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LEGAL UPDATE

Ethiopia Moves to Open Its Capital Market to Foreign Portfolio Investment:

The Draft Foreign Portfolio
Investment Regulation

Hirko and Associates Law Office

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Ethiopia Moves to Open Its Capital Market to Foreign Portfolio Investment: The Draft Foreign Portfolio Investment Regulation

I. INTRODUCTION

The Ethiopian Capital Market Authority is finalizing a landmark regulatory instrument that would, for the first time, permit foreign portfolio investment in Ethiopian securities. The draft **Foreign Portfolio Investment Regulation** (the "Draft Regulation") is currently under review by the Council of Ministers and has been described by officials as a critical component of Ethiopia's financial liberalization agenda. The Draft Regulation is issued pursuant to Article 108(1) of the Capital Market Proclamation No. 1248/2021, which empowers the Council of Ministers to issue regulations for the proper implementation of the Proclamation.

The instrument, if adopted in its current form, would establish a comprehensive legal framework governing the entry, operation, and exit of foreign portfolio investors in Ethiopia. It would permit foreign nationals and foreign entities to invest in shares, debt securities, money market instruments, collective investment schemes, and derivatives traded on licensed Ethiopian exchanges, subject to registration, custodianship, investment limits, holding periods, and reporting requirements. The Draft Regulation also allocates regulatory responsibility between the Ethiopian Capital Market Authority and the National Bank of Ethiopia, establishes a coordination committee, and creates a supervisory architecture for systemic risk monitoring. This update examines the principal features of the Draft Regulation and their implications for investors, intermediaries, and the wider market.

II. REGULATORY BASIS AND OBJECTIVES

The Draft Regulation is expressed to be issued under Article 108(1) of the Capital Market Proclamation No. 1248/2021. Its stated objectives are to deepen financial markets, enhance liquidity, bridge the domestic savings-investment gap, and integrate Ethiopia into the global capital market ecosystem, while balancing capital mobility with financial stability, investor protection, and macroprudential oversight. The Draft Regulation applies to all foreign portfolio investment carried out in Ethiopia, and it defines foreign portfolio investment as a cross-border investment in securities by a foreign portfolio investor.

III. ELIGIBILITY AND CATEGORIES OF FOREIGN PORTFOLIO INVESTORS

The Draft Regulation sets out a broad eligibility framework. A person is eligible to invest as a foreign portfolio investor if it is a foreign national, an enterprise in which a foreign national has an ownership stake, an enterprise incorporated outside Ethiopia, an

enterprise established jointly by such investors, or an Ethiopian permanently residing abroad who prefers treatment as a foreign investor. A foreign national of Ethiopian origin who elects to be treated as an Ethiopian national is not eligible to invest as a foreign portfolio investor. The Draft Regulation further provides that registration shall not be granted, and shall not remain valid, where the investment is primarily used as a conduit for funds originating from Ethiopian residents or from foreign citizens of Ethiopian origin who have elected domestic investor treatment. All foreign portfolio investment must be funded exclusively from sources originating outside Ethiopia in eligible foreign currency and remitted through authorized banking channels.

Investors are classified into two categories. Category I comprises governments, multilateral and international organizations, government-related investors including central banks and sovereign wealth funds, regulated pension and retirement funds and endowments, and institutional investors such as banks, insurance companies, asset managers, investment funds, collective investment schemes, and other capital market service providers. Category II comprises all other eligible investors, including foundations, charitable organizations, corporates, family businesses, individuals, entities investing on behalf of clients, and non-resident individual retail investors. The classification determines the applicable regulatory requirements, including the applicable due diligence and reporting regime.

IV. THE DESIGNATED CUSTODIAN REQUIREMENT

A central feature of the Draft Regulation is the requirement that no person may invest in Ethiopian securities as a foreign portfolio investor unless all assets and financial instruments linked to the investment are safekept by a Designated Custodian licensed by the Authority. The Designated Custodian is responsible for Know Your Client verification, anti-money laundering and counter-financing of terrorism screening, assessment of the authenticity and sufficiency of the information provided, and compliance with the eligibility and documentation requirements of the Draft Regulation. Category I applications must be approved or rejected within five business days of receipt of a complete application; Category II applications within ten business days. Where the applicant's ownership, governance, or control arrangements involve multiple layers, nominee entities, trusts, or intermediary vehicles that impede clear identification of the beneficial owner, the Designated Custodian must refer the application to the Authority for direct assessment.

The custodial architecture is supplemented by provisions permitting foreign portfolio investors to appoint a Global Custodian outside Ethiopia, provided that the Global Custodian acts through a Sub-Custodian licensed in Ethiopia or through a duly licensed subsidiary or branch. Omnibus accounts may be maintained at the Central Securities Depository in the name of the Designated Custodian, designated "Omnibus – FPI," representing the aggregated holdings of all the foreign portfolio investors of that custodian. Commercial banks licensed by the National Bank may provide custody

services, subject to a letter of no objection and confirmation of good standing from the National Bank, minimum capital and capital adequacy requirements, liquidity requirements, an unblemished compliance record, the establishment of a separate and ring-fenced custody business unit, and the prohibition on commingling custodial funds with the bank's own operations. The Authority retains the power to increase the minimum paid-up capital requirement for Designated Custodians where it determines that the existing requirement is insufficient to cover the systemic and operational risk profile of custodians, with a transition period not exceeding six months.

V. PERMITTED INVESTMENTS AND INVESTMENT LIMITS

Foreign portfolio investors may invest in money market instruments, shares, debt securities, public debt securities, units or shares of collective investment schemes registered by the Authority, and derivatives and other securities or financial instruments approved by the Authority. The Authority may impose restrictions, conditions, or prohibitions on participation in securities that are not listed on a licensed securities exchange where it determines that such investment impairs the ability of the Authority or the National Bank to monitor capital inflows and outflows, presents risks to investor protection, undermines the monitoring of ownership thresholds, poses systemic risk, or breaches applicable law.

The Draft Regulation establishes specific limits on equity investment. No single foreign portfolio investor, including affiliates and persons acting in concert, may hold more than ten per cent of the total paid-up capital of an issuer, directly or indirectly. Category I investors may, upon prior approval of the Authority, hold up to fifteen per cent. Any acquisition exceeding the ten per cent threshold requires mandatory approval of the Authority or compliance with the Investment Proclamation No. 1180/2020 and its subsidiary legislation. Where a limit is exceeded as a result of circumstances beyond the investor's control, including capital restructuring, mergers and acquisitions, or other corporate actions, the investor must notify the Authority and the Designated Custodian within five business days and divest the excess within fifteen business days. A one-time extension not exceeding thirty business days may be granted by the Authority on a reasoned request.

The total combined shareholding of all registered foreign portfolio investors in a single listed company may not exceed thirty per cent of the company's total share capital, unless a higher limit is approved by the Authority in respect of specific issuers, sectors, or classes of instruments. Market infrastructures are required to monitor and suspend further foreign purchases once the investment limits are reached. A foreign portfolio investor may not become a member of the board of directors or participate in the management of an issuer in which it has invested; any such act constitutes evidence of intent to exercise control and may result in reclassification of the investment as foreign direct investment. The exercise of ordinary shareholder rights, including voting at general meetings and submitting shareholder proposals, does not constitute participation in

management, but the holding of a board seat with voting rights, the exercise of day-to-day operational or executive authority, or the entry into agreements granting veto rights over core business decisions or the right to appoint executive officers does.

VI. INSTITUTIONAL COORDINATION AND SUPERVISORY ARCHITECTURE

The Draft Regulation allocates regulatory responsibility between the Ethiopian Capital Market Authority and the National Bank of Ethiopia. The Authority is responsible for prescribing notices and guidelines on registration and categorization, enforcing licensing and prudential requirements for capital market service providers and market infrastructures, and directing market infrastructures to implement trading rules, settlement procedures, and operational safeguards. The National Bank is responsible for regulating cross-border capital flows, approving repatriation of proceeds, determining the conditions under which foreign exchange may be introduced, converted, held, or repatriated, overseeing responses during periods of market stress, and supervising banks and authorized dealers in relation to foreign exchange. A Coordination Committee may be established, chaired by the Minister of Finance or a designated representative, with representation from the Ministry of Finance, the National Bank, the Authority, the Ethiopian Investment Commission, the Ministry of Trade and Regional Integration, the Financial Intelligence Service, and other relevant institutions. The Committee is to support coordinated responses during periods of market stress, facilitate inter-agency data sharing, and review policies and legal frameworks relevant to foreign portfolio investment.

VII. FOREIGN EXCHANGE, FUNDING, AND REPATRIATION

Foreign portfolio investors are entitled to repatriate, through authorized dealers, maturity proceeds of debt securities and money market instruments, proceeds from the sale or transfer of securities, redemption proceeds of collective investment schemes, dividends, interest, coupons, and other investment income, capital gains realized from securities transactions, and any other investment-related income lawfully accrued. Repatriation is conditional on compliance with any applicable holding period, settlement of the relevant transactions, payment of all applicable taxes and fees, and compliance with reporting and documentation requirements. The minimum holding period for foreign portfolio investments is not less than one year, although the Authority may set, abolish, adjust, waive, or differentiate holding periods by Directive, having regard to market conditions, the type of instrument, the maturity or residual duration of the instrument, the currency of denomination, and the category and risk profile of the investor. Holding periods applicable to money market instruments are to be imposed by the National Bank.

The Draft Regulation also contains a macroprudential safeguard. The National Bank may, in exceptional circumstances, impose temporary measures to restrict, delay, or condition the repatriation of capital, proceeds, dividends, interest, or other income. Exceptional

circumstances include severe shortages of foreign exchange reserves, systemic stress in the financial system, a balance-of-payments crisis or a material threat thereof, and other material shocks deemed to threaten the financial system. Any such measure must be transparent and publicly communicated, and may not remain in force for more than one hundred and eighty days unless renewed in accordance with applicable law. The inclusion of this provision reflects the tension inherent in opening a capital market to foreign participation while retaining the capacity to respond to capital flow reversals, and it is likely to be a focus of attention for prospective investors assessing the repatriation risk associated with Ethiopian portfolio investments.

VIII. ONGOING OBLIGATIONS, DISCLOSURE, AND REPORTING

The Draft Regulation imposes extensive ongoing obligations on Designated Custodians and foreign portfolio investors. Designated Custodians must ensure that investors maintain their eligibility and registration status, satisfy fit-and-proper requirements, comply with anti-money laundering and counter-financing of terrorism laws and sanctions, observe investment limits, sectoral restrictions, and ownership caps, conduct investment activity through licensed intermediaries and approved market infrastructures, and comply with additional requirements prescribed by the Authority. Material information must be disclosed immediately to the Designated Custodian, and the Designated Custodian must notify the Authority in writing within twenty-four hours of becoming aware of information that materially affects the investor's eligibility, regulatory status, ownership, or ability to invest, or that may affect market integrity, investor protection, or financial stability. Events requiring disclosure include changes in legal status, name, domicile, residency, or regulatory authorisation, the initiation of insolvency or similar proceedings, investigation or enforcement action by any regulatory authority, the imposition of sanctions, material changes in ownership, control, or investment strategy, changes in beneficial ownership, and other events determined by the Authority to be material.

Beneficial ownership disclosure is required when an investor directly or indirectly holds five per cent or more of the paid-up capital of a listed issuer. Holdings are aggregated across affiliated entities, persons acting in concert, and all forms of direct, indirect, or beneficial ownership. Periodic reporting obligations are differentiated by category: monthly reports in respect of Category II investors within seven calendar days after the end of each month, quarterly reports in respect of Category I investors within thirty calendar days after the end of each quarter, and annual reports within ninety calendar days after the end of each financial year. Records must be kept for a minimum of ten years. Issuers are also subject to reporting obligations in respect of foreign portfolio investment holdings, changes in ownership, and voting interests that reach or exceed the prescribed disclosure thresholds.

IX. SYSTEMIC RISK MONITORING AND MARKET STABILITY

The Draft Regulation establishes a systemic risk monitoring framework under which the Authority is to monitor and evaluate risk concentration of foreign portfolio ownership

across issuers and sectors, the volume, composition, and volatility of aggregate foreign portfolio inflows and reversals, asset-class exposure and diversification, price volatility and liquidity conditions, contagion effects between capital market service providers, market infrastructures, and financial institutions, potential spillovers of foreign portfolio investment risk into the financial system, the adequacy of cross-border regulatory cooperation, and other factors. The Authority is to prepare and publish a systemic risk and market stability report at intervals it deems appropriate, anonymising sensitive or confidential information, and may issue early warnings, enforce prudential requirements, require enhanced reporting, or take other proportionate measures where material or emerging systemic risks are identified. Early-warning indicators are to be developed in coordination with the National Bank, covering rapid asset price inflation, sharp surges, reversals, or concentration of inflows and outflows, sudden increases in market volatility or liquidity stress, deterioration in market depth, and operational, clearing, settlement, or custodial disruptions. The Authority may impose enhanced or differentiated prudential requirements on service providers that service a significant volume of foreign portfolio investment activity, are deemed systemically important to foreign portfolio market access, or exhibit elevated risk indicators.

X. INVESTOR PROTECTION, COMPLAINTS, AND DISPUTE RESOLUTION

The Draft Regulation provides that foreign portfolio investors shall receive treatment no less favourable than that accorded to domestic investors in like circumstances, and that no restrictions, limitations, or administrative measures shall apply except where expressly provided under the Draft Regulation or other applicable laws. Investors are entitled to exercise voting rights, receive capital gains, dividends, interest, and other lawful proceeds. The Investor Compensation Fund is to compensate eligible retail foreign portfolio investors who suffer pecuniary loss resulting from the failure of a licensed capital market service provider, subject to coverage limits and procedures. Complaints may be submitted to the Authority, which must establish clear and accessible channels for lodging complaints, requesting clarification, or raising concerns. Complainants are protected from retaliation. The Authority is to decide on complaints within thirty days, extendable to sixty days where the matter is complex or additional information is required. A foreign portfolio investor aggrieved by a final administrative decision of the Authority may appeal to the Administrative Tribunal. Civil disputes arising in the capital market are to be resolved by mediation and, where mediation fails, through arbitration in accordance with the Proclamation and the directives of the Authority.

XI. ENFORCEMENT AND SANCTIONS

The Draft Regulation confers on the Authority a broad range of administrative measures, including orders to cease acts or omissions in violation of the Draft Regulation, orders to cease specific activities or take corrective measures within a specified period, administrative fines proportionate to the gravity, duration, and impact of the violation, suspension or revocation of registration, licence, or approval, suspension, restriction, or

prohibition of trading or participation in the capital market, and any other administrative measure prescribed by directive. Where a capital market service provider facilitates, aids, abets, or fails to exercise due diligence to prevent a breach by a foreign portfolio investor, the Authority may impose administrative measures on the service provider. The Authority may temporarily suspend a foreign portfolio investor's right to trade where there is a pending investigation, and may permanently revoke registration and mandate the orderly liquidation of the Ethiopian portfolio in cases of gross negligence, fraud, or repeated offences. Prohibited acts include investing in securities not listed as eligible instruments, investing outside approved financial instruments, holding more than the specified ownership limit without approval, failing to divest excess ownership within the specified time, circumventing thresholds through affiliates or persons acting in concert, investing without a Designated Custodian, operating trading accounts not linked to a single Central Securities Depository account, opening accounts without Know Your Client due diligence, and utilizing multiple accounts to circumvent ownership caps. The Authority may also order the restitution of any financial benefit obtained to affected market participants where prohibited trading practices have been engaged in.

XII. PRACTICAL IMPLICATIONS

The Draft Regulation, if adopted in its current form, would represent a significant opening of the Ethiopian capital market to foreign participation. For foreign institutional investors, the framework offers a structured route to entry, with clear eligibility criteria, a defined registration process through licensed Designated Custodians, specified investment limits, and explicit repatriation rights. The categorization of investors into Category I and Category II, with differentiated due diligence and reporting requirements, reflects an attempt to calibrate regulatory burdens to risk. The requirement that all investment be funded exclusively from foreign sources in eligible foreign currency, and the prohibition on using foreign portfolio investment structures as conduits for domestic funds, are directed at ensuring that the liberalization does not facilitate capital flight or circumvention of domestic investment rules.

For domestic issuers and market intermediaries, the Draft Regulation creates both opportunity and obligation. Issuers gain access to a new pool of capital, but they also assume reporting obligations in respect of foreign holdings and become subject to limits on aggregate foreign ownership of thirty per cent unless a higher limit is approved. Capital market service providers and market infrastructures assume responsibilities in respect of onboarding, monitoring, reporting, and compliance, and they become subject to prudential requirements proportionate to the risks arising from the foreign portfolio investment activity they service. Commercial banks seeking to provide custody services must satisfy a range of requirements, including the establishment of a ring-fenced custody business unit, the maintenance of separate reporting and control frameworks, and the prohibition on using custodial funds or investor data for commercial banking purposes.

The most significant practical considerations for prospective investors are likely to be the minimum holding period of one year, the macroprudential power of the National Bank to impose temporary capital flow management measures in exceptional circumstances, and the requirement that all investment be routed through a Designated Custodian licensed by the Authority. The one-year holding period, in particular, will affect investment strategies that depend on short-term liquidity, and it will require investors to assess the duration of their intended exposure before committing capital. The capital flow management power, while subject to transparency requirements and a maximum duration of one hundred and eighty days unless renewed, introduces an element of repatriation risk that investors will need to price. The Designated Custodian requirement means that investors will need to select and contract with a licensed custodian before commencing investment activity, and that the custodian will act as the primary point of contact for registration, due diligence, reporting, and compliance.

XIII. CONCLUSION

The Draft Foreign Portfolio Investment Regulation represents a substantial step in Ethiopia's financial liberalization agenda. It establishes a comprehensive framework for the entry, operation, and exit of foreign portfolio investors, allocates regulatory responsibility between the Ethiopian Capital Market Authority and the National Bank of Ethiopia, creates a supervisory architecture for systemic risk monitoring, and provides investor protection and dispute resolution mechanisms. The Draft Regulation remains subject to review by the Council of Ministers, and its final form may differ from the version currently under consideration. Once adopted and published in the Federal Negarit Gazette, it will enter into force on the date of publication. Prospective investors, issuers, custodians, and intermediaries should monitor the progress of the Draft Regulation and prepare for the operational and compliance requirements it will impose. The Authority is expected to issue implementing directives on registration, categorization, reporting, and enforcement, and further guidance will follow.

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