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LAW FIRM

LEGAL UPDATE

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Legal Update on Foreign Exchange Directive (FXD/01/2024)

DABLO LAW FIRM LLP, previously known as Dawit, Addisu& Bruk Law Office was established by its three managing partners Dawit Kidane, Addisu Hailegebriel, and Bruk Geremew in March 2013 to provide trustworthy, dependable, and reliable legal consultancy and advocacy services. As of 27 February 2023, Dawit, Addisu & Bruk Law Office has restructured as DABLO Law Firm LLP pursuant to the Federal Advocacy Service Licensing and Administration Proclamation No. 1249/2021.

Office Address: Addis Ababa, Arat Kilo, Nib Bank Building, 2nd Floor, Office No. 201

Email: info@dablolawfirm.com

Website: www.dablolawfirm.com

LinkedIn: www.linkedin.com/company/ethiolawyers/

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Introduction

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Ethiopia has embarked on a new era of economic policy, marked by currency devaluation and a significant revamp of the foreign currency exchange regime. The National Bank of Ethiopia (NBE) has revised its long-standing practice of fixing and controlling the exchange rate, opting for a market-based exchange regime. It has introduced a new Foreign Exchange Directive (FXD/01/2024) with immediate effect, which repealed all the previous sporadic directives governing the foreign exchange regime and consolidated the applicable rules into a single directive. This move is the fourth and by far the most radical currency devaluation measure taken by the government since the fall of the Derg regime in 1991.

DABLO has examined the content of the new Directive, and here are the key legal changes brought by the Directive.

Market-Based Exchange Regime: The role of the NBE has been reduced to monitoring the overall operation while the foreign exchange regime is to be governed by the market. Banks are allowed to freely set exchange rates and trade currencies with their customers and among themselves.[1] The NBE will compile an Indicative Daily Exchange Rate based on reports of daily exchange rates used by the banks. This rate will serve as a reference to set exchange rates but is by no means binding on the banks, as they are free to negotiate the market rate. Banks are required to report their daily foreign exchange rates to the NBE using a predetermined format.[2]

Currency Surrender: One of the most notable changes in the Directive is the elimination of the requirement for commercial banks and exporters to surrender their export earnings to the NBE. This change aims to give exporters greater flexibility in managing their finances. Exporters are now permitted to retain 50% of their export earnings in foreign currency, up from the previous 40%.[3]

[1] Article 4, The Foreign Exchange Directive No. FXD/01/2024
[2] Article 5
[3] Article 6.2

Exporters are permitted to use the foreign currency solely for their own purposes and may retain it in their retention account for up to 30 days. After this period, the foreign currency must be sold to the transacting bank at a freely negotiated exchange rate. [4]

Import Restrictions and Currency Allocation: The Directive lifts the previously imposed import restriction on 38 product categories while maintaining the restriction on capital account outflows. It is interesting to note that while the Directive uncategorical lifts the restriction on the 38 product categories, a letter written by the Ministry of Finance on July 30, 2024, maintained the restriction imposed on imports of fully assembled automobiles that run on fuel and three-wheel vehicles.

The Directive also removes the rules governing banks' allocation and distribution of foreign exchange, which was previously managed through a waiting list system for various import categories.

Engagement of Non-Bank Actors: The Directive paves the way for non-bank actors to engage in foreign currency transactions at market rates. These entities must obtain prior authorization or a license from the NBE. Further details on the requirements and procedures for these licenses will be outlined in subsequent directives to be issued by the NBE. [5]

Franco Valuta Imports: While the Directive lifts the restriction on valuta imports[6], the implementation of this change will be governed by a new regulation expected to be issued soon by the NBE. This regulation is expected to provide detailed procedures and standards for importing goods without utilizing foreign exchange resources from the banking system.

Foreign Currency Accounts: The new Directive significantly relaxes the rules governing the opening and administration of foreign currency accounts by foreign institutions, foreign direct investment (FDI) companies, and the Ethiopian diaspora. The Directive allows the opening of three types of foreign currency accounts: Foreign Currency (FCY) Accounts for Foreign Entities (such as FDI Companies, International Organizations, Embassies, and Foreign NGOs)[7], FCY Accounts for Residents and Non-Resident Ethiopians,[8] and Retention Accounts for exporters of goods and services.[9]

[4] Article 6.3-6.5
[5] Article 4.2
[6] It means the importation of goods for which foreign exchange from the domestic banking system is not payable.
[7] Article 13
[8] Article 14, ibid.
[9] Article 15, ibid.

Residents are now allowed to open foreign currency accounts based on remittance inflows, transfers from abroad, FX-based salary, or rental income, and use these accounts to make payments for foreign services. They are also allowed to use such accounts to effect payment for foreign services.[10]

Removal of Interest Rate Ceiling on Foreign Borrowings: The Directive completely removes the interest rate ceiling on borrowings by banks and companies from abroad, allowing for more flexible and competitive financing options. However, to ensure regulatory oversight and financial stability, any loan agreement with an external creditor must first be registered and approved by the NBE. [11]

Foreign Investments in Security Market: The Directive opens the Ethiopian Securities Market to foreign investments, paving the way for international participation and investment. However, its implementation is to be governed by specific regulatory requirements established by the National Bank of Ethiopia and the Ethiopian Capital Market Authority (ECMA).[12]

Special Privileges for Companies in Special Economic Zones: Under the Directive, Companies operating in Special Economic Zones (SEZ) are granted special foreign exchange privileges, including the ability to retain 100% of their foreign exchange earnings. [13]

Limits on Foreign Currency: The rules governing the amount of foreign cash travelers could carry while traveling to and from the country have been relaxed.[14] The Directive also stipulates specific time limits for holding and converting foreign currency for individuals entering the country.

Off-Shore Accounts: The Directive also allows the opening of off-shore accounts for Strategic Foreign Direct Investment projects.[15] Projects with special significance and contribution in terms of size, job creation, import substitute, foreign exchange inflows, technology transfer, or sector-specific impact could be allowed by NBE's Executive Management to own off-shore accounts.

[10] Article 14.5 & 14.6
[11] Article 17.1
[12] Article 20
[13] Article 21.3
[14] Article 22.7
[15] Article 19

Sanction: The Directive imposes a sanction of USD 2,500.00 (two thousand five hundred US Dollars) per violation on banks and other licensed entities for any violation of the Directive. In addition, NBE has also been given the discretion to impose further sanctions.