt relevant legal provisions to protect the domestic insurance market by studying and applying international and regional practices;
- Building a legal framework, that requires foreign companies operating on Mongolian territory to be insured with local insurance companies, in order to cut operations of unlicensed foreign insurance companies on Mongolian market through insurance dealers and intermediaries;
- Develop and promote adoption of relevant legislation necessary to establish a national reinsurance company, in order to hold large volumes of funds flowing out to foreign reinsurance companies.
- To build a database equipped with modern software consistent with current market demands, and develop and carry out financial reporting in line with international standards to establish fair and timely insurance information.

3. NON-BANK FINANCIAL INSTITUTIONS

It is a crucial task to reform the Non-bank financial institutions (NBFI) accounting standard, and to create an integrated information database system. The main objectives were to improve supervision of risk management, and to refine the Commission policy based on clarifying and determining the capacity of the market.

A. Promoting Public Confidence in the Financial Market

To improve the legal framework for NBFIs' activities, we welcome recommendations or complaints from the NBFIs Association and professional participants. A task force has been established to recommend amendments of the Non-bank financial institution activities Law. In this framework, we are aiming to learn from the practices and experiences of similar regulatory bodies, and intend to develop amendments to the law.

In order to improve the NBFIs' off-site supervision, build capacity, and bring it into line with international standards, temporary regulations on currency exchange points and off-site supervision guidelines are being developed. This year, the following six guidelines and instructions have been endorsed by the Commission and came into force: a guideline for NBFI record registering, a guideline on monitoring NBFI records, a sample instruction on accounting records and financial reporting of NBFIs.

There were 109 NBFIs licensed from the Bank of Mongolia, and this year the FRC re-licensed them. 10 Limited Liability Companies asked to operate in the NBFIs sector, 17 NBFIs asked to expand their activities through changes in paid in capital amount and structure, 7 NBFIs applied to open a branch office, and 9 NBFIs applied for change of title.

With the aim of further developing regulatory policy, and to improve implementation, we met with each one of the 86 NBFIs which are operating in Ulaanbaatar City and discussed regulatory policy decisions, NBFIs' challenges-difficulties, and further development issues

A policy has been drafted to support and increase the current assets of NBFIs. In this framework, 7 NBFIs qualified for loans from the "Sustainable livelihood" project, which was financed by the World Bank, and part of the project was directed towards development of the Microfinance sector.

In collaboration with the Asian Development Bank, the "Capacity Building for Financial Sector Reforms" project team developed an Information Technology database program Blue-Print for the Commission, and this was the first step towards building an integrated network system for the NBFIs.

B. Promoting Public Financial Education

In order to make information related to NBFIs' activities more transparent for the public, and also with the intention of implementing the regulation, the Commission distributed information by public media on the Commission's regulatory policy actions, regulations which are effective, licensed institutions, and institutions' licenses which were suspended or revoked. This information was publicly distributed by public media and the official website.

Improving and enhancing financial education for the financial institutions' executives and specialists is an essential factor in this sector's development, and in sustainable and risk free operation of the sector. 67 NBFIs' executives and accountants participated in training in 2007. The following training programs were organized for the NBFIs: financial institutions' lending service, market risk management, Non-bank financial institutions prudential ratios, requirement and condition for the licensing of NBFIs and foreign countries' practices on anti-money laundering. During the training programs, common violations, which were spotted during inspection, were openly discussed.

C. Protecting the Legal Rights of Financial Market Participants

Protecting and assuring the legal rights of customers will boost the public confidence in the market, leading to further expansion of the market. Even though NBFIs utilize their own assets to provide a lending service for the public, and they take the risk on their own, trust services, factoring services, and money transfer services present certain risks for customers. Thus, financial institutions' activities will be transparent for the public. It is necessary to provide timely information for the public in order to protect the customers' legal rights.

Following the requirement imposed by the Commission, NBFIs created a bulletin media board, and disclose their financial reports through public media. Some NBFIs have already created web-sites for their customers.

During the reporting period, the FRC inspected and responded to over 450 letters and complaints related to NBFIs.

We aim to modify and make amendments to the laws and regulations which are conflicting with interests of the market participants, as the FRC is the State regulatory body that is responsible for market regulation. We conduct regular reviews of laws and regulations.

D. Fighting Against Financial Fraud and Misconduct

In accordance with the Commission's integrated supervision plan, 46 NBFIs were inspected in line with the special guideline. During the course of supervision we identified a number violation of both regulations and laws relevant to NBFIs and other relevant legislative acts. The following are the common violations we have found:

- Legal entities engaging in some NBFIs activities without the Commission's authorization.
- NBFIs reflecting in financial statements changes in their capital structure without prior notification to the FRC.
- Not conforming to the accounting standards. Financial statements weren't consistent, and there were errors on the balance sheet.
- Opening a branch office /representative office/ without the Commission's permission.
- Breaching the institutional charter, due to failure to operate an internal audit unit and lending committees in a proper manner.
- Not regularly reporting the changes to the company charter and change of the state registration certificate.

While we were conducting inspection of NBFIs, 6.03 million MNT administrative fines were imposed on NBFIs. In order to reduce violations of this sort, we have given out recommendations and advices as well as State Inspectors prompt corrective action official letters. Inspections indicate that violations have been reduced significantly since we conducted the above mentioned actions.

In the reporting year, we received financial statements every quarter, conducted prudential ratio analysis, and gave out detailed instructions and recommendations.

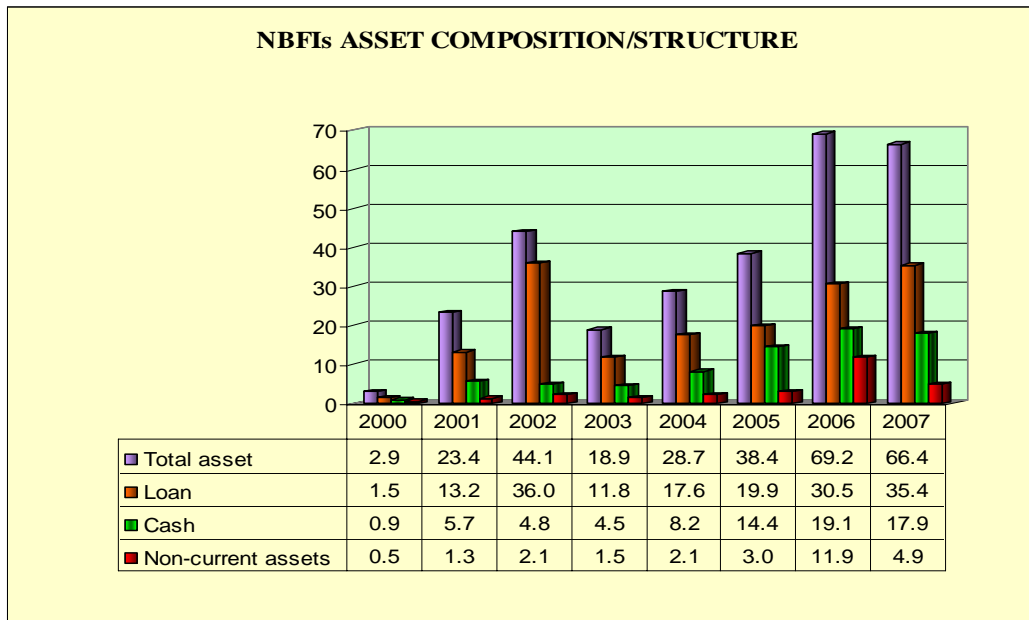
Consolidation and analysis of financial statements is a main way to implement Off-Site supervision. Furthermore, it's important to gather statistical information to identify the scope of services, and defining the accessibility of services will play a large role in further development. In the course of Off-Site supervision, licenses of 14 NBFIs have been suspended, and 12 licenses were revoked, for breaches of Non-bank financial institutions laws and regulations.

E. The Current Situation of the Market

Currently, there are 137 licensed Non-bank financial institutions in the market. Out of 137 Non-bank financial institutions, 112 of them operate in Ulaanbaatar City, and 25 Non-bank financial institutions operate in rural areas. 14 NBFIs were supported with full or partial foreign investment from Japan, UK, China, Korea and Italy.

There are 43 branch offices of the NBFIs, 433 shareholders, and 647 employees sector wide. Moreover, NBFIs provided financial services to in aggregate 72.900 customers.

1. Total assets

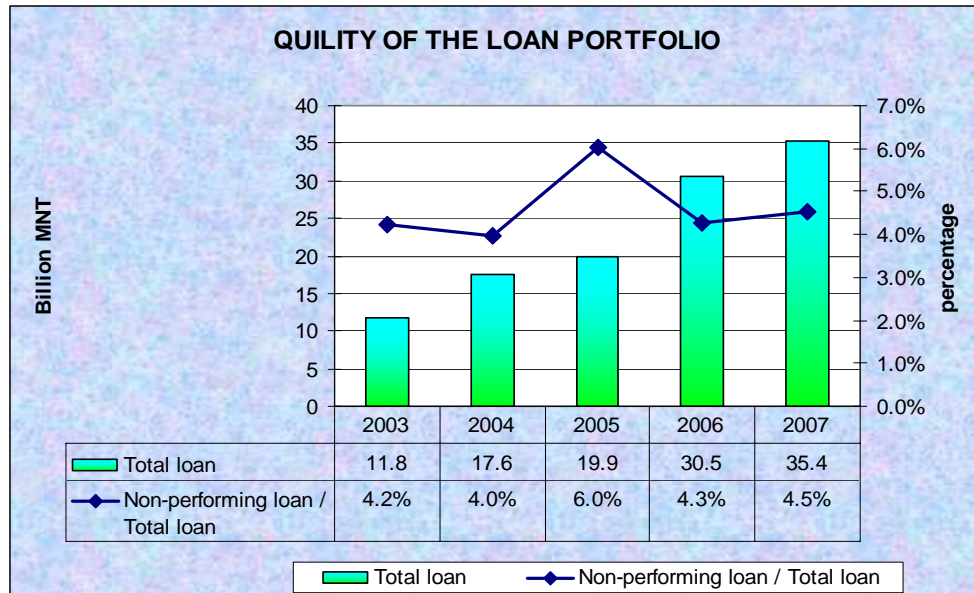


In 2007, NBFIs' total assets reached 66.4 billion MNT, equal to 2.0 percent of banking sector total assets and equal to 1.5 percent of Mongolian Gross Domestic Product.

As a result of increasing the minimum capital requirement of the NBFIs in 2006, total assets grew by 80 percent, but in 2007 some NBFIs failed to meet minimum capital requirements, and their activities were terminated. Therefore, total assets decreased by 4 percent down to 66.4 billion MNT. Nevertheless, the number of legal entities who want to engage in NBFIs activities has increased sharply.

On average, 57.6 of total assets are composed of lending, 26.2 percent of cash, and 9.3 percent of non-current assets.

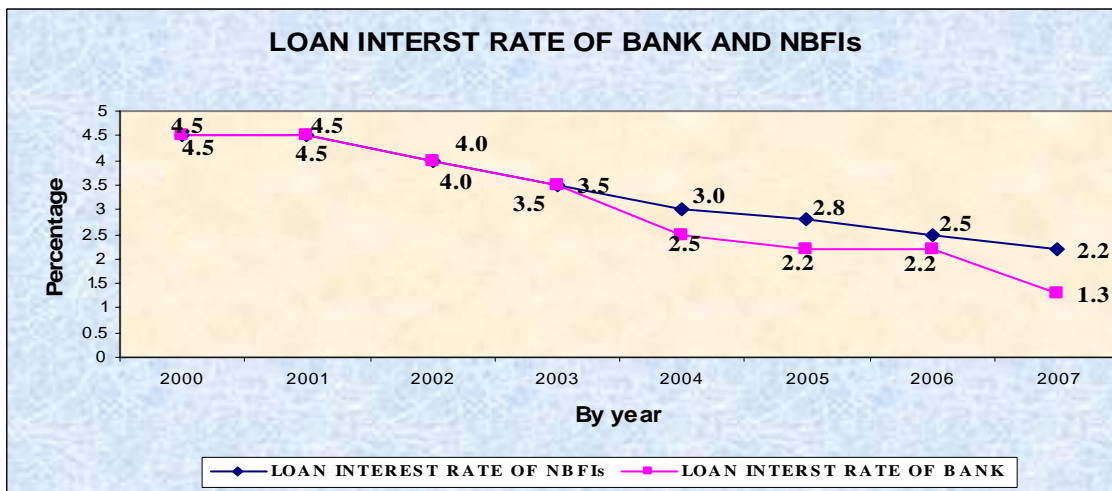
2. Loan portfolio quality



In total, the volume of non-performing loans decreased from 6 percent to 4.3 percent in 2005 through 2006, but in 2007 it increased by 0.2 percent to 4.5 percent, and non performing loans outstanding increased by 23 percent or 288 million MNT.

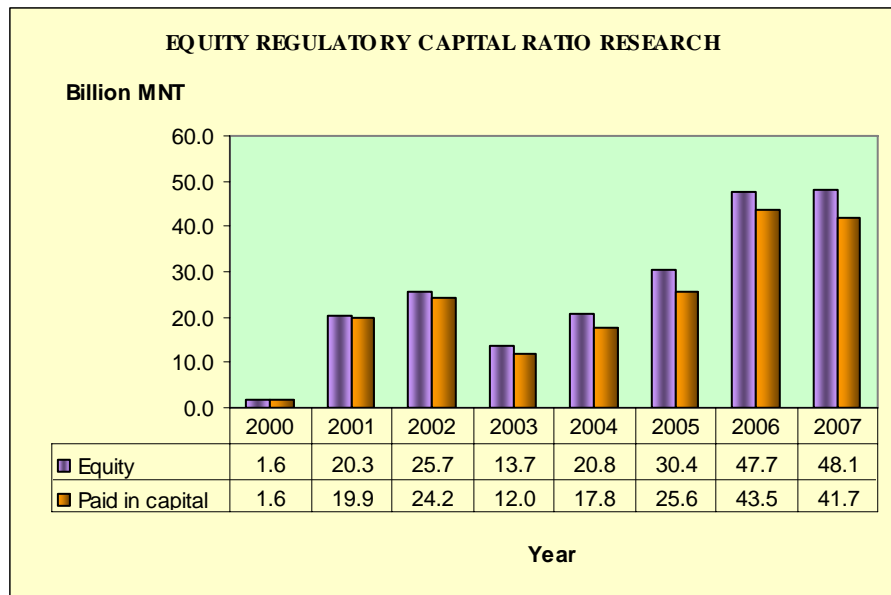
NBFIs have created risk funds worth 1.3 billion MNT which equals 81 percent of the non performing loans.

3. Loan interest rate



In recent years, due to increased banking competition among financial institutions, loan interest rates have been decreasing substantially. In 2007, NBFIs' monthly average interest rate was 2.2 percent, which was 2 times lower than the 2000-2001 level.

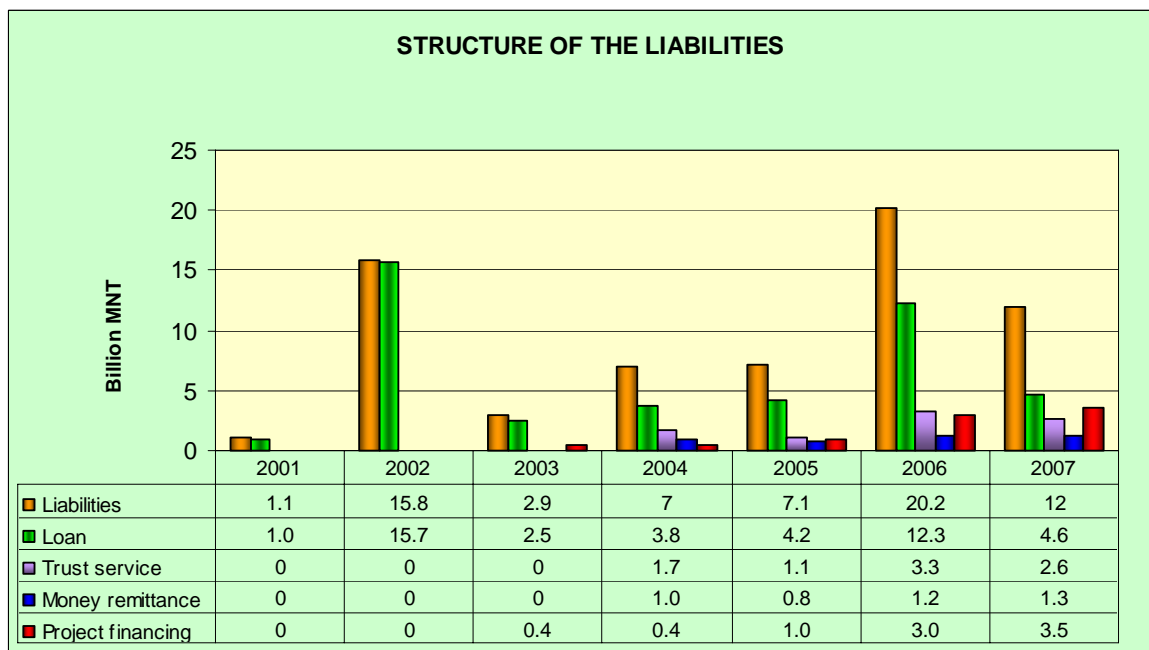
4. Equity and minimum capital requirement



In 2007, total equity of the NBFIs reached 48.1 billion MNT which equals 12.8 percent of the banking sector equity.

In relation to increasing the minimum capital requirement of the NBFIs, equity increased by 56.9 percent in 2006. But in 2007 the FRC made a decision to cancel 36 NBFIs' activities. Still, if we compare with the last year, it has increased by 0.84 percent. Paid in capital decreased by 4.14 percent. 86.7 percent of equity is composed of paid in capital.

5. Liabilities



NBFIs' activities were previously based on bank loans. Starting from 2004, NBFIs have introduced new services like financial trust service and money remittance. Also, NBFIs have increased

funding by participating in bulk loan projects which were implemented by international cooperation agencies and donor institutions.

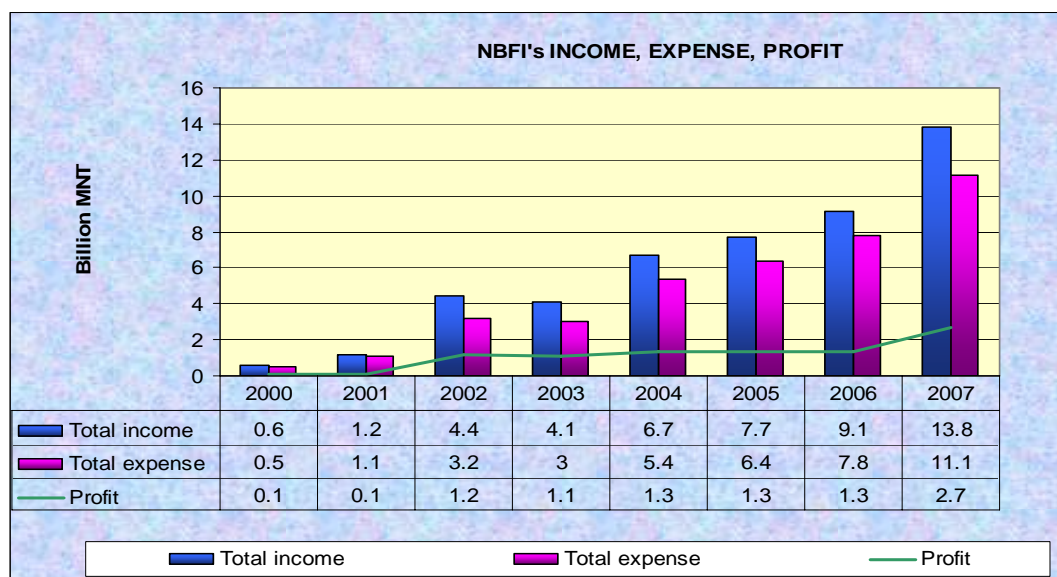
In 2007, NBFIs' total liabilities decreased by 41 percent or 7.8 billion MNT, which was caused by the NBFIs having to reimburse bank loans at interest rates of 0.5-2.0 percent.

NBFI's financial trust service resources do not differ from the deposit service. Thus, in order to prevent potential risks and protect the stability of the financial sector, it is essential to create an appropriate regulatory legal environment.

6. Profitability

NBFIs' industry average return on assets is 4.6 percent. The industry average return on equity is 6.1 percent, compared to the banking sector's indicator return on assets of nearly 2 times higher. The reason for the low return on equity is that NBFIs are not able to fully utilize financial leverage, plus financing operation costs are high.

In past years, NBFIs' lending activities expanded. Therefore, the interest rate return sustainably increased, and in 2007 it increased by 52 percent or 4.7 billion MNT reaching 13.8 billion MNT. But total expenditure has increased by 42 percent and it has reached 11.1 billion MNT.



F. The Further Implementation of the Policy Measures

Although Non-Bank Financial Institutions are one of the main components of the financial sector, the legal environment for this sector is not well developed; staffs are inexperienced and have limited knowledge of financial management. Since there are inadequate assets, it becomes difficult to attract enough customers to the sector. Moreover, there is a lack of motivation to compete with each other in the market. Thus, the following policy measures need to be taken immediately:

- Define mid-term strategies for the microfinance market and gain knowledge from foreign country experiences.
- Pass a range of necessary laws and regulations related to NBFIs' activities, and formulate a regulation on the activities of NBFIs, and ensure enforcement.
- In the framework of improving the legal environment for this sector, and supporting new services and products, an amendment should be made to the current laws related to NBFIs.
- By improving the financial reporting standard, it is necessary to introduce a risk management system.
- Strengthen the quality of off-site supervision and accounting standards
- Support the capacity and quality of the NBFIs' activities by promoting merger of NBFIs, to become larger.
- Promote appropriate Corporate Governance standards for NBFIs.
- In the framework of Government liaison or international institutions' projects, increase loan accessibility for NBFIs.
- Create an integrated information database network for the sector.

4. SAVINGS AND CREDIT COOPERATIVES

The objective of 2007 was to regain public trust and confidence in the sector. Having just emerged from the SCC-related financial crisis, it is an essential task to improve the legal environment for this sector, intensify regulation and supervision, and strengthen licensing requirements.

A. Promoting Public Confidence in the Financial Market

Savings and Credit Cooperatives engage in financial activities, and thus should be regulated by an independent Law on Savings and Credit Cooperatives, rather than a general law on Cooperatives. The SCC law draft has been submitted to the Parliament of Mongolia. The passage of this draft law will help define the development path of the Savings and Credit Cooperatives sector.

In order to intensify the supervision of SCCs' activities, and to improve the financial capacity of the SCCs, the following regulations were passed: "Savings and Credit Cooperatives activities prudential ratio regulation", "SCCs financial solvency regulation", and "On-Site supervision regulation".

In the reporting year, 129 Savings and Credit Cooperatives were licensed and 1 SCC failed to meet the Commission's requirements and thus had its license suspended.

The attention mainly has been directed to lowering savings interest rates and to sustaining financial stability. Regarding market regulation, SCCs' savings interest rates have been averaged to be in line with banks and Non-bank financial institutions.

B. Promoting Public Financial Education

A lack of public knowledge regarding the exercise of joint control over financial institutions, and lack of public information, played significant roles in the crisis of the Savings and Credit

Cooperatives. Therefore, this year we aimed to achieve timely distribution of information to the public.

The Commission's policy implementation on the Savings and Credit cooperatives' activities; results of supervision, and information regarding licensing of SCCs, have been reported regularly on following media : "Zuunii news", "Daily news", "Morning news", "C-1" TV Mongolian National Television and SBN.

The Commission organized a Capital Market Development open fair. During the fair, we distributed hand outs and brochures relating to SCC regulation and ownership rights for deposit holders.

Improving and enhancing the financial market participants' education will play an important role in the market stabilization process, especially for the SCCs' directors and executive employees. Therefore, we have conducted the following training programs and seminars:

In collaboration with the Asian and Mongolian Savings and Credit Cooperatives, organized the 3 days training program "Savings and Credit Cooperatives Management Instruments" for the employees of the FRC and SCCs, which gave an overview of: up coming challenges; future directions; "Savings and Credit Cooperatives development history"; and also has strengthened international cooperation.

In collaboration with XAC bank, we conducted the following training programs in Zavkhan, Arkhangai, Dund-Gobi, and Orkhon, Dornogobi provinces for the Savings and Credit Cooperatives which have a franchise contract with the XAC bank: "Loan risk assessment", and "Legal environment for conducting Savings and Credit Cooperatives activities". 180 participants participated in the training. We concluded that citizens have received good information regarding the "Savings and Credit Cooperatives characteristics", special features of its activities, members' rights for the cooperatives, internal democracy, "financial capacity", and how to improve discipline.

Besides training and seminars, the Commission has given numerous valuable recommendations and advices to the Savings and Credit cooperatives' management and their members on how to improve internal supervision and reporting. We concluded that it has provided significant assistance for the Savings and Credit Cooperatives' activities.

In the reporting year, Savings and Credit Cooperatives Department specialists have given professional legal advices to 336 legal entities, and 600 citizens.

C. Protecting the Legal Rights of Financial Market Participants

In order to protect the interests of the SCCs' deposit holders from potential illegal activities, we collaborated with the relevant institutions and paid special attention to prevention. With the aim of restoring market confidence to citizens, and in order to regain trust, attention was paid to reducing bureaucracy and improving the efficiency of public authorities.

187 complaints from deposit holders who were not able to get their money back from Savings and Credit Cooperatives were reviewed, and 26 complaints with potential criminal implications were transferred to the State Investigation Department.

The Commission has paid constant attention to 6 Savings and credit cooperatives which were in financial difficulties and caused damages to their members. In order to clarify the problems, the Commission has ordered the following assignments:

In the course of operational supervision and during the process of reviewing licensing and complaints, we have double checked the distribution of financial statements to deposit holders. As a result of the requirement, Savings and Credit Cooperatives are starting to get into the habit of posting relevant laws and regulations on the advertisement board, distributing the Commission's brochures, and introducing the Commission's inspection reports to their members.

D. Fighting Against Financial Fraud and Misconduct

There is an indication that shows that SCCs' managements are increasingly operating within the framework of the Law, and deposit holders are starting to strengthen their internal supervision. There are positive improvements and changes in the sector, but the Savings and Credit Cooperatives crisis is not over yet. The Commission continues to strengthen supervision and has taken action towards enforcing and satisfying the license requirement condition.

In the reporting year, in accordance with the Commission's consolidated supervision schedule for the Savings and Credit Cooperatives in 2007, the FRC conducted 8 inspections over 64 Savings and Credit Cooperatives, and based on public information and complaints also conducted supervision over 15 Savings and credit cooperatives which weren't included in the schedule.

The results of the inspections showed the following common violations:

- Cooperatives' governance is not well defined and therefore governors, supervisory board, and loan committee did not comply with the relevant laws, and executive directors did not have a work contract.

Internal controls were not formed or there was a lack of activity, with members' meetings not organized accordance of the law, accurate information not provided regarding the members, accounting standards not followed, attracting funds from non-member depositors, lending to non-members, and supervision over loan repayments not sufficient.

- Failed to meet the capital adequacy requirement, not submitting data and reports to the Commission, and errors on the report, and lack of culture on contacting the State regulatory institutions,

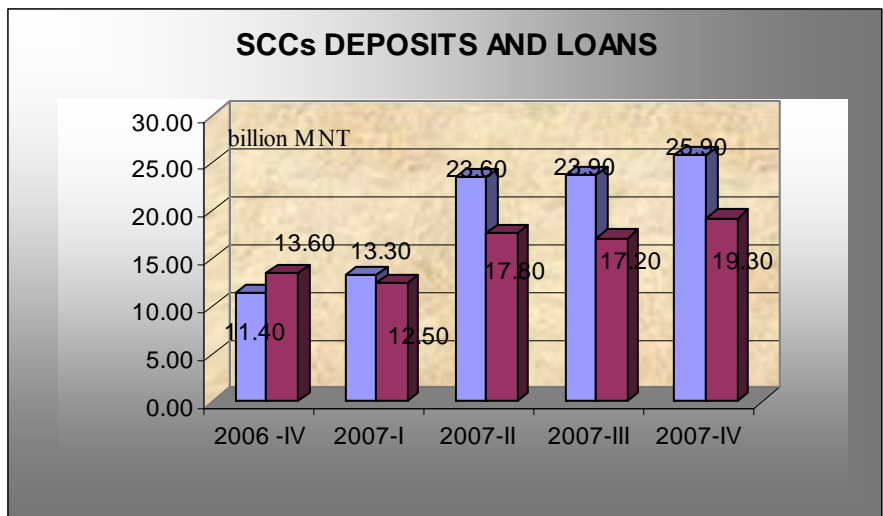
Based on supervision, 5 cooperatives which violated laws and regulations were fined by 460000 MNT, 24 cooperatives received prompt corrective action official letters which were sent to improve their activities. Cooperatives which have caused damage to consumers' interests included 5 cooperatives that were not giving back the customers' savings in accordance with the contract period. This was considered as a criminal case and therefore was transferred to the State Investigation department for further investigation.

Savings and Credit Cooperatives' financial reports, and prudential ratio reports, have been received quarterly and analyzed. In order to prevent future possible risks, we conducted research and gave out numerous advices and recommendations.

E. The Current Situation of the Market

At the end of 2007, 100 Savings and Credit Cooperatives operated in Ulaanbaatar city and 81 in local regions. 21 percent or 38 SCCs are under the XAC bank franchise service, and operate in the local regions.

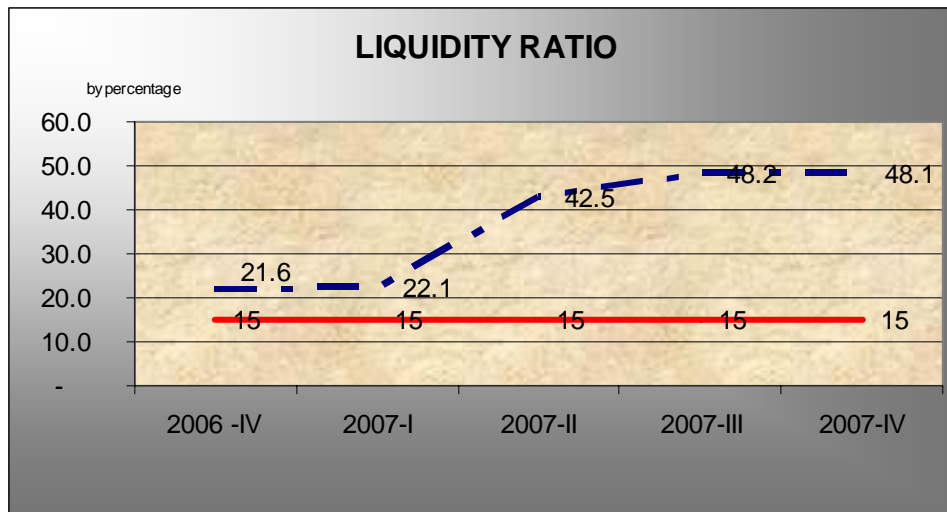
1. Deposit and loan



At the end of 2007, deposit savings amount to 25.9 billion MNT, which was 2.3 times higher than compared to the previous year. Outstanding loans were 19.3 billion MNT, which constitutes an 18.4 percent increase compared to 2006.

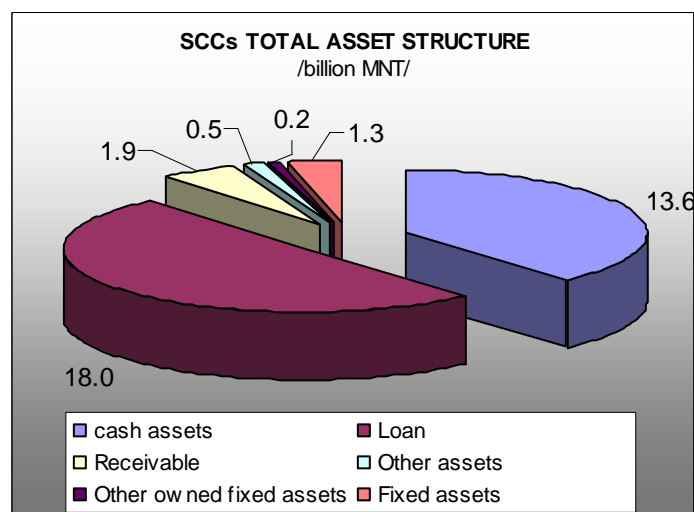
74.5 percent of the deposits were utilized for lending, and 25.5 percent were placed as cash in hand or in other institutions.

2. Savings and credit cooperatives' liquidity ratio capacity



The benchmark liquidity ratio of cooperatives' liquid assets divided by short term loans from others is above 15 percent. Thus, the performance indicates that it is higher than the prudential ratio requirement by 33.1 percent, which shows that the repayment capacity has increased.

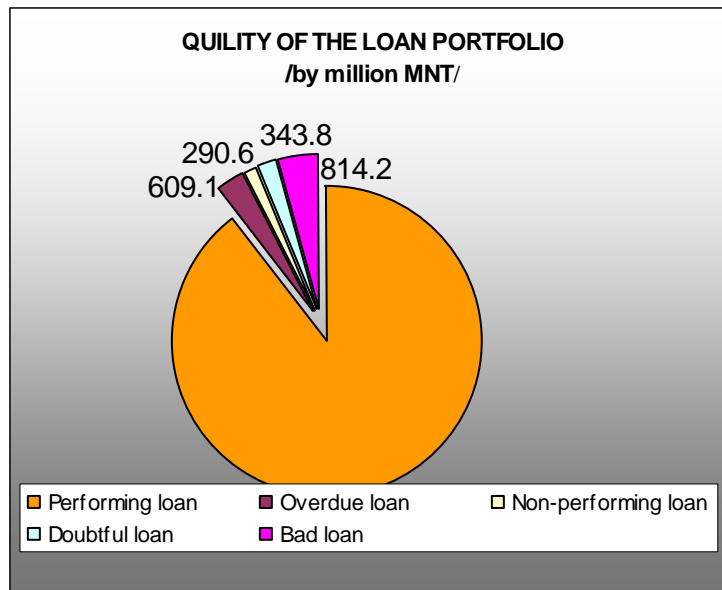
3. Savings and credit cooperatives' assets structure



SCCs' total assets reached 35 billion MNT at the end of 2007, a 44.5 percent increase compared to 2006. 38 percent of total assets were composed of cash, 51.4 percent of loans, 5.4 percent of receivables, 0.7 percent of other assets, and 3.7 percent of fixed assets.

Asset generating revenue has increased by 61.2 percent to 18 billion MNT, reaching 85 percent of this good profit trend. In the reporting year, Savings and Credit Cooperatives are running at a loss 1.85 billion MNT and 1.9 billion MNT of accumulated profit, so the SCC sector as a whole has made a profit of over 50 million MNT.

4. Quality of the savings and credit cooperatives loans

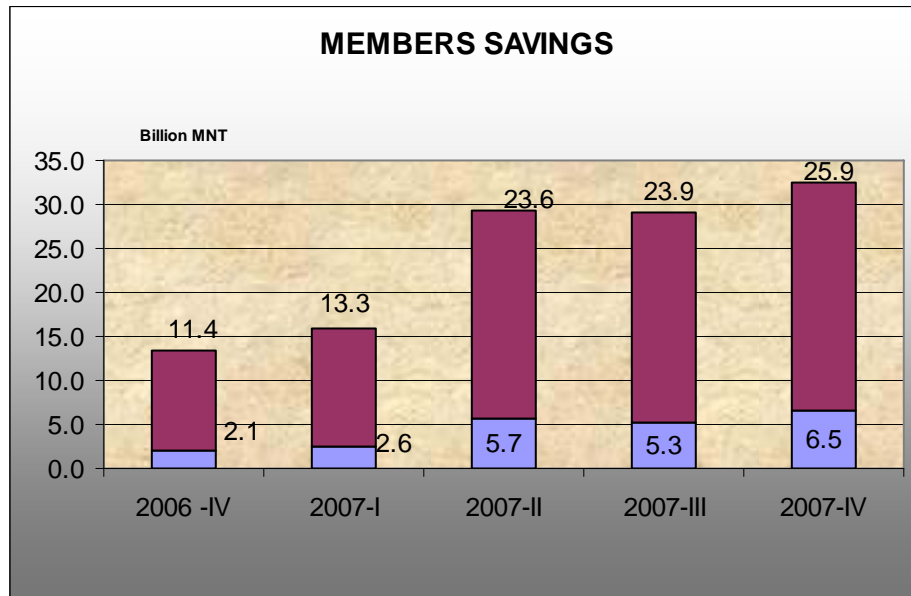


Total lending of the SCCs is 19.3 billion MNT. Compared to the previous year it has increased by 5.7 billion MNT, but total non-performing loans increased by 1.3 percent and reached 2.1 billion MNT. 1.2 billion in MNT risk reserve funds has been created for the SCC loan portfolio.

5. Savings and credit cooperatives' liabilities and shared capital

At the end of 2006, Savings and credit cooperatives' liabilities, shared capital ratio was 18.4 percent, but in the reporting year it reached 25 percent. This indicates that cooperatives tend to raise funds from members' deposits. Once again, it shows the possibility of financial risk higher in the sector.

Members' total deposits accounts for 74 percent and the prudential ratio norm is 70 percent.



6. Future policy implementation

The contribution of microfinance institutions in the financial market is increasing, and the accessibility of microfinance loans is broadening. For that reason, we ought to define SCC development tendencies and to create a legal environment which best suits the current situation of the market.

First of all, the FRC needs to implement the following specific tasks as a priority.

- Learn and study from international best practices, to develop a local model.
- Create a central database for the SCCs, and start data consolidation.
- Expand activities of the microfinance service in rural areas and provide policy support.
- Create a mechanism to involve SCCs in the insurance market service
- Savings and Credit Cooperatives' accounting standard shall be improved in line with international standard, establishing accurate financial reporting information.

THREE. FINANCIAL PERFORMANCE

The financial operations of the FRC were focused on spending budget resources as prescribed to achieve steady operation of the Commission Office, to expand international relations, to upgrade facilities and working environment, to improve staff social welfare, and to disseminate public information about its operation.

The State Great Hural (Parliament) of Mongolia endorsed the budget of the FRC at 541.4 million MNT, of which 381.4 million MNT was planned to be funded from the state budget, and 160.0 million MNT to be generated from its operational revenue. In addition, 30 million MNT was granted from the Mongolian Development fund to improve housing conditions of the FRC staff.

Income

The FRC received 357.9 million MNT from the State Budget, and raised 151.6 million MNT to the State Budget from its operations. In addition, total income of 486.0 million MNT was made from its main activities while carrying out the functions, of which 96.8% of income was from regulatory fees and the rest 3.2%, was from other resources.

Expenditure

The FRC spent 351.1 million MNT on salaries and social security expenditures, while 170.3 million MNT was spent for products and services out of the allocated 521.4 million MNT budget. The FRC regularly and promptly reported the Commission's 13.9 million MNT budget expenditure to the State Fund.

Savings from expenditure lines such as transportation, fuel, overseas and domestic business trips, trainings and internships, disseminations and advertisements, and the fee and commission charge 0.4 - 4.4 million MNT was transferred to cover overspent budget lines.

The following expenditure budgets were exceeded:

- Stationery expenditure was exceeded by around 1 million MNT due to increased costs related to integration of the regulatory bodies' accounting and financial reports, following off-site supervision feedback.
- Post and telecommunication costs were surpassed by 1.9 million MNT caused by the transfer and installation of the cables and related items as a result to change the office twice.
- As a result of the implementation of the decision from the State Great Hural (Parliament) to increase the number of FRC employees, planned expenditures on purchasing and installing furniture, technical and internet devices were surpassed by 2.6 million MNT.

There were no payables and receivables recorded in its operation in 2007.

Assets

In 2007, total assets of the FRC increased by 162.1 million MNT.

- Following the decision of the Government of Mongolia and State Property Committee, the Government House 4 building annex was transferred to the FRC's use, and in relation to this, private investment 52.6 million MNT which was previously put in to this building annex was reimbursed back to the investors by the FRC and the asset is recorded to Commission Offices' balance sheet;
- The FRC purchased "Land Cruiser 105" for 56.8 million MNT in order to enhance access of the FRC services in rural area; and,
- Purchased facilities and technical devices worth 32.1 million MNT, furniture and other movable property for 20.6 million MNT.

According to the decision of the General Manager and Head of Office based on “Law on Civil Service” and “Internal Rule for Operation of the Commission Office”, 30 million MNT which was allocated from the Mongolian Development Fund was spent to improve housing condition of employees.

Attached are the “Financial Statements of the FRC in 2007”.

The Commission in 2008

- By consolidating and analyzing the accomplishments in the scope of “Capital Market Development Year”, it can be said that although tasks that were planned were not fully accomplished, it is considered that a good development trend has been established, and first steps have been taken towards reform. In order to continue the practice to dedicate “the current year” to implement something beneficial that was stated in the Commission Strategic Plan, the FRC announced 2008 as “Micro Finance Market Development Year”. In relation to this, according to the plan, some actions are planned to be particularly taken on the non-bank financial institutions market, savings and credit cooperatives and insurance market, and some tangible conclusions are expected from these actions.
- The FRC will use its best endeavors to carry out initiatives and duties which are stated in the Main Guideline for socio-economic development of Mongolia, Government Action Plan, and a Performance Agreement signed between General Budget Administrator, the Chairman of the Commission and the General Manager (and the Head of Office) in their designated time frames.
- Direct legal and other regulatory actions to improve financial market professional participants’ ethics, responsibility, and discipline by strengthening requirements, and develop and secure compliance of the risk management methodology for the State remote supervision system.
- Improve efficiency of the organization of the Commission Office, enhance working conditions, build capacity of professional human resources, seek opportunities to standardize operations, and start to build the “Financial Education and Information Center” of the Commission.

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