

The Importance and Function of Self-Regulatory Organizations in the Ethiopian Capital Market

1. Introduction

A centralized capital market system is one of the indicators of Ethiopia's economic reform. A critical component of this evolving financial landscape is the establishment and expansion of Self-Regulatory Organizations (SROs) and their regulatory system. As defined in Capital Market Proclamation No. 1248/2021 and Directive No. 1031/2024, SRO is an institution that plays a key role in market regulation. This article provides an overall analysis of the importance, responsibilities, and regulatory framework of SROs. Drawing directly from the main provisions of the Proclamation and the Directive, it examines the role SROs play in promoting market integrity and protecting investors.

2. Ethiopian Capital Market and the Importance for Self-Regulation

The Ethiopian Securities Exchange (ESX) is one of the established SRO under the Proclamation; it is an entity licensed by the Authority and has its own members. The Ethiopian capital market was established to mobilize long-term finance, expand investment opportunities, and support the country's major development goals.

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The Capital Market Proclamation created the legal basis for this exchange, establishing the Authority as the main regulator. Recognizing that an effective regulatory system requires a

multi-tiered approach, the Proclamation introduced the self-regulation concept.

SRO is defined as a non-governmental entity that exercises regulatory authority over its members, which include securities brokers, securities dealers, and securities exchanges. The delegation of specific regulatory functions to SRO has multiple aspects. It allows the SRO to utilize industry knowledge; enables the creation of tailored, flexible, and clear rules for specific market segments; reduces the direct regulate pressure of the Authority; and promotes a culture of compliance within the industry. The Directive No. 1031/2017 elaborates in detail the licensing and supervision procedures for such entities in the Ethiopian context, showing that a significant step has been taken to extend a multi-layered control system.

3. Legal Basis: Proclamation and Directive

The operational framework for SRO is derived from a two-tier legal framework: the Capital Market Proclamation No. 1248/2013. Article 22

of the Proclamation states that the Authority has the power to license SROs and delegates certain regulatory functions to them. It also lists key criteria for obtaining a license, including adequate capacity and competence, fair and transparent membership rules, and governance structures that prioritize the public interest.

The second is Directive No. 1031/2017, which elaborates on the detailed licensing and supervision procedures. The Directive covers application processes, governance levels, ongoing obligations, supervision methods, and enforcement measures. This Directive serves as a legal framework and control tool for any entity that wishes to be and operate as a Self-Regulatory Organization in Ethiopia.

This framework establishes a delegation of authority relationship and makes self-regulatory organizations work as frontline regulators, but they are accountable to the Authority and subject to its continuous control.

4. The Licensing Process: Establishing SRO

The Directive establishes a strict and clear licensing process for any entity initiating to be officially licensed as a SRO. Operating as SRO without the Authority's license is prohibited, and the licensing process includes the following key criteria:

Submission of Application: A formal application containing extensive documents must be submitted in English or Amharic.

Documentary Requirements: The applicant must provide constitutive documents; detailed procedures, rules and policies prepared to prevent money laundering and terrorist financing; organizational structure; financial and administrative capacity; technological tools; and proof of the suitability and competence of its key professionals. In particular, it must show that its rules are consistent with the Capital Market Proclamation.

It must also submit an agreement signed by the applicant and key professionals to comply with the code of conduct issued for capital market service providers, key professionals and persons

of significant influence, and other applicable laws.

Staff Assessment: At least three of the applicant's key professionals, including the Chief Compliance Officer, must undergo an interview with the Authority. This helps to assess and confirm that the human resources behind the applicant are competent and reliable.

Recognition Decision Period: The Authority is expected to announce its decision within fifteen days of receiving a complete application. This indicates that the licensing process is intended to be structured and completed in a short time.

License Refusal: The Directive clearly lists rejection or license refusal grounds such as insufficient capacity, false information, non-compliance with rules, or failure to meet suitability and competence criteria. An applicant whose license request is to be rejected must be given the right to be heard.

This strict process helps ensure that only entities with visible knowledge, skill, and a

strong administrative structure, and that have passed strict vetting, obtain a license.

5. SRO Role, Power, and Function

Once a Self-Regulatory Organization obtains a license, it assumes significant responsibilities central to daily market control.

Main Obligations: A Self-Regulatory Organization must prioritize investor protection, promote market integrity, reduce systemic risk, and strive to develop capital market ecosystem. It is authorized to admit only licensed capital market service providers as members and must have fair and transparent admission criteria and processes.

Delegated Power and Duties: Subject to the Authority's approval, SROs have the authority to do the following:

1. **Rule-making:** Establish rules that govern the behavior and activity rights and obligations of its members and put them into effect upon the Authority's approval.

2. **Monitoring and Enforcement:** Set minimum operational standards for members, conduct on-site or off-site inspections and investigations, and review member records.

3. **Discipline:** Enforce rules by conducting investigations and imposing sanctions on members found to be at fault.

4. **Market Surveillance:** Perform market monitoring to analyze potential trading abuses.

5. **Dispute Resolution:** should establish procedures and rules for resolving disputes that arise between members or between a member and an investor.

6. **Client Compensation:** Establish a client compensation fund, subject to the Authority's approval, to compensate investors for losses caused by members, thereby enhancing confidence in the market.

This responsibility positions the SRO as the first line of defense in monitoring market

participants, ensuring compliance, and promoting orderly trading practices.

6. Governance and Operational Obligations

The Directive imposes strict governance levels on SROs to ensure their members operate independently and for public interest.

Impartiality: SROs must maintain a clear separation between their business activities and regulatory functions. This means separating their business activity and their regulatory work by assigning different human resources. Fines from disciplinary actions and service fees must be used solely for control purposes. They must develop and implement policy and procedure regarding this performance.

Governance Structure: It must ensure objective control of by including at least one-third independent directors on its board who have no relationship with itself or its members.

Fit and Proper Criteria: Both the Self-Regulatory Organization and its employees must meet high ethical and professional

standards. Key professionals must provide a police clearance certificate and can be rejected based on criteria related to their record of past financial crimes, malpractice, or bankruptcy.

Chief Compliance Officer: This officer is the main responsible for the Self-Regulatory Organization's compliance structure work process and reports any violations directly to the Authority. This position cannot be vacant for more than one business day, and the SRO must have a replacement Chief Compliance Officer plan, which emphasizes the critical nature of this role.

Systems and Controls: SROs must implement robust internal control, risk management, and compliance systems. They must conduct regular security vulnerability assessments on their technology based trading and regulation system.

7. The Supervision System of the Ethiopian Capital Market Authority

The self-regulation model is one of delegated regulation, not self-determination. Under this model, the Authority retains ultimate authority.

Continuous Supervision: The Authority has unrestricted authority to conduct announced or unannounced on-site or off-site inspections of self-regulatory organizations and to obtain all records.

Reporting Obligations: SROs are required to submit detailed quarterly and annual reports to the Authority on their investigation, inspection, disciplinary, and dispute resolution activities. They must also immediately report any legal violations or suspected market manipulation activities.

Administrative Measures: It is found in the Proclamation and the Directive that the Authority can take punitive measures against a self-regulatory organization for misconduct. These include penalties, warnings, mandatory rule amendments, suspension of employees, and ultimately, license revocation. It is also found that SROs affected by such action have the right

to appeal to the Ethiopian Capital Market Administrative Tribunal.

This framework indicates that while SROs conduct daily oversight, they operate within a clearly defined scope of power and they are accountable for their performance/action.

8. Conclusion

The introduction of a legal and regulatory framework for SROs through the Proclamation and Directive indicates that the Ethiopian capital market's control system is designed to operate beyond a government-centric model. By delegating certain frontline regulatory functions to specialized industry participants entities under strict criteria while retaining others under the Authority's immutable control, aims to promote private sector efficiency. It is founded on the goal of protecting public interest by protecting investors, promoting market fairness and financial stability, and creates a conducive environment for the joint regulatory role to be played.