

The Benefit of Dematerialization of Publicly Offered Securities

1. Introduction

Dematerialization of publicly offered securities in Ethiopia is a significant step that will bring about a major change in the management and trading of securities in the history of Ethiopian financial sector. The process is guided by Ethiopian Capital Market Proclamation No. 1248/2021 and Directive No. 1047/2025 (Dematerialization of Securities) which has been issued to implement the Proclamation. .

This article presents a general analysis of the benefits of dematerializing publicly offered securities in Ethiopia, by

analyzing the provisions of directive No. 1047/2025 and showing how this system is designed to enhance trading efficiency, strengthen investor protection, reduce systematic risks, and to show the preparedness of Ethiopia's capital market for integration with the global financial system.

"Countries with developed financial systems have long embraced dematerialization—the process of converting physical securities into electronic form, as a non-negotiable standard for market operations."

Its primary objective is to eliminate paper based securities and convert them into electronic form, thereby ensuring greater efficiency and convenience in both the custody and trading of securities. Moreover, by undertaking this initiative, our country can be laying the foundation for a transparent, secure and dynamic capital market infrastructure capable of accelerating and sustaining economic reforms.

2. The Importance of Dematerialized Securities for a Modern Capital Market

For decades, global capital markets have undergone a profound digital transformation, moving away from the cumbersome and risky practice of issuing and trading physical share certificates. Countries with developed

financial systems have long embraced dematerialization—the process of converting physical securities into electronic form, as a non-negotiable standard for market operations. Ethiopia, having recently established its formal capital market framework with the Capital Market Proclamation No. 1248/2021, is now taking a decisive step to align itself with these global best practices.

The preamble of Directive 1047/2025 explicitly states the necessity of this transition: to create an "efficient, secure, and transparent electronic system that enhances market operations, promotes investor confidence, and improves the capital markets overall functioning." The role of dematerialization, therefore, extends far beyond mere administrative

convenience. It is the central nervous system of a modern exchange, facilitating speed, security, and trust. This article explores this role across several dimensions, using the directive as its primary blueprint.

3. The Basis of Dematerializing Publicly Offered Securities

A critical first step in any dematerialization process is establishing the legal validity of electronic records. Directive 1047/2025 addresses this head-on in Part I, Article 5. It unequivocally states that dematerialized securities are "legally recognized, valid, and enforceable financial instruments." This legal certainty is paramount.

Electronic Records as Prima Facie Evidence: Article 5(2) and 5(4) establish that ownership is no longer proved by a paper certificate but by the electronic record maintained by the Central Securities Depository. This register becomes the "authoritative source of evidence of ownership," superseding any physical documents or company-held registers after the "Dematerialization Date" (Article 13).

Fungibility: Article 5(5) establishes that dematerialized securities of the same type are fungible, meaning they are exchangeable from one hand to the other. This is a fundamental principle for creating a liquid market. Dematerialization standardizes the handling of securities, ensuring that each electronic register unit is similar to any

other unit of the same type of securities issued by the same issuer. By removing the need to track specific paper documents, it replaces the old paper based system with a secure digital system. As paper based securities are vulnerable to forgery and other crimes, the electronic register of securities system which is recorded and maintained electronically within a Centralized Securities Depository(CSD), eliminates the traditional vulnerable paper based system.

4. The Dematerialization Process

Directive 1047/2025 outlines a meticulous process for transitioning to the new system, clearly demonstrating the steps to be taken including the

precaution to be taken during the process.

4.1 Information Exchange and Data Migration

The process begins with robust information exchange and data migration. Article 6 obliges issuers to notify all their security holders about the requirement under the directive', the dematerialization process and its initiation. Notifications must be published in widely circulated newspapers in both Amharic and English, with optional use of SMS, email, and websites. This ensures widespread awareness and inclusivity.

Issuers must first reconcile their shareholder registers to ensure accurate records. Article 7 of the Directive focuses on data migration and

reconciliation. Migration is the transfer from paper-based securities (certificates) to the Central Securities Depository (CSD) electronic registry, and reconciliation is capturing accurate details of all security holders, including the total number of securities, capital on the securities, unique identification number and other holder details. In addition, if the security is pledged, information on pledger and pledgee securities with their detail agreement should be included.

Reconciliation is a vital pre-requisite to prevent disputes and ensure a clean migration of data to CSD. During this transformation period, the issuer acts as a "temporary safe keeping agent" as per (Article 7(8)). However, this role does

not grant the issuer any rights over these securities (Article 7(9)).

1.2 Account Opening and Certificate Submission

No person can buy or sell securities without having a securities account. The main requirements and process to open account for investors are outlined in Articles 8 and 9.

1/ **Open a Securities Account:** An investor or Security Holder is required to open and maintain a Securities Holder account with the CSD through a licensed Securities Depository Member, such as a Securities Broker. Article 8(3) of the directive further strengthens investor protection by mandating Securities Depository Member to maintain a

strict segregation between their own assets and those of their clients.

2/ **Submit Physical Certificates:** The holder then submits their physical certificates and a completed deposit form to their Securities Depository Member.

3/ **Verification by Issuer:** The Securities Depository Member submits these physical certificates to the issuer for verification of its records.

4/ **Electronic Credit:** Once the Securities Depository Member has verified the deposited securities in accordance with its procedures, the issuer shall approve the credit of the securities into the owner's electronic CSD account (Article 9(5)). The physical certificates are then marked

as dematerialized and stored by the issuer for a minimum of ten years (Article 9(6)).

This process creates a clear, auditable chain of digital custody.

2. Enhancing Market Efficiency

The shift to dematerialization is fundamentally an efficiency play. The limitations of a paper-based system are severe; the following are the major ones:

- **Slow Transfers:** Physical delivery and endorsement of certificates are time-consuming.
- **High Costs:** Printing, secure storage, courier services, and manual processing are expensive.

- **Risk of Loss/Theft/Forgery:** Physical certificates are vulnerable to damage, loss, and fraudulent duplication.
- Dematerialization, as enabled by Article 5(3), eliminates these bottlenecks. The transfer of ownership occurs instantaneously through "electronic book entries in the Central Security Depository system." Dematerialized securities trading:

Clearing Settlement: Trades can be settled in a T+1 or T+2 cycles (Trade date plus one or two days), aligning with international standards, instead of taking weeks in a physical system.

Reduces Transaction Costs: Eliminates costs associated with printing, postage, and manual handling.

Increases Liquidity: Faster and cheaper transactions encourage more frequent trading, enhancing market liquidity and making it easier for investors to enter and exit positions.

3. Strengthening Protection and Confidence of Investor

A secure and transparent market is essential for attracting and retaining investors, both domestic and foreign. Directive 1047/2025 embeds multiple layers of investor protection.

Eliminating Risks of Loss or Damage to Paper Based Security Certificates: The risk of losing a paper based certificate or having it stolen is

completely eradicated. Security holding is securely recorded in the CSD.

Official Depository Records: The CSD maintains an accurate record of security holders (Article 15). Investors can request statement of accounts directly from the CSD or Security Depository Member (Article 17), providing them with direct and undeniable proof of their holdings.

Protection for Pledged Securities: Article 10 of the Directive states that pledged securities certificates can be dematerialized in coordination with the pledger, and the CSD must record the certificates in its electronic register, marked as pledged for the pledgee. This measure ensures both transparency and security for all parties involved in the agreement of pledge.

Segregation of Assets: The requirement that Securities Depository Members segregate client assets from their own (Article 8(3)) has been noted. This prevents client assets from being used to cover the Member's debts

Clear Dispute Resolution

Mechanism: Article 12 of the Directive establishes a structured procedure for resolving complaints. Investors are initially required to report any errors to the issuer, who must investigate and resolve the matter within ten business days. If the issuer fails to address the issue, the investor may escalate the complaint to the Ethiopian Capital Market Authority, which is also required to issue a final decision within ten business days. This framework provides efficient and specialized alternative to

lengthy court proceedings. If the matter is not resolved at this stage, the investor or the aggrieved party can appeal to the Ethiopian Capital Market Administrative Tribunal within 28 working days after the Authority has issued its decision.

