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Ethiopian Securities  
Exchange

# **Interpretative Guidance Notes/ Explanatory Commentaries** To The Rulebook Of The Ethiopian Securities Exchange, 2024



**INTERPRETATIVE GUIDANCE NOTES/  
EXPLANATORY COMMENTARIES TO THE  
RULEBOOK OF THE ETHIOPIAN SECURITIES  
EXCHANGE, 2025**

**June 2025**

## **DISCLAIMER**

The Interpretative Guidance Notes/Explanatory Commentaries (“IG/EC”) published by the Ethiopian Securities Exchange (ESX) do not constitute professional advice (whether legal, investment, financial, risk management, etc.) to any reader or user.

The purpose of the IG/EC is to provide clarity on certain provisions of the Rulebook of ESX, 2024, and it is expected that readers and users will consult the applicable advisers as may be relevant for the achievement of such reader’s or user’s activities and objectives, provided that such activities and objectives do not violate applicable laws, directives and rules governing the Ethiopian capital market.

Furthermore, all readers and users should note that activities listed, and examples used herein, are not exhaustive of situations that the applicable rules may apply to. In line with the provisions of Rule 2.4. Interpretation of the Rules, Procedures and Other Instruments, Rulebook of the Ethiopian Securities Exchange, 2024 (General Rules), as may be amended, *“the interpretation of any of these Rules, Procedure and other Instruments issued by ESX shall rest with the Board of Directors of The Exchange or any committee, person, entity, or organ authorised by the Board”*.

- Should you require further clarification, kindly contact .....
- The Rulebook of The Ethiopian Securities Exchange is available on The Exchange’s website (.....), for additional reference.

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# OVERVIEW

## Introduction

The Ethiopian Securities Exchange (hereinafter referred to as “ESX” or “The Exchange”), in line with its mandate to foster an orderly, transparent, and efficient capital market, has developed the Rulebook of the Ethiopian Securities Exchange, 2024 (hereinafter referred to as “Rulebook”) pursuant to Articles 35, 36, 37, and 38 of the Capital Market Proclamation No. 1248/2021. The Rulebook establishes a regulatory framework governing the activities of trading members, issuers, and other market participants within the Exchange, ensuring a robust foundation for market integrity, investor protection, and fair-trading practices.

Given the inherent complexities of securities markets and the evolving nature of financial transactions, a need arises to interpret the rules effectively to bridge gaps between the documented provisions and their practical application. This need is particularly critical in areas where the Rulebook provides a range of possible actions, requiring clear guidance on the factors that ESX will consider in decision-making processes. Accordingly, ESX has developed this Interpretative Guidance Notes/Explanatory Commentaries (“IG/EC”) to enhance understanding and facilitate consistent application of the Rulebook’s provisions.

## Objective

The Interpretative Guidance does not alter or amend the Rulebook but provides clarity on the expectations of ESX in relation to enforcement, compliance, and market conduct. It aims to support market participants in navigating the regulatory framework, ensuring that disciplinary measures are applied in a transparent, proportionate, and predictable manner.

## Key Considerations

In drafting this IG/EC, the following were key considerations.

- a. **Jurisdictional Analysis of the Legal and Regulatory Frameworks**: A comprehensive assessment of existing laws and directives, including the following, was conducted:
  - i. Capital Market Proclamation No. 1248/2021;
  - ii. Commercial Code of Ethiopia Proclamation No. 1243/2021;
  - iii. Directives issued by the Ethiopian Capital Market Authority; and
  - iv. Other relevant Ethiopian proclamations, codes and directives both within and outside the Ethiopian Capital Market.
- b. **Assessment of the Provisions of the Rulebook of ESX**: Analytical review of:
  - i. Queries received from stakeholders during the public consultation and approval stage;
  - ii. Provisions that are envisaged to be prone to multiple/diverse interpretations;

- iii. Perceived conflicts with established systems and structures, including laws, in the financial market and/or other sectors;
  - iv. Potential unintended consequences or illogical results; and
  - v. Any conflict, whether actual or perceived, with pre-existing market practices.
- c. **Global Benchmarking**: Extensive research was conducted on the regulatory frameworks, practices, and processes of other jurisdictions, which were carefully benchmarked and adapted to suit the unique characteristics of the Ethiopian operating environment.

## **SECTION 1 – VOLUME A (GENERAL RULES)**

### **Background**

Volume A (General Rules) provides the foundation for the Rulebook of the Ethiopian Securities Exchange (“ESX” or “the Exchange”), outlining principles, definitions, and administrative processes that ensure smooth operations, regulatory compliance, and transparency. It defines key mechanisms such as fee structures, ancillary services, and general conduct standards, aligning Trading Members’ practices, Issuers’ activities, and activities of other market participants with market integrity, client protection, and regulatory objectives.

This Section of the Interpretative Guidance Notes/Explanatory Commentaries (“IG/EC”) focus on ancillary services offered by Trading Members, as governed by Rule 3.3. Brokerage Fees and Commissions Charged by Trading Members under the General Rules. Rule 3.3. outlines the authority of The Exchange to prescribe brokerage fees and commissions while ensuring that any additional fees for ancillary services align with structures approved by the Ethiopian Capital Market Authority (ECMA).

This Section aims to:

- a. Define Ancillary Services: Clarify the scope of the supplementary activities.
- b. Ensure Compliance: Provide a structured process for approval and adherence to the prescribed fee framework.
- c. Promote Transparency: Establish clear requirements for fee disclosure, protecting investors’ interests, and reinforcing fairness and accountability in fees charged for the services.

### **Provision of Ancillary Services by Trading Members**

- **Authority of The Exchange**

Rule 3.3: Brokerage Fees and Commissions Charged by Trading Members (General Rules) authorises The Exchange to prescribe the maximum brokerage fees and commissions that Trading Members may charge for transactions involving securities listed on The Exchange. These prescribed fees shall be subject to the approval of the Ethiopian Capital Market Authority (ECMA) and shall be published periodically to ensure transparency and market compliance.

Additionally, the Rule stipulates that for any ancillary service related to securities listed on The Exchange, a Trading Member may only charge additional fees for ancillary services related to securities listed on the Exchange as approved by ECMA.



- **Examples of Ancillary Services**

Ancillary services may include, but are not limited to:

- a. Advisory Services: Offering investment advice and strategy planning, where permitted or authorized by ECMA.
- b. Research and Analysis: Providing in-depth market analysis and reports.
- c. Margin Lending: Offering loans to clients to purchase securities, where The Exchange and ECMA permit such activities.
- d. Corporate Actions: Assisting with activities like dividend payments, stock splits, and mergers.
- e. Transfer Agent Services: Managing the issuance and transfer of securities. This includes record keeping on behalf of an Issuer, if permitted by The Exchange and ECMA.
- f. Tax Services: Assisting with tax reporting and planning related to investments.

The fees for these ancillary services shall be clearly communicated to clients and shall adhere to the prescribed fee structure set by The Exchange.

- **Introduction of Ancillary Services**

Any Trading Member seeking to introduce a new ancillary service that is not covered by ESX or approved by ECMA, shall take the following steps:

- a. Proposal Submission: The Trading Member should prepare a detailed proposal outlining the ancillary service they wish to offer. The proposal should include a description of the service, its benefits to clients, and the rationale for its implementation.
- b. Regulatory Review: The proposal should be submitted to ESX and, if required, to ECMA for review and approval. The submission should comply with any specific guidelines or requirements set by ESX and ECMA.
- c. Feedback and Adjustments: Trading Members should be prepared to provide ESX and ECMA with additional information, modifications, or clarifications to the proposal. The Trading Member should also be prepared to make any necessary adjustments.
- d. Approval and Implementation: Once the proposal is approved by ESX and ECMA, the Trading Member can implement the ancillary service. They must ensure that all additional fees related to the service are clearly communicated to clients and charged in compliance with the approved structure.
- e. Communication to the Market: ESX will promptly communicate the introduction of a new ancillary service to the market to ensure all stakeholders are informed. The communication will include the following details:

- i. Service Description: A brief overview of the new ancillary service being introduced.
- ii. Purpose and Benefits: An explanation of the purpose of the service and the benefits it offers to market participants.
- iii. Implementation Date: The effective date from which the new service will be available.
- iv. Fee Structure: Information on any additional fees associated with the new service, as prescribed by ESX and approved by ECMA.
- v. Contact Information: Details of the department or individual to contact for further information or clarification.

- **Monitoring and Review of Ancillary Services by Trading Members**

Generally, the Trading Member is expected to regularly monitor, audit and review the implementation of the ancillary service to ensure ongoing compliance with the regulatory guidelines and any conditions set by ESX and/or ECMA.

- **Oversight of Ancillary Services by ESX**

To ensure proper monitoring and oversight, ESX will implement the following measures:

- a. Inspections: Assessment of ancillary services provided by Trading Members, and associated fees charged, may be included as focus areas for ESX during routine and/or random/ad-hoc inspections by ESX.
- b. Review of Records: Ensuring that Trading Members maintain comprehensive and transparent records of all transactions, fees, and services provided, which will be reviewed periodically.
- c. Compliance Reporting: Requiring Trading Members to submit regular reports on their fee structures, ancillary services, and compliance measures, which will be reviewed for adherence to regulations.
- d. Market Surveillance: Utilizing advanced surveillance systems to monitor trading activities and identify any irregularities or potential breaches of the rules.
- e. Client Feedback: Establishing a mechanism for clients to report any concerns or grievances related to fees and services, which will be investigated.

- **Transparent Pricing (Fees and Charges) for Ancillary Services**

The fees for ancillary services should be clearly communicated to clients and adhere to the prescribed fee structure set by ESX.

All fees and charges shall be subject to applicable taxes, which should be indicated separately to clients. ESX will ensure that all prescribed fees remain aligned with market standards while maintaining flexibility for necessary adjustments, subject to regulatory approval.

## **SECTION 2 – VOLUME B (MEMBERSHIP RULES)**

### **Background**

Volume B (Membership Rules) sets out the eligibility requirements, operational obligations, and governance standards that Trading Members of the ESX must comply with. These rules are central to maintaining the integrity, transparency, and efficiency of The Exchange's operations, ensuring that Trading Members operate in a manner consistent with regulatory objectives and market best practices.

The Membership Rules establish a framework for admission, supervision, and ongoing compliance of Trading Members. They address critical issues such as membership eligibility criteria, governance structures, the roles and responsibilities of key personnel, capital adequacy, client protection mechanisms, and disciplinary actions.

Collectively, the provisions of the Membership Rules promote confidence in The Exchange by ensuring that Trading Members meet high standards of conduct and financial soundness.

This Section of the IG/EC focuses on select Membership Rules that are central to the effective operation and compliance of Trading Members, providing additional clarity on their application and interpretation. Specifically, Section 2 covers the following key areas:

- a. Distinction between Digital Sub-Brokers and Trading Members, and the relationship between sponsors and Digital Sub-Brokers;
- b. Trading Members' obligation to maintain market integrity;
- c. End-to-end walkthrough of the membership application and evaluation process (with scenarios);
- d. Inactivity of Trading Members;
- e. Voluntary exit (relinquishment of membership);
- f. Compliance with minimum capital and liquidity requirements;
- g. Retention of jurisdiction over former personnel of Trading Members;
- h. The role of the Compliance Officer; and
- i. Compensation Fund (Claims Process and Calculation of Compensation).

### **Distinction between Digital Sub-Brokers and Trading Members, and the Relationship between Sponsors and Digital Sub-Brokers**

- **Ineligibility of Digital Sub-Brokers for Admission as Trading Members**

The categorization and admission of Trading Members, as contained in Rule 1.3. Categories of Trading Members (Membership Rules), disqualifies Digital Sub-Brokers for admission and recognition as Trading Members by the ESX under any circumstance.

The primary rationale for this is rooted in regulatory compliance as ESX's approach aligns with the ECMA's Capital Market Service Providers Licensing and Supervision Directive No. 980/2024 (hereinafter referred to as "CMSP Directive"). The CMSP Directive provides that Digital Sub-Brokers are only permitted to provide digital trading platforms through a Securities Dealer or Securities Broker, rather than directly engaging in securities trading. This distinction ensures that only licensed Securities Brokers and Dealers are authorized to trade on a licensed exchange, thereby reinforcing the integrity of the trading environment and safeguarding investor interests.

Furthermore, Digital Sub-Brokers are not expected to maintain the same operational and regulatory requirements as Trading Members, including capital adequacy, governance standards, and reporting obligations.

Operational control and risk management considerations further underscore the importance of the Rules. Unlike Securities Dealers and Brokers, Digital Sub-Brokers are not required to have the infrastructure or capacity to manage direct transactions on The Exchange. This lack of direct engagement in trading activities reduces their exposure to certain regulatory and compliance requirements but also necessitates a clear delineation of their permissible functions.

By clarifying the roles of different market participants, this rule ensures consistency within the regulatory framework and brings Ethiopia's capital market structure in line with international best practices.

A joint reading of the relevant provisions of the CMSP Directive and the ESX Rulebook further affirms the ineligibility of Digital Sub-Brokers for Trading Membership. Under Rule 1.2: Definitions (General Rules), "Trading Member" is defined as:

*"(www.) 'Trading Member' means an entity that has been issued a Membership Certificate by The Exchange to trade in one or more securities listed on The Exchange"*

(Note: Underlining added for emphasis.)

This definition implies that Trading Membership is granted solely for the purpose of trading securities listed on ESX. However, the CMSP Directive explicitly prohibits Digital Sub-Brokers from dealing directly with securities on an exchange or handling investors' funds, as contained in the following provisions of the CMSP Directive:

The following provisions of the CMSP Directive clarify the trading restrictions applicable to Digital Sub-Brokers:

**Article 2: Definitions:**

*"20. "Digital Sub-Broker" means a provider of digital platforms for the trading of securities on a licensed securities exchange or over-the-counter trading facility through a licensed Securities Broker or Securities Dealer."*

**Article 40: Authorized Activities of Securities Brokers, Securities Dealers and Securities Digital Sub-Brokers:**

*"(3) Securities Digital Sub-Brokers shall have the following functions:*

*a. Provide digital channels to clients for the sale and purchase of securities on a licensed securities exchange or over-the-counter trading facility only through one or more Securities Brokers or Securities Dealers who shall be the Securities Digital Sub-Broker's Sponsoring Securities Broker(s); and"*

*"(4) Under no circumstance shall a Securities Digital Sub-Broker engage in the maintenance or management of investors' funds."*

(Note: Underlining added for emphasis.)

Digital Sub-Brokers must be sponsored by entities that are empowered to trade—i.e., Trading Members—if they wish to gain access to ESX through their digital channels. Examples of Trading Members eligible to sponsor Digital Sub-Brokers include Securities Brokers, Securities Dealers, and Investment Banks (authorized to operate as Securities Broker and/or Securities Dealer) licensed by the ECMA.

- **Eligibility Criteria, Recognition, and Continuing Obligations of a Sponsor**

Chapter 10: Sponsoring Brokers, Dealers or Investment Banks for Digital Sub-Brokers (Membership Rules) provides expectations, rationale, and compliance obligations for entities seeking to sponsor Digital Sub-Brokers, ensuring that these market participants operate within a structured and compliant framework.

The regulatory framework outlined in the Chapter serves several key purposes:

- a. Risk Management and Compliance: By establishing clear criteria and responsibilities for sponsoring Trading Members, the rules aim to mitigate risks associated with the activities of Digital Sub-Broker. Ensuring that Digital Sub-Brokers are properly licensed and monitored helps maintain the integrity of the market.
- b. Investor Protection: By setting eligibility requirements and prescribing compliance processes, the rules aim to safeguard investors who transact through Digital Sub-Brokers. This ensures that investors engage only with reputable and compliant entities.
- c. Market Integrity: By mandating that sponsoring Trading Members notify The Exchange of their relationship with Digital Sub-Brokers and establishing defined supervision and compliance obligations, the rules seek to uphold market integrity. In addition, the provisions seek to address potential conflicts of interest and ensure transparency in transactions.
- d. Adaptation to Digital Trends: Recognizing the increasing digitalization of the securities market, the rules provide a regulatory structure that supports innovation while ensuring The Exchange maintains oversight over market activities.
- e. Accountability and Oversight: The requirement for internal reviews and supervisory controls by sponsoring firms ensures that Digital Sub-Brokers' activities are continually monitored. This accountability seeks to prevent malpractices and prohibited activities, while ensuring that any violation is swiftly addressed.

- f. Regulatory Enforcement: The inclusion of sanctions and suspension measures for non-compliant entities underscores ESX's commitment to consistent regulatory enforcement. The objective of this deterrent is to help maintain discipline and ensure compliance within the market.

- **Structure of the Relationship between Sponsors and Digital Sub-Brokers**

The relationship between Sponsors and Digital Sub-Brokers is primarily one of oversight and support, ensuring adherence to applicable laws, directives, regulations, and rules. Key aspects of this relationship include:

- a. Sponsorship: Sponsors are responsible for identifying and selecting Digital Sub-Brokers that meet regulatory criteria. This involves verifying licenses, ensuring proper support systems are in place, and securing the necessary approvals from The Exchange.
- b. Support and Infrastructure: Sponsors must establish the required infrastructure, systems, and processes to enable Digital Sub-Brokers to provide efficient and secure digital trading platforms.
- c. Custody of Client Assets: Sponsors and Digital Sub-Brokers must adhere to the relevant provisions of Article 44: Other Provisions Specific to Securities Digital Sub-Brokers and Sponsors of Securities Digital Sub-Brokers, CMSP Directive (as may be amended), regarding the custody of client assets.
- d. Accountability: Sponsors are accountable for the compliance of their Digital Sub-Brokers. Where a Digital Sub-Broker violates regulations, the Sponsor may face sanctions. Sponsors are also required to notify The Exchange of any termination of their relationship with a Digital Sub-Broker within twenty-four (24) hours. For regulatory purposes, The Exchange considers the sponsorship relationship terminated as soon as either party issues a termination notice, regardless of whether the other party accepts it.

Sponsors are responsible for ensuring that Digital Sub-Brokers comply with all applicable laws, rules, and directives. This includes adherence to Know Your Client (KYC) requirements, market regulations, and other compliance obligations set by regulatory bodies.

Additionally, sponsors must implement internal reviews and supervisory controls to monitor the activities of their Digital Sub-Brokers, ensuring robust compliance frameworks are in place.

## **Members' Obligation to Maintain Market Integrity**

- **Authority of The Exchange**

The Capital Market Proclamation No. 1248/2021 and the provisions of the ECMA's Directive on Licensing, Operation, and Supervision of Securities Exchanges, Derivatives Exchanges, and the Over-The-Counter Market No. 1009/2024, place obligations on a securities exchange

to oversee the operations and activities of its Trading Members to ensure market integrity and investor protection.

In addition, Rule 2.1. Authority to Admit Members (Membership Rules) establishes the administrative powers of ESX as it relates to membership of The Exchange, extending beyond only admission of members. It empowers The Exchange with the sole authority to admit, suspend and revoke membership of entities. It further restricts the operations of Trading Members to dealings that support the operation of a fair and orderly market, failing which ESX can suspend and/or revoke the membership of Trading Members.

To monitor the market and trading activities, ESX leverages advanced surveillance systems and other technology solutions. These tools are essential for preventing and detecting misconduct or actions that could disrupt the market, ensuring ESX can effectively uphold its authority.

- **Activities Contrary to Maintaining Market Integrity**

Activities that undermine the operation of a fair and orderly capital market include any action that can compromise transparency, fairness, and ethical standards as such activities could erode trust, disrupt stability, and diminish the efficiency of the market. Hence, maintaining market integrity requires adherence to principles that ensure honesty, accountability, and equitable treatment of all participants.

General violations of established rules and regulations further compromise the effectiveness and reliability of the market.

Examples include:

- a. Failure to operate within the defined parameters and restrictions stipulated by ESX as a condition for Membership of The Exchange.
- b. Market manipulation by creating appearances of misleading trading activity to influence market prices of securities.
- c. Insider trading using non-public and material information to gain an unfair advantage.
- d. Fraudulent practices by engaging in deceptive schemes to mislead investors.
- e. General rule violations by ignoring or contravening established market rules and regulations, which could lead to significant financial or reputational damage.

The different volumes of the ESX Rulebook contain various rules that highlight prohibited practices to ensure the integrity and fairness of the market. These rules are designed to prevent activities that could undermine market stability and investor confidence.

Therefore, while Membership of ESX is a voluntary choice, it comes with mandatory responsibilities. Once an entity decides to become a Trading Member, compliance with the ESX Rulebook is not optional but a requisite as the obligation to adhere to these rules is fundamental to maintaining a fair and orderly market. It ensures that all market participants are treated equitably and that the market operates with the highest standards of transparency and integrity.



## Membership Application and Evaluation Process

- **Eligibility and Summary of the Application/Evaluation Process**

Applicants must be licensed Capital Market Service Providers or Dealing Member Banks (as may be approved by ECMA) or have an ongoing application to the ECMA for the applicable category, and provide necessary documentation, including business plans, incorporation documents, and evidence of professional capacity.

Upon meeting the initial requirements, ESX may grant an Approval-In-Principle (AIP) that is valid for six (6) months, allowing the applicant to fulfill all operational pre-requisites. Successful evaluation, during ESX's certification is mandatory to convert the AIP to full Membership. Additionally, applicants must meet additional criteria, including technological compliance and proof of opening designated bank accounts, to commence operations.

Thereafter, successful applicants may be admitted by ESX as Trading Members and entered into the Register of Trading Members. The Membership admission process ensures that only qualified, licensed, fit and proper entities are admitted as Trading Members of ESX. This is aimed at upholding the integrity and professionalism of ESX's market by setting minimum criteria for membership, including key documentation, professional capacity, and compliance with regulatory requirements. The AIP and Certification Inspection processes are designed to thoroughly vet applicants, ensuring they meet all operational and compliance standards before commencing trading activities. Ultimately, these rules seek to protect investors, maintain market stability, and foster trust and transparency within the Ethiopian capital market.

- **End-to-End Walkthrough of the Membership Admission Process**

**Case Study/Scenario:** To illustrate the application process, consider **ABCXYZ Securities S.C.**, intending to become a Trading Member of ESX.

- **STEP 1: Application for Membership**

- **Submission:** ABCXYZ Securities S.C. submits the application in the prescribed manner, including all required documents (e.g., business plan, incorporation documents, board resolutions, etc.).
- **Verification:** ESX reviews the application and identifies documentation gaps.

- **STEP 2: Addressing Documentation Gaps**

- **Scenario 1: Prompt Resolution Example:** ESX notifies ABCXYZ Securities S.C. that their tax identification number and incorporation documents are missing.
  - **Notification of Gaps:** ESX informs ABCXYZ Securities S.C. of the missing documents and specifies a deadline to submit them.

- Submission of Additional Documentation: ABCXYZ Securities S.C. promptly gathers the missing tax identification number and incorporation documents and submits them to ESX within the specified period.
  - Review and Verification: ESX verifies the additional documents and confirms they meet the required standards.
- **Scenario 2:** Delayed Resolution Example: ABCXYZ Securities S.C. faces delays in obtaining the required documents.
  - Notification of Gaps: ESX informs ABCXYZ Securities S.C. of the missing documents and specifies a deadline to submit them.
  - Request for Extension: ABCXYZ Securities S.C. requests an extension due to delays in obtaining the documents from the relevant authorities.
  - Extension Granted: ESX reviews the request and grants an additional extension as specified, failing which the application will be rejected and the applicant would be required to reinitiate the application, including payment of any applicable application fee.
  - Submission of Additional Documentation: ABCXYZ Securities S.C. submits the missing documents within the extended period.
  - Review and Verification: ESX verifies the additional documents and confirms they meet the required standards.
- **STEP 3: Approval-In-Principle (AIP)**
  - Decision: After resolving documentation gaps, ESX grants ABCXYZ Securities S.C. an Approval-In-Principle (AIP).
  - AIP Grant: ABCXYZ Securities S.C. receives an AIP, valid for six (6) months, allowing them to complete the necessary requirements for commencement of operations.
  - Preparation: ABCXYZ Securities S.C. works on fulfilling the operational requirements (e.g., setting up infrastructure, hiring qualified personnel, completing the CMSP licensing process with the ECMA, completing Appointed Representative licensing with ECMA, opening designated bank accounts, etc).
- **STEP 4: Meeting Operational Requirements**
  - **Scenario 1:** On-Time Completion Example: ABCXYZ Securities S.C. prepares and submits evidence of meeting all operational requirements to ESX within the six-month window.
    - Documentation: ABCXYZ Securities S.C. provides all required documents, including evidence of licenses, compliance with technology and risk management requirements, and proof of opening required bank accounts.

- Certification Inspection: ESX conducts a Certification Inspection to verify that ABCXYZ Securities S.C. has met all the conditions for commencement of operations.
- **Scenario 2:** Delay in Meeting Requirements Example: ABCXYZ Securities S.C. faces unforeseen delays and is unable to complete the requirements within the six-month AIP window.
- Request for Extension: ABCXYZ Securities S.C. submits a formal request to ESX, in the prescribed format, for an extension. This request should include:
  - The reason for requesting the extension (e.g., pending regulatory approvals, unforeseen operational challenges);
  - Documentation supporting the reasons for the delay; and
  - A detailed plan outlining the steps the applicant will take to fulfill the remaining requirements within the extended period, if granted.
- Decision: The Exchange will review the extension requests and supporting documentation to ensure they are complete and justify the need for an extension. This review may include:
  - Verification of the reasons provided for the delay; and
  - Assessment of the applicant's plan to meet the remaining requirements.

ESX will decide whether to grant the extension based on the review. Possible outcomes include:

- Rejection of the extension request if the reasons are deemed insufficient (see scenario 2 under step 5 below);
- Approval of the extension for a specified period, not exceeding three (3) months. Note that ESX may extend the validity of the AIP beyond the additional three (3) months if the extension is due to a pending activity at the ECMA, given that the applicant has met all its obligations related to the pending activity; or
- Conditional approval is subject to additional requirements or documentation.

Where the request for an extension is granted, ABCXYZ Securities S.C. is expected to complete any other remaining operational requirements and keep ESX informed of their progress and any further issues that may arise.

#### – **STEP 5: Conversion of AIP to Membership**

- **Scenario 1:** On-Time Completion Example: Upon successful inspection, ABCXYZ Securities S.C.'s AIP is converted to full Membership.

- Certification: ESX confirms that ABCXYZ Securities S.C. has met all operational requirements and grants them a Membership Certificate.
- Imposition of Conditions: The Exchange may impose conditions or restrictions on the approval of an application, such as limiting the scope of business and operations of ABCXYZ Securities S.C.
- **Scenario 2: Revocation of AIP Example:** If ABCXYZ Securities S.C. fails to meet the requirements, their AIP is revoked.
  - Notification of Revocation: ESX notifies ABCXYZ Securities S.C. that their AIP has been revoked due to non-compliance.
  - Re-application: ABCXYZ Securities S.C. must address the issues causing the delays and may reapply for Membership once they are fully prepared to meet all requirements.

## **Inactivity of a Trading Member**

- **Determination of the Period of Inactivity**

Rule 2.7. Status of a Trading Member (Membership Rules) prohibits Trading Members from ceasing day-to-day trading activities for which it was admitted, except under circumstances beyond its control. A Trading Member is considered inactive on any day where it does not carry out or record any trading activity while the market is open for trading. Similarly, a Trading Member is considered inactive for consecutive trading days if it does not carry out or record any trading activity on those consecutive trading days.

Continuous cessation of trading activities by a Trading Member for a period of one (1) calendar year, whether voluntarily or involuntarily, may result in the revocation of such Trading Member's membership.

ESX will maintain detailed trading records for all its Trading Members, and by monitoring such trading activities, will identify periods where no trading activity has been recorded for a specific Trading Member.

- **Determination of Circumstances beyond a Trading Member's Control**

Circumstances beyond a Trading Member's control generally refer to certain unforeseen events or situations that prevent the Trading Member from carrying out its usual business activities. Examples of such circumstances may include:

- a. Natural Disasters: Events like earthquakes, floods, landslides, volcanic eruptions or other natural calamities.
- b. Political or Economic Instability: Situations such as civil unrest, government interventions, or economic sanctions.
- c. Technical Failures: Major disruptions in technology infrastructure, such as extended system outages, cybersecurity breaches, or significant technical malfunctions.

- d. Health Crises: Pandemics or major health emergencies that impact the ability of the Trading Member to operate.
- e. Legal Issues: Significant legal disputes or regulatory actions that impede business operations.

The determination of whether a situation qualifies as a circumstance beyond a Trading Member's control rest with The Exchange. To ensure that claims of circumstances beyond control are valid and that decisions are made fairly and consistently, ESX processes will include the following:

- a. Review and Assessment: ESX will review the details of the situation presented by the Trading Member, assessing the impact on business activities and the nature of the event.
- b. Evidence Submission: The Trading Member may be required to submit evidence or documentation supporting their claim of the circumstance being beyond their control.
- c. Compliance with Business Continuity Requirements: ESX will assess whether the Trading Member complied with established business continuity requirements. This includes having a documented business continuity plan, conducting regular risk assessments, and implementing appropriate measures to ensure operational resilience.
- d. Discretionary Judgment: ESX may exercise discretion based on the provided information, historical precedents, and the specific context of the situation. The Exchange will consider whether the Trading Member took all reasonable steps to prevent or mitigate the impact of the event.

### **Voluntary Exit (Relinquishment of Membership)**

- **Powers and Focus of The Exchange**

Relinquishment of Membership is a voluntary choice made available to Trading Members, based on their business needs and strategic decisions. This differs from the revocation of membership by The Exchange, which is an involuntary exit resulting from an administrative sanction. This underscores the commitment to ESX to provide Trading Members with the flexibility to make independent decisions regarding their market participation.

However, as ESX imposes conditions for entry to ensure that new members meet the necessary standards for market participation, it similarly imposes conditions for exit to maintain market integrity and protect investors. When a Trading Member decides to relinquish its membership, ESX plays a pivotal role in ensuring an orderly exit and safeguarding investors' assets.

Rule 2.8. Relinquishment of Membership (Membership Rules) provides the framework for the voluntary exit of a Trading Member from its membership of The Exchange. This rule ensures that relinquishment occurs in a structured manner that safeguards market integrity and

investor assets. It reinforces The Exchange's role as the sole administrator of its membership while ensuring compliance with regulatory requirements.

ESX's powers in the relinquishment process include:

- a. **Proprietary Interest and Non-Transferability:** In alignment with Rule 2.5. Proprietary Interest of The Exchange over Membership Certificates (Membership Rules), ESX retains sole ownership of any Membership Certificate issued. The certificate must be returned or relinquished to ESX immediately in specific circumstances, including but not limited to the voluntary exit of a Trading Member. Membership rights remain non-transferable and do not form part of the Trading Member's assets used to settle liabilities.
- b. **Preventing Trading Activity:** Upon submitting the notice of relinquishment, the Trading Member forfeits the right to carry out any trading activity, except for activities necessary to meet the conditions of the relinquishment.
- c. **Conditional Acceptance of Relinquishment:** ESX may accept the relinquishment of membership conditionally, ensuring that all obligations to clients are met, all transactions are settled, or a succession agreement is signed with another Trading Member.

- **Engagement with the Trading Member and ECMA**

The Exchange has an obligation to the ECMA to regulate the activities of its members, and during the relinquishment process, ESX will coordinate with both the Trading Member and ECMA to ensure an orderly exit process. This includes verifying that all regulatory requirements are met, and any pending activities at the ECMA are resolved. Key activities include:

- a. **Notice of Relinquishment:** A Trading Member wishing to relinquish membership must give ESX at least three (3) months' notice in writing. This notice will be posted on ESX's applicable portal(s) and website.
- b. **Disclosure of Obligations:** The relinquishing Trading Member must inform ESX of any outstanding debts, obligations, and transactions.
- c. **Acceptance of Relinquishment:** ESX may accept the relinquishment unconditionally, or accept it conditionally, ensuring that all obligations to clients are met, transactions settled, or a succession agreement is signed with another Trading Member.

- **Rationale for Public Disclosure of Relinquishment**

The public disclosure of the notice of relinquishment of a Trading Member allows investors and other market participants including other Trading Members to become aware of such voluntary exit and communicate any outstanding debts, obligations, and commitments of the relinquishing Trading Member to The Exchange. This allows The Exchange to exercise its rights to effect a conditional relinquishment on the concerned Trading Member.

- **Impact of a Failure to Fulfil the Conditions for Relinquishment**

The failure of a Trading Member to fulfil the conditions for relinquishment can have significant implications, potentially leading to the revocation of membership. The implications are provided below:

- a. Continued Obligations: pending the fulfilment of all conditions for relinquishment, the Trading Member may remain obligated to fulfil regulatory requirements, client obligations, and market commitments as stipulated by ESX.
- b. Compliance Requirements: The Trading Member must continue to comply with all rules and regulations set forth by ESX, pending the fulfilment of conditions for relinquishment. Failure to do so may result in administrative sanctions, or further scrutiny by The Exchange.
- c. Trading Restrictions: once the Trading Member has filed a notice of relinquishment with ESX, such Trading Member may face restrictions on its trading activities until the conditions for relinquishment are satisfactorily met.
- d. Potential Revocation of Membership:
  - i. Non-Compliance: where a Trading Member fails to meet the conditions set by ESX for relinquishment, such as fulfilling client obligations, settling outstanding transactions, or signing a succession agreement, ESX may view this non-compliance as grounds for revocation.
  - ii. Market Integrity Concerns: Persistent non-compliance or failure to adhere to the relinquishment conditions can raise concerns about the integrity and stability of the market. To protect market participants and uphold its standards, ESX may initiate revocation proceedings against the Trading Member.
  - iii. Inactivity: Given that trading activities would have been restricted during the relinquishment process, prolonged inactivity could result in revocation of Membership, in line with the provisions of Rule 2.7. Status of a Trading Member (Membership Rules).

## **Compliance with Minimum Capital Requirements and Liquidity Ratios**

- **Objective of Minimum Capital and Liquidity Requirements**

Chapter 4: Capital and Financial Reporting (Membership Rules) establishes the minimum capital and liquidity requirements for Trading Members, and outlines the necessary compliance measures, monitoring mechanisms, and potential enforcement actions in cases of non-compliance. The intent is to maintain financial stability within the securities market and protect investors by ensuring that Trading Members have sufficient capital reserves.

The core objective of the rules under this chapter is to uphold the financial stability and operational integrity of Trading Members. By enforcing minimum capital and liquidity requirements, the rules help safeguard market participants and foster investor confidence. The implementation of monitoring mechanisms ensures that potential liquidity shortfalls are identified and addressed promptly, thereby reducing systemic risks.

In a pre-funded market structure, where Trading Members are required to commit funds in advance for transactions, minimum capital and liquidity requirements are essential for ensuring financial stability, risk management, and maintaining market integrity. The rules seek to prevent defaults by ensuring Trading Members have sufficient financial resources and adequate liquidity buffers to enable timely settlement of obligations, minimizing disruptions, while mitigating counterparty risk.

Additionally, they serve as mitigants for systemic risks, as the failure of one participant in a pre-funded market structure could have far-reaching consequences as the financial stability of each participant may be interconnected. In such cases, a failure by one participant to meet their obligations can trigger a chain reaction, impacting other parties that rely on the completion of those transactions.

The rules align with global best practices and regulatory standards aimed at ensuring the resilience of capital market participants. Further reference can be made to statutory requirements and international frameworks governing capital adequacy.

- **Guidelines for Maintaining Minimum Capital Requirements and Liquidity Ratios**

**Case Studies/Scenarios:** The scenarios below illustrate the application of these rules, highlighting both the risks of non-compliance and the benefits of proactive adherence.

- **Case Study 1: ABC Capital S.C – Breach of Minimum Capital and Liquidity Requirements**

ABC Capital S.C, a mid-sized Trading Member, has been active in the securities market for over fifteen (15) years. Due to a combination of poor investment choices, high operational expenses, downturn in the stock market and inadequate financial monitoring, the firm experiences financial difficulties and losses.

As a result, the firm's capital reserves fell below the prescribed threshold, and its liquidity ratio deteriorated due to a decrease in the value of its liquid assets. Additionally, the company failed to notify ECMA and The Exchange of its non-compliance within the required 24-hour period, thus breaching its reporting obligations.

**Regulatory Intervention and Outcomes:**

Following a routine financial review of the firm's financial report for the second quarter (Q2) of the current financial year, The Exchange detected ABC Capital S.C's non-compliance and initiated regulatory measures. The firm was issued a compliance notice, requiring it to notify ECMA, provide proof of notification, and submit a recapitalization plan. However, despite proposing a 45-day recapitalization timeline, ABC Capital S.C failed to raise sufficient capital, leading to its suspension from trading. After sixty-five (65) days, the firm secured emergency funding from a strategic investor, enabling The Exchange to reinstate its trading privileges under strict monitoring conditions.

- **Case Study 2: XYZ Securities S.C – Proactive Compliance with Minimum Capital and Liquidity Requirements**



XYZ Securities S.C, a well-established Trading Member, identified a potential liquidity shortfall during an internal financial review. Instead of waiting for regulatory intervention, the firm promptly notified ECMA and The Exchange, as required. It also developed and submitted a recapitalization plan, committing to restore compliance within thirty (30) days.

### **Regulatory Intervention and Outcomes:**

By acting swiftly, XYZ Securities S.C maintained regulatory confidence and avoided enforcement actions. The firm implemented a series of proactive measures, including securing additional capital from shareholders, reducing operational costs, and adjusting its investment portfolio to improve its asset mix ratio. Within twenty-five (25) days, XYZ Securities S.C successfully met its minimum capital and liquidity requirements, ensuring continued trading operations without penalties or disruptions.

#### **– Key Points to Note:**

- Importance of Timely Reporting: Early detection and immediate action prevent or minimize the impact of regulatory breaches.
- Communication: Timely notification and transparent communication with regulators strengthen compliance.
- Capital and Liquidity Management: Poor capital and liquidity management often results in financial distress, while proactive management provides an enabling environment for financial resilience and regulatory trust.
- Compliance Monitoring and Risk Management: Ongoing monitoring and structured risk management frameworks support long-term stability.

To ensure compliance with minimum capital and liquidity requirements, Trading Members must adopt a proactive approach to financial risk management. This begins with the implementation of daily capital and liquidity monitoring mechanisms, allowing firms to detect potential shortfalls early and take corrective action. Trading Members should also establish a robust risk management framework that includes periodic stress testing, liquidity buffers, and position limits to mitigate market volatility and financial shocks.

Investment in financial tools, such as capital management software and real-time monitoring systems, can significantly enhance a firm's ability to maintain adequate liquidity. Additionally, transparent and timely reporting to regulators is crucial. Trading Members must adhere to prescribed reporting timelines, maintain open communication with ECMA and The Exchange, and submit financial data that accurately reflects their capital positions.

Beyond these operational measures, internal governance structures play a pivotal role in ensuring compliance. Firms should designate internal committees to oversee capital and liquidity management, conduct regular internal audits, and establish clear policies for managing capital adequacy. Effective training programs should also be implemented to ensure that employees understand regulatory requirements, recognize early warning signs of liquidity stress, and escalate concerns promptly. A compliance-focused corporate culture will ultimately contribute to stronger financial stability and reduced regulatory risk.

## **Retention of Jurisdiction over Trading Members' Personnel**

- **Authority of The Exchange**

The Exchange oversees the activities of its Trading Members, extending this oversight to the personnel responsible for the operations of Trading Members. This oversight is reinforced in Chapter 6 – Appointed Representatives and Other Personnel, which regulates the appointment, termination, and activities of Appointed Representatives, employees, and other personnel.

Rule 6.4: Retention of Jurisdiction over Former Appointed Representatives, Employees, or Other Personnel (Membership Rules) govern The Exchange's authority to retain jurisdiction over former personnel of Trading Members. This rule empowers The Exchange to investigate, sanction, and summon individuals previously associated with a Trading Member for violations of The Exchange's rules and regulations during their tenure. Even after an individual leaves their role, The Exchange can investigate and take action against them for any violations that occurred during their employment or appointment. The Exchange can also compel their testimony in investigations.

The Exchange enforces compliance with its rules and regulations, even when individuals are no longer associated with a Trading Member. This is crucial for maintaining market integrity and ensuring accountability for rule violations, regardless of the individual's current status. The Exchange's duty to oversee its members and their personnel is outlined in the Capital Market Proclamation No. 1248/2021 and the Directive on Licensing, Operation, and Supervision of Securities Exchanges, Derivatives Exchanges, and the Over-The-Counter Market No. 1009/2024. These regulatory frameworks require The Exchange to monitor, supervise, and enforce compliance with the securities regulatory framework to ensure fairness, efficiency, transparency, and investor protection.

By retaining jurisdiction over former personnel of Trading Members, The Exchange can:

- a. **Ensure Accountability:** Individuals who violate The Exchange's rules during their tenure cannot evade responsibility simply by leaving their position.
- b. **Facilitate Comprehensive Investigations:** The Exchange can compel former personnel to provide testimony, documents, or other materials necessary for thorough investigations. This ensures all relevant information is accessible, leading to comprehensive findings and appropriate sanctions.
- c. **Protect Market Integrity:** By addressing past violations and holding individuals accountable, The Exchange maintains market integrity. This reassures investors that their investments are protected and that bad actors cannot avoid accountability.

- **Case Studies Illustrating the Impact of The Exchange's Retention of Jurisdiction:**

- **Case Study 1: Market Manipulation by a Former Appointed Representative**

A former Appointed Representative of a Trading Member is accused of manipulating the price of a traded stock. The Exchange investigates and discovers that the

manipulation caused significant market distortion, harming other investors. Using its retained jurisdiction under Rule 6.4, The Exchange compels the former representative to provide trading logs and communications. The investigation reveals clear evidence of manipulation, and The Exchange imposes sanctions, including a permanent ban from dealing with The Exchange.

The Exchange's retained jurisdiction ensures that individuals who engage in market manipulation can be held accountable, even after they have left their role. This protects investors and maintains market integrity.

– **Case Study 2: Compliance Failures by a Former Compliance Officer**

A former Compliance Officer at a Trading Member is suspected of failing to report suspicious trading activities that violated The Exchange's Rulebook. After the officer resigns, The Exchange launches an investigation into the Trading Member's compliance failures. Using its jurisdiction under Rule 6.4, The Exchange compels the former officer to testify and provide access to compliance reports. The investigation reveals systemic compliance lapses, leading to sanctions against both the Trading Member and the former officer.

Retained jurisdiction allows The Exchange to access critical information from former personnel, enabling comprehensive investigations that can uncover broader compliance issues. This leads to improved regulatory compliance across the market.

The Exchange's ability to impose post-employment sanctions acts as a deterrent against misconduct, ensuring individuals are aware of the consequences of violating the rules. By retaining jurisdiction over former personnel, The Exchange upholds market integrity, ensures accountability, and protects investors, reinforcing the importance of compliance with its rules and regulations.

## **The Role of a Compliance Officer**

- **Requirements and Qualifications for a Compliance Officer**

Under Rule 6.2. Obligation to Designate and Obtain Approval for Appointed Representatives (Membership Rules), every Trading Member is required to designate a Compliance Officer who must be duly licensed by the ECMA as an Appointed Representative of the Trading Member. This ensures that the Compliance Officer is recognized by the regulatory authority and meets the necessary professional standards.

The Competency Framework under the CMSP Directive sets out specific competency requirements for the roles of Chief Compliance Officer and Compliance Officer, including role description, minimum qualifications and certification, minimum years of experience, and required skills. These competency requirements must be met by an individual appointed/employed to be the Chief Compliance Officer or Compliance Officer of a Trading Member, and such Compliance Officer must be well-equipped to perform their duties effectively and maintain the integrity of the Trading Member's operations.

As outlined in Rule 6.7. The Compliance Officer (Membership Rules), some specific roles and responsibilities of the Compliance Officer include:

- a. Interpretation and Application of Regulations: The Compliance Officer must have the ability to interpret and apply legislation, rules, regulations, and guidelines relevant to the capital market. This includes monitoring regulatory changes and ensuring their implementation within the Trading Member.
- b. Compliance Monitoring: The Compliance Officer is responsible for assessing and ensuring compliance with both internal and external rules and policies. This involves conducting regular compliance reviews and submitting regulatory reports as required. For example, the Compliance Officer is responsible for reporting compliance with whistle blowing requirements, in line with defined whistleblowing policies which must also be made known must be known to employees, stakeholders, and the public. Although the responsibility for implementing such a policy and establishing a mechanism for reporting illegal or unethical behaviour may not reside with the Compliance Officer, the Compliance Officer plays a key role in ensuring that these mechanisms are effective and that whistle-blowers are protected.
- c. Risk Mitigation: The Compliance Officer must ensure that all investments and operational transactions comply with relevant laws and regulations. This includes implementing control systems to minimize and mitigate risks.
- d. Dissemination of Regulatory Updates: The Compliance Officer must keep the Trading Member, its Appointed Representatives, and other personnel informed of regulatory changes and compliance requirements.

- **Guidelines on Conflict Management and Addressing Unethical Activities**

- a. Identifying and Managing Conflicts of Interest: Under Rule 6.3. Code of Conduct for Appointed Representatives of Trading Members and their Obligation (Membership Rules), all Appointed Representatives, including Compliance Officers, are required to identify and manage any potential or actual conflicts of interest. This is critical to maintaining the independence and neutrality of the Compliance Officer, as emphasized in Rule 6.7.(3), which states that the Compliance Officer must have a direct reporting line to the Board of Directors and always remain independent.
- b. Reporting Violations: Rule 6.7.(2) mandates that the Compliance Officer must report any legal or rule violations to the Exchange within twenty-four (24) hours of becoming aware of such violations. The Compliance Officer is also required to propose appropriate remedies to address the violations. This ensures prompt action is taken to rectify any breaches and maintain market integrity.

- **Case Study 1: Conflict of Interest in Trading Activities**

A Compliance Officer at a Trading Member identifies a potential conflict of interest where a senior executive is involved in trading activities that could be perceived as benefitting such senior executive personally at the expense of clients. The Compliance Officer, following Rule 6.3., documents the potential conflict and reports it to the Board

of Directors. The Board takes immediate action to reassign the executive's responsibilities and implements additional controls to prevent future conflicts.

The Compliance Officer's role in identifying and managing conflicts of interest ensures that the Trading Member operates with integrity and transparency.

– **Case Study 2: Whistleblowing on Unethical Behaviour**

An employee at a Trading Member reports unethical behaviour involving the manipulation of client accounts to the Compliance Officer. The Compliance Officer, adhering to Rule 6.7.(2), reports the violation to the Exchange within twenty-four (24) hours and proposes corrective actions, including disciplinary measures against the responsible individuals. The Compliance Officer also ensures that the whistle-blower is protected from retaliation, in line with the whistleblowing policy mandated by the CMSP Directive.

The Compliance Officer's prompt action in response to whistleblowing ensures that unethical behaviour is addressed swiftly, maintaining trust in the Trading Member's operations.

## **Compensation Fund - Claims Process and Calculation of Compensation**

- **Non-Obligation to Establish a Compensation Fund**

In line with Rule 11.1. Establishment of and Contribution to the Clients' Compensation Fund (Membership Rules), while ESX has the authority to establish and operate a Clients' Compensation Fund ("CCF" or "Fund"), it is not an obligatory requirement.

The decision to create the fund is at the discretion of ESX, and if established, will be administered by an independent Board of Directors with contributions from Trading Members as stipulated. The Board of the CCF shall be a separate governance structure independent of The Exchange's Board of Directors and will be composed predominantly of independent individuals, ensuring impartiality and independence in the management and administration of the Fund.

In line with Rule 11.2. Governance and Management of the CCF, the Board of Directors of the CCF of ESX shall consist of a maximum of five (5) members to be drawn as follows:

- a. A representative from the Trading Members of The Exchange;
- b. A representative from The Exchange;
- c. A representative from the central securities depository;
- d. A representative from the ECMA; and
- e. One (1) person representing a registered shareholders association/ or similar industry group, independent experts etc.

- **Procedure for Compensating Investors**

Where ESX elects to establish a CCF, the procedure for compensating investors who suffer pecuniary losses, due to the failure of a Trading Member of The Exchange to meet its contractual obligations, is provided for in Chapter 12: Compensation of Investors (Membership Rules).

The rules in Chapter 12 detail the verification process, conditions for compensation, rejection criteria, multiple claims handling, and the determination of compensation amounts. Additionally, they provide subrogation rights, whistle-blower protection, and the application of a Code of Conduct for the Compensation Fund's Board of Directors.

The rules' scope encompasses claims by individuals and entities affected by Trading Members' failures and outlines the processes for verification, payment adjustments, and recoveries. They also underscore the importance of safeguarding whistle-blowers and adhering to ethical conduct by decision-makers.

The rules comprehensively address investor compensation, including provisions for handling multiple claims and mechanisms for fund recovery, and align with global best practices.

- **Conditions for Compensation and Claim Rejection**

The Rules mandate the Board of the CCF to pay compensation upon the satisfaction of certain conditions by an investor, one of which is that the Trading Member is unable to satisfy the claim within a reasonable period. Similarly, a cogent reason for the rejection of such an investor's application is the inability to provide sufficient evidence of failure or neglect on the Trading Member's part.

For the purposes of Chapter 12, "**Reasonable period**" will be defined by the Board of the CCF upon establishment of the CCF, during which Trading Members are expected to settle claims before CCF intervention occurs. The period determined would take into consideration the need to ensure timely compensation while allowing Trading Members reasonable flexibility to address claims. "**Sufficient evidence**" includes, but is not limited to, the following examples:

- a. Trade confirmations issued by the Trading Member or The Exchange.
- b. Contract agreements outlining the nature of the transaction.
- c. Official correspondence between the claimant and the Trading Member regarding the disputed transaction.
- d. Account statements showing relevant transaction details.
- e. Payment records or banking documents verifying executed transactions.
- f. Sworn affidavits or witness testimonies in cases where documentation is unavailable.

- **Case Studies/Scenario Analyses**

- **Scenario 1: Reasonable Period for Claim Settlement**

- **Case:** Investor A files a claim for compensation following a Trading Member's insolvency. The Trading Member has yet to respond less than X number of days. Here, "X" represents the reasonable period defined by the Board of the CCF.
- **Application:** Since the Board of the CCF has defined a "reasonable period" as X days, the CCF's Board waits for the full X days before intervening. If the Trading Member fails to settle the claim within this timeframe, the Board of the CCF assesses and processes the claim.

Upon assessing the claim, the Board of the CCF determined that Investor A provided sufficient evidence and is eligible for compensation.

- **Outcome:** Investor A's claim is approved, and compensation is provided. Hence, with the specification of a timeframe vis-a-vis the activities, unnecessary delays are prevented as all parties concerned can be appropriately guided by the provision of the rules, including what to expect and/or do at various times.

○ **Scenario 2: Sufficient Evidence for Claim Verification**

- **Case:** Investor B submits a compensation claim citing unpaid funds from a Trading Member but provides only a verbal statement with no supporting documents.
- **Application:** Since Investor B has not provided the required documents to fulfil the "sufficient evidence" requirement such as including trade confirmations, contract agreements, and official correspondence, the claim is initially rejected.
- **Outcome:** Investor B later submits trade confirmations and account statements, meeting the evidentiary requirements. The claim is then approved, subject to the Board of the CCF determining that Investor B has provided sufficient evidence and is eligible for compensation.

• **Claims Processing, Due Diligence and Liability of the Investor**

Claimants are required to provide complete documentation and to exhaust all internal resolution channels before filing claims. In reviewing these claims, the Board of the CCF will strive to ensure impartiality and adhere to due process throughout the entire process.

For example, where the Board of the CCF determines that the loss is as a result of the Investor's participation in a prohibited or illegal activity (e.g., investment in a guaranteed investment scheme), such claim stands rejected by-default as such Investor would also be deemed fully liable for such loss.

Investors should follow the proper procedure to apply for compensation, ensuring they provide all necessary documentation and evidence. Claims may be rejected if they are not supported by proof of the contractual relationship, loss suffered, or if the claim is not promptly made within six (6) months of becoming aware of the issue as stipulated in the rules.

- **Calculation and Amount of Compensation**

The rules provide that the maximum compensation payable to an investor is as determined by the Board of Directors of the CCF. Where the loss suffered is less than the maximum amount, the investor may be paid the full amount of the loss, less any other benefits received from a source other than the CCF in reduction of the loss.

In addition, Investors are entitled to only one claim for compensation per Trading Member, even if they have multiple claims against the CCF. The Board may review and adjust the maximum compensation amount based on prevailing market conditions. If an investor receives a settlement from the Trading Member after being compensated by the CCF, such an Investor is obligated to refund the CCF and may be required to execute and undertaking to this effect, prior to the disbursement of funds from the CCF.

It should also be noted that The Board of the CCF may adjust compensation payments if it deems immediate payment in full is not prudent. This could be due to multiple compensation applications or uncertainty about the investor's overall net claim. For example, in cases where the Board of the CCF determines that the Investor has the prospect of recovery from a third party or another compensation scheme or that the Investor is partly responsible for the loss, such an Investor may only be eligible for partial or reduced payments.

- **Subrogation Rights of the Client Compensation Fund**

The rules provide that upon payment of compensation, the Board of Directors of the CCF is subrogated to the investor's rights against the Trading Member. This means the CCF is authorized to recover an equivalent amount from the Trading Member or the sale of its assets.

To ensure that the CCF remains sustainable and available for future claims, any amount recovered through subrogation is paid remitted into the CCF.

- **Case Study/Scenario Analysis**

- **Scenario 1: Reasonable Period for Claim Settlement**

- Situation: An Ethiopian investor, Mr. Haile, invests in securities listed on ESX through a Trading Member, EFGH Trading Company. Due to financial mismanagement, EFGH Trading Company fails to meet its contractual obligations, leading to a pecuniary loss of ETB 500,000.00 for Mr. Haile.
      - Claim Process:
        - Verification: Mr. Haile submits a claim to ESX, providing evidence of his investment and the losses incurred.
        - Internal Resolution: ESX attempts to resolve the complaint through its internal complaint resolution procedure, but EFGH Trading Company is unable to satisfy the claim within a reasonable period.



- Compensation Fund Application: Mr. Haile applies for compensation from the CCF, which the Board of Directors of the CCF verifies and confirms that the claim meets the criteria for compensation.
- Compensation Payment: The Board of Directors of the CCF decides to compensate Mr. Haile for his verified losses, up to the maximum compensation limit set by the CCF.

Assuming the CCF has a maximum compensation limit of ETB 150,000, Mr. Haile receives 150,000 Birr as compensation from the CCF for his verified losses.

- Subrogation Process:
  - Subrogation Rights: Upon paying the compensation, the Board of Directors of the CCF is subrogated to all rights of Mr. Haile against EFGH Trading Company to the extent of the payment made, i.e., ETB 150,000.
  - Recovery Action: The CCF now has the right to pursue recovery of ETB 150,000 Birr from EFGH Trading Company. This can include legal action, claims against the Trading Member's assets, or other means of recovery.
  - Recovery Outcome: If the CCF successfully recovers ETB 150,000 from EFGH Trading Company, this amount is paid back into the CCF.

## SECTION 3 – VOLUME C (LISTING RULES)

### Background

Volume C (Listing Rules) provides for the regulations that govern the listing of securities on the ESX. These rules establish the eligibility criteria, disclosure requirements, principles, and ongoing obligations for Issuers seeking to list their securities and have them remain listed, ensuring that all Issuers comply with rigorous standards of transparency, corporate governance, and financial integrity.

Public disclosure plays a central role in the Listing Rules, which are designed to protect investors by ensuring that Issuers remain accountable and provide accurate, timely, and comprehensive information about their financial health, operations, and governance practices. The emphasis on consistent and reliable disclosure aims to level the playing field for participants by reducing information gaps and promoting fair competition. These Rules also seek to foster investor confidence, encourage participation, and contribute to the long-term stability of the capital market.

This Section of the IG/EC focuses on key provisions of the Listing Rules to aid in their interpretation and practical application. The specific areas covered include:

- a. The listing process, including initial application procedures and ongoing reporting obligations for various boards;
- b. Criteria for the eligibility of securities to be listed, with an emphasis on minimum capitalization, shareholders' equity, and public float;
- c. The continuous obligations of listed companies, including financial reporting, corporate governance practices, and shareholder rights;
- d. The treatment of related party transactions and the disclosure of material events that may affect shareholders or the broader market; and
- e. Delisting procedures, including the conditions under which a company may be delisted from The Exchange.

### Minimum Capitalization, Shareholders' Equity, and Public Float Requirements for the Main Board

- **Rationale**

Rule 5.1. ESX Main Board Listing (Listing Rules) outlines the key requirements for companies seeking to list equity shares on the Main Board of ESX. It specifies the eligibility criteria, including the need for issuers to meet certain financial thresholds, such as market capitalization and shareholders' equity. Additionally, Issuers must comply with other related requirements, such as submitting proper documentation and meeting the public float criteria. The rule also refers to other relevant listing requirements found in Chapter 3: The General Requirement for Listing of Securities on The Exchange and Listing Procedure (Listing Rules)

and Rule 4.4. General Requirements (Listing Rules), which define the foundational conditions for listing securities and the specific regulations for equity shares.

The intent behind Rule 5.1. is to establish minimum thresholds for Issuers, ensuring that only companies of sufficient size and stability can list on the Main Board of ESX. The requirements for market capitalization and shareholders' equity aim to ensure that listed companies are financially robust and capable of meeting the regulatory obligations associated with being publicly listed. Similarly, the public float is essential for ensuring liquidity and facilitating price discovery, as shares in the public float are available for trading on ESX.

These measures align with best practices where most exchanges require minimum levels of market capitalization, equity, and public float for listing on their main boards. By requiring minimum levels of market capitalization, shareholders' equity, and public float, Rule 5.1. ensures that only stable and liquid companies are allowed to access the public markets. Issuers that do not meet the required levels are unlikely to be granted listing approval. These provisions help ensure that only companies with adequate size and market liquidity are permitted to list, promoting stability and investor confidence.

- **Market Capitalization vs. Shareholders' Funds/Equity vs. Subscribed and Paid-Up Capital**

The rule requires that companies seeking to list on the Main Board must meet either the market capitalization or shareholders' equity requirement, with a minimum threshold of Five Hundred Million Birr (ETB 500,000,000.00).

Market Capitalization is a measure of the market value of the company, while shareholders' funds/equity is a measure of the book value of the company. Conversely, Subscribed and Paid-Up capital is not a measure of the company's value, but rather a measure of shareholders' commitment to provide financial resources to the company or measure of financial resources provided to the company by the shareholders.

A company's share capital is usually divided into a certain number of shares of a nominal value each. The nominal value, also known as the par value or face value in many jurisdictions, represents the arbitrary value assigned to the shares during their creation and does not necessarily reflect their current market value. The nominal value serves as a reference point in a company's financial structure and is often used to calculate the total value of the share capital.

For example, assuming a company has a share capital of ETB 5 billion. This may be divided into:

1. 5 billion shares of ETB 1.00 each;
2. 10 billion shares of ETB 0.50 each; or
3. 50 billion shares of ETB 0.10 each.

In this example, the monetary value of ETB 1.00, ETB 0.50, and ETB 0.10 represent the nominal value or par value respectively. When the nominal or par value is multiplied by the

number of shares in each case, we get the share capital of ETB 5 billion. From time to time, a company may solicit funds from investors to enable the company to run its operations and engage in economic projects. In exchange, companies offer shares to investors at a price. When investors agree to purchase the shares of the company, the shares are referred to as subscribed shares, representing a commitment by the investor to acquire them. Once the investor fulfills this commitment by paying the shares, they are then classified as paid-up shares.

Subscribed/issued and Paid-Up capital play a key role in accounting and financial reporting. They represent the financial resources provided by its owners as recorded in the company's books and financial statements. Depending on the circumstances, a company may offer its shares at par value, at a premium, or at a discount.

– **Case Study/Scenario Analysis (Shares Offered at Par Value, at a Premium, or at a Discount):**

a. Illustrating the shares of a company offered at par value

Consider a company that has ETB 5 billion share capital divided into 5 billion shares of ETB 1.00 each. The shares are offered to investors at a nominal value, subscribed and fully paid up:

- This means that the company has subscribed and paid-up shares of ETB 5 billion.
- The investors become part-owners or shareholders of the company.

b. Illustrating the shares of a company offered at a premium

Consider a company that has ETB 5 billion share capital divided into 5 billion shares of ETB 1.00 each. The shares are offered to investors at ETB 1.30 (i.e., at a premium of ETB 0.30 per share), subscribed and fully paid up:

- The company will realize ETB 6.5 billion from the sale of shares.
- The accountants will record subscribed and paid-up share capital of ETB 5 billion and record the premium of ETB 1.5 billion in share premium reserve account.

c. Illustrating the shares of a company offered at a discount

Consider a company that has ETB 5 billion share capital divided into 5 billion shares of ETB 1.00 each. The shares are offered to investors at ETB 0.90 (i.e., at a discount of ETB 0.10 per share), subscribed and fully paid up:

- The company will realize ETB 4.5 billion from the sale of shares.
- The accountants will still record a share capital of ETB 5 billion and record the discount of ETB 0.5 billion in the share discount account.

Hence, whatever the case (whether issued at a premium, par or discount), the subscribed and paid-up share capital is recorded and measured at the nominal value.

– **Case Study/Scenario Analysis (Determining Shareholders' Equity and Market Capitalization):**

a. Illustrating how to determine shareholders' equity

Consider a company that has ETB 5 billion share capital divided into 5 billion shares of ETB 1.00 each. In its first year of operation the company makes ETB 0.8 billion profit and pays ETB 0.5 billion out as dividend, the remaining ETB 0.3 billion will be left as retained earnings or revenue reserve.

- **Shareholders' equity** = subscribed and paid-up share capital + the share premium or discount + retained earnings
- **The shareholders' equity when the shares are offered at par:**
  - = subscribed and paid-up share capital + balance in the share premium or discount account + retained earnings
  - = ETB 5 billion + 0 + ETB 0.3 billion
  - = ETB 5.3 billion
- **The shareholders' equity when the shares are offered at a premium (premium valued at ETB 1.5 billion):**
  - = subscribed and paid-up share capital + balance in the share premium or discount account + retained earnings
  - = ETB 5 billion + ETB 1.5 billion + ETB 0.3 billion
  - = ETB 6.8 billion
- **The shareholders' equity when the shares are offered at a discount (discount valued at 0.5 billion):**
  - = subscribed and paid-up share capital + the share premium or discount + retained earnings
  - = ETB 5 billion + (ETB 0.5 billion) + ETB 0.3 billion
  - = ETB 5 billion - ETB 0.5 billion + ETB 0.3 billion
  - = ETB 4.8 billion

b. Illustrating how to determine market capitalization

Market capitalization is calculated by multiplying the subscribed and paid-up shares by the offer price (listing price). The offer price is determined by the Issuer and its Financial Advisers using generally accepted principles of equity valuation. The Issuer and the Advisers will have to determine the value of the shares when the company intends to offer its shares to the public in terms of IPO or to other investors such as in private placement and mergers and acquisitions. Examples of acceptable principles of equity valuation include but are not limited to the following:

- i. **Discounted Cash Flow Model**, which utilizes the present value of estimated future cashflows the company is expected to generate over a reasonable forecast period or the investors are expected to generate by holding the shares of the company.
- ii. **Price and Enterprise Value Multiples**, which utilizes price or enterprise value multiples of a similar companies that are listed. Some commonly used price multiples are Enterprise Value to Earnings Before Interest, Taxes, Depreciation & Amortization (EV/EBITDA), Price to Operating Cashflow Ratio, Price to Sales Ratio, and Price to Earnings ratio (P/E), etc.
- iii. **Assets-Based Valuation** that values a company on the basis of the market value of the assets or resources it controls.

Continuing with our previous example, but now assuming that the Issuer and its Financial Advisers, having applied the above steps, have determined the offer price to be ETB 1.30.

- Offer Price: ETB 1.30
- Subscribed and Paid-Up Shares: 5 billion
- Market Capitalization: Subscribed and Paid-Up Shares x Offer Price

$$= 5,000,000,000 \text{ shares} \times \text{ETB } 1.30$$

$$= \text{ETB } 6,500,000,000.00$$

A company seeking to list its shares on the Exchange, may request to list its shares at a price which is equal to the nominal value, the price at which the shares were offered to the market or at any other price - higher or lower-than these, depending on the issuer's assessment of the true worth of the shares. For newly incorporated companies with minimal economic activities since incorporation, the listing is typically equivalent to the nominal value. In cases where the application for listing is submitted concurrently with the offer (i.e., a listing by IPO) or shortly after its completion, and the Issuer believes the company has not significantly increased its value post-offer, the listing price is usually aligned with the offer price. In the cases where the company has operated substantially since after incorporation or since after the last public offer, the Issuer should determine the listing price of the shares following the methods indicated above.

### **How to determine Market Capitalization during an Initial Public Offering?**

Consider a company seeking to raise ETB 700,000,000.00 from the Ethiopian Market for the first time by issuing 1 billion shares of ETB 0.10 each at ETB 0.70 per share. At the end of the offer period, only 500 million shares were subscribed for by investors.

- Total Shares Offered in IPO: 1 billion shares
- Offer Price per Share: ETB 0.70
- Total Capital Expected to be Raised: ETB 700 million

- Actual Subscribed Shares: 500 million shares
- Total Capital Raised:  $500,000,000 \times 0.70 = \text{ETB } 350,000,000$
- Market Capitalization: Subscribed shares x Offer Price  

$$= 500,000,000 \text{ shares} \times \text{ETB } 0.70$$

$$= \text{ETB } 350,000,000.00$$

Given that the Market Capitalization of the company ETB 350,000,000.00 is less than the minimum required level of ETB 500,000,000.00, the company has not met the requirement under the rule.

– **Case Study/Scenario Analysis (Summary of the difference between "Market Capitalization", "Shareholders' Funds/Equity", and "Subscribed and Paid-Up Capital")**

Consider a company that has a Subscribed and Paid-Up Capital of 1 billion shares of ETB 0.01 each, with a listing price of ETB 0.70 per share, and a negative accumulated reserve of –ETB 120 million.

- Nominal Value of the Subscribed and Paid-Up Share Capital:  $1 \text{ billion shares} \times \text{ETB } 0.01 = \text{ETB } 100,000,000.00$ .
- Market Capitalization:  $1 \text{ billion shares} \times \text{ETB } 0.70 = \text{ETB } 700,000,000.00$ .
- Shareholders' Equity:  $\text{ETB } 100,000,000.00 - \text{ETB } 120,000,000.00 = -\text{ETB } 20,000,000.00$ .

Given that the Market Capitalization of the company ETB 700,000,000.00 is more than the minimum required level of ETB 500,000,000.00, the company has met the requirement under the rule.

• **Public Float**

Under the rules, "Public Float" means the number of shares that an Issuer has outstanding and available to be traded on The Exchange. It includes all shares held by the investing public and excludes shares held directly or indirectly by promoters, directors, and their immediate family members, substantial shareholders, employee share, controlling shareholders, or affiliated person of an Issuer or its subsidiary companies holding five percent (5%) and above of the issued share capital.

The rule provides that where an issuer has a market capitalization of at least Two Billion Birr (ETB 2,000,000,000.00) ESX may permit a reduced Public Float of ten percent (10%). This provides discretion for larger companies that may not meet the standard public float criteria but still possess sufficient market value.

For a company seeking listing by introduction, it is required that the company should meet the required minimum level of Public Float at the point of listing given that no offer to the public is planned. However, for a company seeking listing by an Initial Public Offer (IPO), the public

float shall be computed including the shares held by the existing public shareholders provided such shares are not under moratorium plus the shares offered to the public.

Public Float is essential for maintaining market liquidity, fostering price discovery, and promoting investors' confidence. A larger Public Float means that a stock has more shares available for buying and selling implying an increased supply of the stock in the market which leads to greater liquidity, making it easier for investors to enter or exit positions without causing large price fluctuations. A well-distributed shareholding structure means that the stock price can better reflect the true value of the company, as it is more likely to be determined by the forces of supply and demand.

A lack of Public Float can lead to a stock price that is more easily manipulated, as there are fewer shares being traded by fewer shareholders. A larger Public Float can increase investor confidence in a stock. It suggests that the company is more transparent, accessible, and willing to share its ownership with a broad range of investors. Conversely, if a company's Public Float is too small, investors may view it as being controlled by a few insiders, which can lead to concerns over the company's governance or market manipulation. Public Float is a key listing requirement of securities exchanges around the world. For example, Bursa Malaysia requires a minimum public float of twenty-five percent (25%), while Singapore Exchange Securities Trading Limited (SGX-ST) mandates at least ten percent (10%) for listed companies. These requirements help balance market stability with accessibility, making public markets more attractive for both issuers and investors.

In the event of non-compliance with public float requirements, this will be deemed a breach of the continuing listing obligations, and the provisions of the Schedule of Administrative Sanctions to the Listings Rules shall apply.

- **Guidance on Maintaining Public Float:** Issuers are expected to monitor their shareholding structure regularly to ensure that the minimum public float threshold is upheld at all times. In cases where the public float falls below the required threshold, Issuers must take prompt remedial action, such as issuing additional shares to public investors or implementing other measures as may be prescribed by The Exchange. Issuers should establish robust internal governance mechanisms to track changes in shareholding and prevent inadvertent breaches of public float requirements.
- **Reporting Requirements:** As part of their annual reporting obligations, Issuers are required to include disclosures related to public float. These may include:
  - a. A detailed breakdown of the shareholding structure, highlighting the percentage of shares held by public investors.
  - b. A statement confirming compliance/non-compliance with public float requirements during the reporting period.
  - c. Any material changes to the shareholding structure that occurred during the reporting period, along with measures taken (if any) to maintain public float.
- **Case Study/Scenario Analysis:** *Computation of Public Float*

A company with 15,000,000,000 shares outstanding might calculate its public float as follows:



Description of shareholder	Number of shares (Assumption)	%
Total Outstanding shares	15,000,000,000	100.00
<b>Less:</b> Strategic shareholders (5% and above)	(7,500,000,000)	(50.00)
<b>Less:</b> Restricted shares (e.g. shares issued via private placement)	(200,000,000)	(1.33)
<b>Less:</b> Directors/promoters and immediate family members/close relatives	(3,500,000,000)	(23.33)
<b>Less:</b> Shares held by government	(1,000,000,000)	(6.67)
<b>Less:</b> Shares held in trust for employees	(200,000,000)	(1.33)
<b>Others (public float shares)</b>	<b>2,600,000,000</b>	<b>17.34</b>
With the public float of 17.34% as computed above, the company is eligible for listing under the rule.		

### **Minimum Growth, Public Float, Capitalization and Shareholder Equity Requirements for the Growth Board**

- **Rationale**

Rule 6.1. ESX Growth Board Listing (Listing Rules) outlines the listing requirements for issuers seeking admission to the ESX Growth Board. The purpose of this rule is to provide a structured framework that facilitates access to capital markets for small and medium-sized enterprises (SMEs) and other growth-stage companies. Compared to the requirements for listing on the Main Board, the Growth Board listing criteria are designed to be less stringent, making it easier for emerging companies to raise funds while ensuring sufficient investor protection.

Issuers seeking to list on the Growth Board must comply with the general requirements applicable to all securities listings, as set out in Chapter 3 of the Listing Rules, as well as the general requirements for equity listings in Rule 4.4. Additionally, they must meet specific eligibility conditions, including financial track records, growth prospects, financial statement disclosures, public float requirements, market capitalization thresholds, and other documentation requirements.

- **Minimum Growth Requirement**

Under Rule 6.1(2), an Issuer must have demonstrated a minimum annual revenue growth rate of twenty percent (20%) over the past two years. If the issuer has not been in operation for two (2) full years, the requirement may be satisfied through the track record of a core investor or technical partner with at least two (2) years of operations and a comparable growth trajectory.

This provision aims to ensure that only companies experiencing sustained growth can qualify for listing. It is important to note that the rule requires annual revenue growth of at least twenty percent (20%), meaning that a company with inconsistent growth — such as sixteen percent (16%) in the first year and thirty percent (30%) in the second—would not meet the requirement, even though its cumulative growth over two (2) years exceeds forty-four percent (44%). This interpretation highlights the rule’s emphasis on the sustainability of growth rather than aggregate performance over time.

- **Public Float Requirements**

Rule 6.1(4) establishes the minimum public float threshold, requiring at least ten percent (10%) of the Issuer’s total shares to be held by at least fifty (50) public shareholders, an investment bank acting as a firm underwriter, or other institutional investors. Existing public shareholders may be included in the computation, provided their shares are not subject to moratorium restrictions.

The rationale behind this provision is to promote market liquidity and facilitate price discovery by ensuring that a sufficient volume of shares is available for public trading. Public float plays a crucial role in fostering an efficient and active secondary market for listed securities.

For an example of a computation, refer to the applicable section under “Minimum Capitalization, Shareholders’ Equity, and Public Float Requirements for the Main Board”.

- **Market Capitalization and Shareholder Equity Requirements**

Any reference to "subscribed and paid-up capital" in the sub-rule (5), under Rules 6.1. ESX Growth Board Listing (Listing Rules) should be interpreted to mean total market capitalization/shareholders’ equity. This interpretation ensures consistency with the established standard applied to the Main Board, aligning market capitalization definitions across all Boards.

For the avoidance of doubt, an Issuer shall have a total market capitalization/shareholders’ equity of at least ETB 50,000,000.00 (Fifty Million Birr) upon listing on the Growth Board.

The use of total market capitalization/shareholders’ equity provides a comprehensive and accurate measure of an Issuer’s value, reinforcing the principles of transparency and fairness promoted by The Exchange.

For detailed information on the rationale, examples of computations and guidance on determining the various thresholds, please refer to the applicable section titled “*Minimum Capitalization, Shareholders’ Equity, and Public Float Requirements for the Main Board*”.

## **Disclosure Obligations – Definition of “Immediately”**

- **Definition of “Immediately”**

Rule 8.2.: Timely Disclosure (Listing Rules) provides that Issuers should immediately disclose occurrences of price sensitive nature to the market to enhance investors’ decision of buy, sell or hold, prevent information asymmetry and promote fair and equitable market. This rule

should be read in conjunction with the provisions of sub-rule (2) of Rule 9.3. Board Meetings (Listing Rules).

The objective of the rule is to put in place an efficient and effective information disclosure process for the monitoring of Issuers Listed on ESX to prevent ambiguity in the obligations imposed under ESX's Rules. The rules are expected to:

- a. Provide specific timelines for certain activities required of the Issuers.
- b. Provide clarity in sections of the rules that had ambiguity.
- c. Align the rules with global best practice.
- d. Minimize possible abuse on/arising from non-specified rules provisions.
- e. Enhance disclosure and transparency on the handling of Information by Issuers.

This is to ensure that information about Issuers is disseminated to investors as quickly as they develop to avoid information asymmetry and to promote fair and equitable market.

While the word "Immediately" can be interpreted in different ways by different readers, the intent of the rule is that such occurrence should be disseminated to the investing public as soon as the company becomes aware of it not later than one (1) business day. It must also be noted that Issuers may be granted the allowance of disseminating such occurrences beyond one (1) business day if such occurrence has made it impossible for the Issuer to operate optimally. Occurrences during weekends and non-business days should be disseminated not later than the end of the next business day.

### **Material Non-Public Information**

Rule 8.2. Timely Disclosure (Listing Rules) mandates that issuers must promptly inform investors and the public of any significant information that could impact their interests. This includes any material information that could influence market activity, prices, or the value of listed securities. Immediate disclosure of such price-sensitive information is essential to ensure transparency and maintain market integrity.

- **Material Information**

Material information is any information that can affect the share price of an Issuer or influence shareholders' decision to either buy, sell or hold the securities of the Issuer. It refers to information that a reasonable person would consider important or that will reasonably influence the individual's investment decision.

For this rule, material information shall include inside information which is defined under Article 93. Inside Information, of the Capital Market Proclamation, and aims to prevent individuals and institutions with privileged access to such information from gaining an unfair advantage over the general investing public, thereby preserving market confidence and integrity.

- **Non-Public Information**

Non-public information refers to any information that is known to the Issuer and its insiders but has not been disclosed to the investing public.

- **Material Non-Public Information**

Material Non-Public Information refers to confidential information about an Issuer that has not been released to the public but could significantly impact the Issuer's share price. It refers to information that is only known or available to the Issuer and its insiders but has not yet been disclosed to the investing public. Information remains non-public until it has been officially disclosed to the market and is accessible to all investors.

Material non-public information includes, but is not limited to:

- a. Earnings reports and corporate actions;
- b. Business combinations (e.g., mergers, acquisitions, joint ventures);
- c. Major balance sheet re-alignments (e.g., asset disposals, acquisitions);
- d. Significant research breakthroughs (e.g., new products or discoveries);
- e. New licenses, patents, trademarks, or regulatory approvals/rejections;
- f. Changes in top management or Board composition;
- g. Auditor's report modifications or third-party rating changes;
- h. Bankruptcies or significant legal disputes;
- i. Large-volume transactions by significant shareholders;
- j. Related party transactions; and
- k. Changes to government policies that can impact the Issuer's business operations.

## **Related Party Transactions**

- **Applicability of the Rule**

The Rules governing related party transactions are designed to address and manage conflicts of interest that may arise when an Issuer engages in transactions with affiliated persons. These affiliated persons, as defined in the ESX Rulebook (Rule 1.2. Definitions (General Rules)), include key individuals and entities with a direct or indirect influence on the Issuer. The rules apply to all companies with equity securities listed on ESX.

However, foreign companies with a secondary listing on ESX are exempted from these requirements. This exemption acknowledges that foreign issuers are already subject to similar regulations in their primary listing jurisdictions, where the rules of the home securities exchange will govern related party transactions.

- **Transactions within the Purview of the Rules**

For the purposes of the related party transaction rules, the following shall be considered as related party transactions:

- a. Transactions of a recurring nature which are necessary for the day-to-day operations of the Issuer e.g. purchase or sales of raw materials;
- b. Acquisition, disposal or leasing of assets such as land or land-based property, vessels, aircraft, plants etc.;
- c. Provision or receipt of financial assistance which may involve loans, guarantees, or financial support, or funding from parent entities;
- d. Rendering or receiving of services;
- e. Acquisition or disposal of securities;
- f. Entry into joint ventures which may involve shared ownership, management and risks;
- g. Grant or exercise of an option in relation to the acquisition or disposal of financial instruments or assets; and
- h. Such other transactions as may be determined by the ESX from time to time.

- **Disclosure Requirements and Medium of Disclosure**

As with other price sensitive/material information, related party transactions are expected to be disclosed to the ESX and the investing public as they occur. This disclosure should be made through the following:

- a. Annual Reports and Interim Financial Statements: Issuers are required to disclose information on the related party transactions that occurred during the year or financial period in their financial statements in line with the provisions of the relevant accounting standards. Specifically, the International Financial Reporting Standards (IFRS) IAS 24: Related Party Disclosures, require companies to disclose information on related parties with a focus on the nature of the transaction, the type of relationship, comprehensive information on the transactions, outstanding balances and commitments. The objective of these disclosures is to ensure that users of financial statements understand the potential effect of the related party relationship on the Issuers financial statements.
- b. Formal Notification to ESX: Issuers will also be required to disclose related party transactions to ESX within twenty-four (24) hours through the medium to be prescribed by ESX.

- **Reporting Threshold and Requirement for Securities Holders' Approval**

To provide clarity to Issuers, any related party transaction with a value equal to or exceeding five percent (5%) of the Issuer's total assets must be disclosed. Furthermore, if the aggregate value of related party transactions reaches or surpasses ten percent (10%) of the Issuer's total assets, reporting becomes mandatory.

Additionally, transactions valued at ten percent (10%) percent or more of the Issuer's total assets require prior approval from securities holders, aligning with the provisions of Articles 306, 394 and 395 of the Commercial Code, as may be amended.

Where transactions of a recurring nature are involved, Issuers must seek annual approval from securities holders to ensure continued oversight and accountability.

- **Valuation of Related Party Transactions**

Determining the value of a Related Party transaction involves assessing the full financial exposure or risk faced by the Issuer as follows:

- a. Transactions entered into by a subsidiary of the Issuer: The value of the related party transaction shall be the entire consideration paid or received and not limited to the Issuer's interest in the consideration.
- b. Joint venture transactions: The value of the related party transaction shall be guarantees given by the Issuer.
- c. Grant or exercise of an option: The value of the related party transaction shall be the consideration of the total issue price of the option and its exercise price.
- d. Financial assistance: The value of the related party transaction shall be the total consideration receivable or payable under the transaction.

- **Acceptable Independent Financial Adviser**

To safeguard the integrity of related party transactions, an acceptable independent financial adviser, required under Rule 10.4. General Mandate (Listing Rules), is any entity licensed by the Ethiopian Capital Market Authority (ECMA) to provide investment advisory services.

## **Procedures for Voluntary Delisting**

- **Rationale**

The purpose of Chapter 12: Delisting of an Issuer and its Securities from The Official List of The Exchange (Listing Rules) is to ensure that the process of removing the equity shares of an Issuer, that has elected for voluntary delisting, from the Official List of The Exchange is conducted in a transparent, fair and orderly manner after obtaining relevant approvals. It sets out clear requirements for an issuer seeking to delist its equity shares from the Official List of The Exchange and covers the conditions that must be fulfilled before a voluntary delisting application is considered and approved by The Exchange.

The rule outlines the process for voluntary delisting from the Official List of The Exchange which would only be considered by The Exchange when the Issuer has been listed on The Exchange for a period not less than three (3) years from the initial listing of its equity shares, thus ensuring that Issuers do not exploit listing opportunities for short-term benefits.

- **Authority of The Exchange to Mandate Disclosure to the Public**

In certain circumstances, The Exchange may mandate that an Issuer publicly disclose their intention to delist within the stipulated timeframe for notifying the market of price-sensitive information. Examples of such circumstances include, but are not limited to, situations where it is necessary to prevent market manipulation of the share price, ensure transparency for investors, maintain market integrity, or address regulatory compliance issues.

- **Funding Requirements for Minority Shareholder Protection**

Rule 12.3 (4) states that an Issuer seeking to delist from The Exchange is required to set aside sufficient funds to purchase the interest of all minority shareholders. Such funds shall be deposited in a commercial bank and shall be blocked under the name of the securities depository for a minimum period of three (3) months, or as may be prescribed by Commercial Code or any other law in force in Ethiopia.

In interpreting this Rule, Issuers should note that the funds to be set aside are irrespective of the response from shareholders who may decide whether to continue as shareholders of the Issuer or not. The Issuer is mandated to deposit sufficient funds to cover all minority stakeholders. These funds are required to remain in the escrow account until after the minimum period of three (3) months when an offer is made to the minority shareholders.

For the purpose of this chapter, sufficient funds mean an amount equal to or greater than the number of shares held by minority shareholders multiplied by the offer price at which the minority shares are offered to be purchased, and inclusive of all estimated fees and charges.

To compensate for the opportunity cost of depositing funds for the purpose of purchasing the interest of minority stakeholders, The Exchange may direct or permit that the funds are deposited in an interest-bearing account.

## **SECTION 4 – VOLUME D (TRADING RULES)**

### **Background**

Volume D (Trading Rules) provides a comprehensive framework that promotes ethical conduct, accountability and orderly trading of securities listed on ESX. These rules are designed to uphold the principles of fairness, transparency, and market integrity ensuring that all participants operate within guidelines that foster efficient market functioning, accurate price discovery, and investor confidence.

The rules focus on trading practices, order handling, client asset management, and the prevention of market manipulation, ensuring the efficient and equitable functioning of the exchange. They also provide mechanisms to deter misconduct, prevent disruptions, and maintain a stable trading environment.

This Section of the Interpretative Guidance/Explanatory Commentaries aims to provide detailed guidance on the critical elements of the Trading Rules that address the trading obligations of Trading Members. These include:

- a. Activities constituting market manipulation, insider dealing, and other prohibited trading practices;
- b. Management and protection of clients' assets;
- c. Order handling and best execution principles;
- d. Obvious errors and procedures for managing them;
- e. Fair treatment and prioritization of clients benefit in trading activities; and
- f. Clearing and settlement processes and responsibilities, including reporting failed transactions and rectifying defective transfers.

### **Client Benefit Irrelevance**

It is imperative for Trading Members to note that compliance with the Trading Rules is mandatory, regardless of whether the trading activities result in profit or loss to its clients. The principle of Client Benefit Irrelevance underscores that a Trading Member remains liable for any breaches of these regulations, even if such breaches inadvertently result in financial gains for the client. The repercussions of non-compliance include:

- a. Legal and Regulatory Repercussions: Non-compliance may lead to significant legal and regulatory consequences, including fines, suspension, and revocation of the Trading Member's Membership Certificate.
- b. Ethical Standards Compromise: Breaches of these regulations compromise the ethical standards and operational integrity of the Trading Member.
- c. Erosion of Public Confidence: Non-compliance erodes public confidence in the financial system and damages the goodwill of The Exchange, which is built on transparency, accountability, and trust.



- d. **Market Discipline and Integrity:** Consistent application of these rules is critical to maintaining market discipline and safeguarding the interests of all stakeholders.
- e. **Reputation Damage:** Violations tarnish the reputation of the Trading Member and undermine the trust and integrity of The Exchange.
- **Facilitating Compliance by Design**
  - a. **Detailed and Auditable Records:** Trading Members are expected to maintain detailed, auditable records for all client transactions and authorizations, ensuring that these records are readily available for inspection by The Exchange or regulatory authorities. They must implement robust internal controls, including regular audits and oversight by authorized supervisors, and establish mechanisms for identifying and addressing potential compliance breaches promptly.
  - b. **Comprehensive Internal Policies and Procedures:** Trading Members are required to develop comprehensive internal policies and procedures to ensure compliance with the rules, regularly updating these policies to reflect changes in regulatory requirements or operational risks. A robust risk management framework should be established to identify, assess, and mitigate potential breaches, incorporating routine compliance checks and audits into the framework.
  - c. **Leveraging Advanced Technology:** To further safeguard compliance, Trading Members should leverage advanced technology, such as automated monitoring tools, to detect and prevent breaches in real-time. Data analytics can also be utilized to identify patterns or trends that could indicate non-compliance.
  - d. **Regular Training:** Regular training sessions for all personnel are essential to familiarize them with the rules, their compliance obligations, and to emphasize ethical practices and the safeguarding of client assets.
  - e. **Open Communication:** It is important for Trading Members to maintain open communication with The Exchange and other regulatory authorities to stay informed of compliance expectations. Any issues, irregularities, or breaches must be promptly reported to The Exchange, and full cooperation with investigations and disciplinary decisions is required.

## **Clients' Assets Management Principles**

- **Objectives of the Rules**

Chapter 3: Client Assets (Trading Rules) provides a framework for how Trading Members must handle client assets, including funds and securities.

Generally, Trading Members are required to:

- a. Properly segregate client funds into designated accounts to prevent commingling;
- b. Exercise a duty of care to make sure that the clients funds are not misappropriated;
- c. Refrain from carrying out unauthorised sales of shares and other securities;

- d. Avoid exercising discretion in clients account without proper authorisation; and
- e. Process payments from the sale of securities exclusively through electronic money transfer in favour of the account holder, using the account details in the client's KYC documentation).

These rules aim to protect client funds from misuse or misappropriation by mandating segregation, preventing conflicts of interest, and enforcing transparency in transactions. The key focus is to ensure that clients' interests are safeguarded, while fostering ethical business practices within the trading system.

Key objectives include:

- a. **Protecting Client Assets:** The protection of client funds and securities from misuse, misappropriation, or unauthorized transactions is the primary concern. This reduces the risk of financial loss for clients and upholds the integrity of the market.
- b. **Protect Clients' Interests:** Ensuring that all transactions made on behalf of clients align with their investment goals is essential for maintaining trust in the financial system.
- c. **Prevent Conflicts of Interest:** The segregation of client funds from business funds ensures that Trading Members cannot use client funds for their own operations, which reduces the risk of internal fraud.
- d. **Promote Transparency and Accountability:** Accurate record-keeping is required for all transactions, ensuring that clients can trace the status of their funds and securities, thus preventing disputes and fraud.
- e. **Ensure Ethical Conduct:** Strict prohibitions against actions such as unauthorized selling or misappropriating client funds, with penalties are designed to act as a deterrent for misconduct.
- f. **Maintain Market Integrity:** Ethical behaviour is essential to ensure the proper functioning of the market. These rules enforce such behaviour through penalties and, if necessary, revocation of membership.

- **Case Studies/Scenarios Analyses**

CDEF Investment S.C., a Trading Member of ESX, provides a wide range of investment services to clients. The Exchange recently conducted a targeted inspection of Trading Members to ensure compliance with the trading rules, including Rules 3.1. through 3.5., which cover the use and segregation of client funds, misappropriation of client funds, unauthorized sale or transfer of securities, discretion in client accounts, and payments for purchase or sale of securities.

- **Rule 3.1. Use and Segregation of Client Funds**

- **Scenario:** Mr. Alemayehu deposits ETB 1,000,000.00 into CDEF Investment S.C.'s segregated clients' bank account for purchasing securities. However, instead of retaining the funds in the segregated account for its intended purpose, CDEF Investment S.C. transfers the money into their general operational bank account to cover operational expenses.

- **Non-Compliance Issues:**
  - Client funds were not kept in a separate account but were commingled with business funds.
  - The transfer of client funds to the operational account was unauthorized.
- **Rule 3.2. Misappropriation of Client Funds**
  - **Scenario:** During an inspection by The Exchange, it was uncovered that CDEF Investment S.C. had not only transferred Mr. Alemayehu's funds into their operational account but had also utilized these funds for unauthorized purposes such as:
    - a. Paying office rent and salaries;
    - b. Funding marketing campaigns for a new product; and
    - c. Investing in high-risk securities for the firm's portfolio.

Additionally, the firm had gained significant benefits from the misappropriated funds, including interest, dividends, and capital appreciation.
  - **Non-Compliance Issues**
    - The firm misappropriated client funds by using them for unauthorized purposes.
    - Retaining benefits accrued from the misappropriated funds, such as interest and dividends, is prohibited
- **Rule 3.3. Unauthorized Sale or Transfer of Securities**
  - **Scenario:** To address a liquidity issue, CDEF Investment S.C. also sold 4,000 units of shares belonging to Mr. Alemayehu without obtaining his authorization.
  - **Non-Compliance Issues:**
    - The firm violated the client's ownership rights by selling securities without authorization.
    - Retaining any benefits from the unauthorized sale is prohibited.
- **Rule 3.4. Discretion in Client Accounts**
  - **Scenario:** A representative of CDEF Investment S.C. exercised discretionary power in Mr. Alemayehu's account, purchasing high-risk securities that were inconsistent with his investment objectives, without obtaining written authorization from Mr. Alemayehu. The purchase led to significant financial losses.
  - **Non-Compliance Issues:**

- Discretionary actions were taken without obtaining written client consent, leading to investments that did not align with the client's goals.
- **Rule 3.5. Payments for Purchase or Sale of Securities**
- **Scenario:** CDEF Investment S.C. received payment for the purchase of securities from Mr. Alemayehu in cash. Additionally, the firm transferred the proceeds of a sale to another bank account in Mr. Alemayehu's name, which was not registered with CDEF Investment S.C. in his KYC documents.
  - **Non-Compliance Issues:**
    - Payment for the purchase of securities was not made via electronic money transfer as required.
    - Proceeds of the sale wrongly transferred to an unregistered account.
    - While the bank account used for the erroneous transfer may belong to Mr. Alemayehu, it was not listed in his KYC/account opening documents with CDEF Investment S.C. This discrepancy could potentially indicate that the account is fraudulent or being used for purposes not sanctioned by the client. Without proper verification, the firm cannot confirm the legitimacy of the account, increasing the risk of financial fraud or money laundering. This emphasizes the critical importance of adhering to KYC procedures to ensure the security and integrity of transactions. In such a situation, the client should be mandated to update his KYC details before executing such a transaction, failing which the proceeds will be remitted to the client's registered bank account.
- **Record Keeping Requirements**
- **Scenario:** During an inspection by The Exchange, it is uncovered that CDEF Investment S.C. has been maintaining incomplete and inaccurate records of client fund transactions. Several transactions, including deposits and withdrawals, are not properly documented, making it difficult to distinguish between client funds and business funds. Specifically, the firm fails to document the source of certain funds and cannot accurately account for the disposition of these funds over a period of six (6) months.
  - **Non-Compliance Issues:**
    - The firm failed to maintain accurate and detailed records of client fund transactions.
    - Incomplete documentation and poor record-keeping practices hinder transparency and traceability.

## Order Handling and Best Execution Principles

Chapter 4: Order Handling and Best Execution (Trading Rules) establishes that Trading Members have a fiduciary duty to act in the best interest of their clients when handling investment actions and executing orders.

Best Execution means the duty to take all sufficient steps to obtain the best possible result for the client under the relevant circumstances when executing transactions on the client's behalf. Hence, Trading Members must ensure that investment decisions and order execution prioritize the sole benefit of the client, considering known facts and circumstances.

Achieving Best Executing principles entails that a Trading Member must implement procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders, by satisfying the following conditions:

- a. Ensure that orders executed on behalf of clients are promptly and accurately recorded and allocated.
- b. Ensure that orders executed on behalf of clients are conducted in a fair, clear, and open manner to achieve the best possible outcome for clients.
- c. Not misusing information relating to client orders and must take all reasonable steps to prevent the misuse of such information by any of its employees.

<b>Areas</b>	<b>What Best Execution Principles Entail</b>	<b>What Best Execution Principles Prohibit</b>
<b>Price</b>	Executing client's order at the best available market price (competitive and efficient trading).	Executing trades at uncompetitive or manipulated prices.
<b>Speed of Execution</b>	Minimal time lag between when a client's order is received and when it is placed by Trading Member to secure the optimal outcome for the client.	Delaying execution of client's order, thereby subjecting the client's order to higher cost of execution.
<b>Order Handling</b>	Processing and placing clients' orders consistently to provide better pricing and faster execution.	Subjecting client's order to the Trading Member's inefficient internal processing of mandates.
<b>Cost</b>	Ensuring minimal transaction fees by not exposing client's order to potential abuse.	Delay in executing client's order, where it is practicable to do so exposes the client to higher cost of execution and abuse, e.g. front running.
<b>Transparency</b>	Providing clients with a post-trade report detailing execution price, fees, and time of execution.	Not making available or delay in making available the trade execution details for the clients through their preferred channels of communication.

Areas	What Best Execution Principles Entail	What Best Execution Principles Prohibit
<b>Client Order Priority</b>	Ensuring client orders are giving priority in execution within prevailing market conditions before Trading Member proprietary trades.	Prioritizing the firm's trades over client orders in a manner that the client is worse off or that best execution was not achieved for the client.

- **Case Study/Scenarios Analysis A:** *Ensuring Fairness in Order Handling for Multiple Clients with Limited Share Availability*

- **Situation:** ABC Trading Limited is a Trading Member on the Ethiopian Securities Exchange (ESX), serving a diverse clientele that includes institutional investors, retail investors, and high-net-worth individuals (HNIs). The firm must adhere to the best execution principles and ensure fairness in handling orders, avoiding favouritism among clients.

The clients involved include:

- Institutional Investor: XYZ Pension Fund places an order to buy 50,000 shares of Company A.
- Retail Investor: Mr. Abebe places an order to buy 200 shares of Company A.
- High-Net-Worth Individual: Ms. Eleni places an order to sell 1,000 shares of Company A.

ABC Trading Limited also intends to place an order to buy 5,000 shares of Company A for its proprietary account.

The total quantity of available shares of Company A is 48,000, which is less than the aggregated volume of the buy orders.

- **XYZ Pension Fund's Large Volume Trade:** XYZ Pension Fund, aware of an opportunity in Company A, placed an order to buy 50,000 shares. The trading desk at ABC Trading Limited knew that such a large volume of trade would require obtaining necessary approvals for large volume or block trades. The firm's order execution policy mandated that such trades must receive regulatory approval to ensure compliance and maintain market integrity.

While awaiting approval, the trading team monitored market conditions to execute the order at the best possible price once approval was granted.

- **Mr. Abebe's Retail Order:** Meanwhile, Mr. Abebe, a retail investor with ABC Trading Limited, placed an order to buy 200 shares of Company A.
- **Ms. Eleni's High-Value Sell Order:** Simultaneously, Ms. Eleni, a high-net-worth individual known for her strategic investments, placed an order to sell 1,000 shares of Company A. The trading team at ABC Trading Limited recognized the importance of

quick execution to avoid market fluctuations. They executed Ms. Eleni's sell order promptly, ensuring that she received the best price available.

- **Handling Limited Share Availability:** With the total available shares of Company A being 48,000, less than the aggregated volume of the buy orders (50,200), ABC Trading Limited faced a challenge in ensuring fairness.
- **Pro-Rating the Shares:** Assuming that ESX has permitted pro-rating of shares as an acceptable fair allocation methodology in line with Rule 4.7. Aggregation and Allocation of Orders, and taking into consideration the provisions of Rule 4.8, which prohibits the aggregation and allocation of client transactions with the firm's proprietary account:
  - XYZ Pension Fund's order of 50,000 shares represents approximately 99.6% of the total buy orders (50,200 shares), Mr. Abebe's order of 200 shares represents approximately 0.4% of the total buy orders (50,200 shares).
  - Based on these proportions and to ensure that each client's order was partially fulfilled fairly, based on the available shares, and no client was unfairly favored over another, ABC Trading Limited allocated the available 48,000 shares as follows:
    - XYZ Pension Fund received approximately 47,808 shares (i.e.,  $48,000 * 99.6\%$ ).
    - Mr. Abebe received approximately 192 shares ( $48,000 * 0.4\%$ ).
  - ABC Trading Limited's proprietary buy order for 5,000 shares was not aggregated with the client orders and was handled separately, ensuring compliance with Rule 4.8. Prohibition of Aggregation and Allocation of Client Transactions with Trading Member's Proprietary Account
- **Ensuring Fairness and Compliance:** Throughout the process, ABC Trading Limited demonstrated its commitment to fairness and compliance with the best execution principles.
  - Best Execution Principle and Criteria (Rule 4.1.):
    - Acting in the Best Interest of Clients (4.1.(3a)): The firm prioritized the interests of XYZ Pension Fund, Mr. Abebe, and Ms. Eleni, ensuring each order was executed at the best possible price.
    - Establishing Transparent Procedures (4.1.(2)): All clients were informed about the order execution policy, which was available on the firm's website. This transparency ensured that clients understood their commitment to fairness.

### **Sample (Typical Content) of an Order Handling/Best Execution Policy**

Trading Members are required to establish transparent and comprehensible procedures to ensure fair and orderly execution of client orders.

*Note: this sample and the examples provided therein are for illustrative purposes only and is not intended to serve as a substitute for a fully developed and tailored policy. Any actual Policy must be detailed, comprehensive, and compliant with the relevant legal and regulatory requirements.*

1. Introduction and Purpose: This policy aims to ensure all client orders are handled efficiently and executed to achieve the best possible results, adhering to the directives of ECMA and the rules and regulations of ESX, and other relevant regulatory requirements.
2. Execution Factors: When executing client orders, we consider factors such as:
  - a. Price: Obtaining the best available price for clients.
  - b. Speed: Ensuring timely execution of trades.
  - c. Costs: Minimizing transaction fees and related expenses.
  - d. Likelihood of execution and settlement: Prioritizing successful completion of orders.
  - e. Size and nature of the order: Adapting strategies based on the specifics of the transaction.

3. Relative Importance of Factors: The importance of each execution factor may change depending on the type of financial instrument, market conditions, and the client's preferences.

*Example: For government bonds on the ESX, the likelihood of settlement might take precedence, while for highly liquid stocks, price and speed could be the top priorities.*

4. Execution Venues: We execute orders exclusively through approved venues, such as the Ethiopian Securities Exchange (ESX), or other trading platforms recognized by the Ethiopian Capital Market Authority (ECMA).

5. Client Instructions: Specific client instructions take precedence over the standard best execution process.

*Example: A client requests that their order be executed at a specific time during the trading session, prioritizing timing over price considerations. This instruction is followed and documented appropriately.*

6. Order Handling: All orders are handled fairly and transparently, with clear procedures for managing partial fills or order rejections.

*Example: If multiple clients submit orders for the same security at the same time, the ESX trading system may prioritise execution based on price and time.*

7. Monitoring and Review: We monitor the effectiveness of this policy regularly and review it periodically to ensure continued compliance with ESX and ECMA requirements.

*Example: A quarterly review is conducted to evaluate execution practices and implement improvements where necessary.*

8. Disclosure: Clients are provided with a summary of this policy, detailing the execution factors, venues, and order handling procedures. In addition, the full text of the policy is available on our website and on demand by the client.

*Example: This policy is shared during client onboarding and is updated annually to reflect any regulatory or operational changes in the Ethiopian capital market.*



- Timely Execution (4.1(3b)): XYZ Pension Fund's large order was executed after obtaining necessary approvals. Mr. Abebe's smaller order was processed immediately, and Ms. Eleni's sell order was executed swiftly to avoid market volatility.
- Role of Price and Total Consideration (Rule 4.3.):
  - Evaluating Total Consideration (4.3. (1)): The total consideration for each order was evaluated, including price, execution costs, and fees.
  - Comprehensive Execution Factors (4.3. (2)): The firm considered factors like speed, likelihood of execution, and market impact to ensure the best possible result.
- Order Handling and Execution (Rules 4.4.):
  - Effective Arrangements for Best Result (4.4. (2a)): Advanced trading algorithms and real-time market data were used to achieve the best possible result for each client's order.
  - Order Execution Policy (4.4. (2b, 2e)): The firm's policy highlighted the importance assigned to execution factors like price and speed, ensuring no favoritism.
  - Monitoring and Compliance (4.4. (2h)): Regular monitoring and audits ensured high standards of execution and confirmed that no client received preferential treatment.
- Following Clients' Specific Instructions (Rule 4.5.):
  - Executing Specific Instructions (4.5. (1a)): Specific instructions from clients, like Mr. Abebe's price threshold, were followed without delay.
- Communication and Record-Keeping (Rule 4.6.):
  - Prompt and Accurate Recording (4.6. (2a)): All order details were recorded promptly and accurately.
  - Client Communication (4.6. (2b)): Clients were informed of any material difficulties encountered during the execution process.
  - Preventing Information Misuse (4.6. (3)): Confidentiality measures ensured that sensitive information was not misused.
- Aggregation and Allocation of Orders (Rule 4.7.):
  - Fair Allocation (4.7.(1a)): The aggregation of orders and transactions was done in a way that did not undermine fair allocation methodology.
  - Order Allocation Policy (4.7.(1b)): The firm's order allocation policy, effectively implemented, provided for the fair allocation of aggregated orders and transactions, including the treatment of partial executions.

- Prohibition of Aggregation and Allocation of Client Transactions with Trading Member's Proprietary Account (Rule 4.8.):
  - No Aggregation with Proprietary Account (4.8): ABC Trading Limited ensured that none of the client orders were aggregated with the firm's proprietary account transactions, maintaining the integrity of client transactions.
- Audit Trail Requirements (Rule 4.9.):
  - System for Order Tracking and Monitoring (4.9.(1)): ABC Trading Limited established a robust system for tracking and monitoring orders, ensuring an end-to-end trail through the life cycle of each order.
  - Evidence of Audit Trail (4.9.(2)): Evidence of the audit trail, including time stamps and records of amended, cancelled, and executed orders, was maintained in the firm's system to provide visibility into the entire order life cycle.
- **Case Study/Scenarios Analysis B:** Fixed Income Market Order Handling and Trade Execution
  - Scenario: ABC Bank S.C. is a Dealing Member on The Exchange ETP, specializing in fixed income securities. The firm must adhere to the rules and guidelines set forth by The Exchange to ensure proper handling, execution, and reporting of fixed income trades.
 

ABC Bank S.C. receives multiple fixed income orders and quotes for various debt securities and money market instruments. The firm must navigate through different methods of trading, quoting conventions, and trade execution requirements to ensure compliance and best execution.

Other participants include:

    - Counterparty Dealing Member: XYZ Bank S.C.
    - Institutional Investor: Alpha Investments
  - Order Handling Methods:
    - Request for Quote (RFQ) Method:
      - Alpha Investments requests a quote for purchasing ETB 10,000,000 worth of Ethiopian Government Bonds through the RFQ module on The Exchange ETP.
      - ABC Bank S.C. provides a quote based on the yield, displaying the clean price of the coupon bond.
      - The quote is given in standard amounts as determined by The Exchange.
    - Firm Order Placed in the ETP:

- XYZ Bank S.C. places a firm order to sell ETB 2,000,000 worth of corporate bonds.
- The order is displayed on The Exchange ETP with the clean price and yield.
- The order remains valid until XYZ Bank S.C. decides to change the amount or price, or the order is executed.
- Bilateral/Negotiated Method:
  - ABC Bank S.C. negotiates a trade with XYZ Bank S.C. to buy ETB 5,000,000 worth of Treasury Bills through a chat platform.
  - The negotiated trade must be reported and booked in the trade reporting system within The Exchange ETP.
  - The telephone conversation related to the trade execution is recorded for compliance purposes.
- Execution of Trades:
  - Dealing through The Exchange ETP:
    - All trades, including the RFQ and firm order trades, are executed through The Exchange ETP.
    - The bilateral trade negotiated via the chat platform is reported and booked in the trade reporting system within ten minutes of execution.
  - Reporting Requirements:
    - ABC Bank S.C. ensures compliance with reporting requirements for all trades.
    - Telephone conversations related to trade execution are recorded and maintained.
- Trade Conclusion:
  - No Refusal to Deal:
    - ABC Bank S.C. does not refuse to deal after quoting a price if XYZ Bank S.C. decides to buy at the quoted price.
    - The firm is bound to deal once the price and quantity are agreed.
  - Confirmation of Deal:
    - The deal is executed when Alpha Investments confirms the purchase of the standard amount of Ethiopian Government Bonds quoted at the indicated price.

## **Error Trades and Orders**

- **Meaning of Obvious Error**

Rule 5.4: Management of Obvious Error (Trading Rules) outlines the steps to be taken by the ESX when a trade is executed under conditions that are obviously incorrect. The rule ensures that ESX has the authority to cancel or adjust erroneous transactions to maintain market integrity and fairness in the trading experience. Obvious errors may result from technical glitches, human mistakes, or other anomalies that cause trades to be executed with significant deviations from intended conditions.

- **Examples of Obvious Errors**

Obvious errors in trading may occur due to:

- a. Technical Glitches: Malfunctions in trading algorithms may cause orders to be processed incorrectly, such as reversing buy and sell orders or executing trades at outlier prices beyond the daily limit movement of a security.
- b. Fat-Finger Errors: Traders may mistakenly enter incorrect order details, such as inputting a price of ETB 100.00 instead of ETB 10.00 or mis-keying an account number (e.g., entering 001234567 instead of 010234567).

This rule applies in cases where obvious errors occur in security trading due to unforeseen errors in order entry or execution. ESX will intervene in situations where:

- Orders are executed at prices significantly deviating from the fair market value due to technical errors.
- Orders are mistakenly placed with incorrect quantities, prices, or account numbers.
- Transactions result from system malfunctions or incorrect settings applied by Trading Members.

To correct an erroneous trade, ESX will act within a reasonable period from the time the error is identified. A reasonable period will be inferred based on industry standards, past practices, and the urgency required to maintain market integrity.

Where a Trading Member reasonably believes that he/she has executed a transaction as a result of an obvious error, the obvious error should be reported in writing to an officer of the ESX within thirty (30) minutes of executing the transaction and requests that the transaction be adjusted or cancelled. Otherwise, the Trading Member would be unable to make such request. The request to ESX must include the following information:

- a. The symbol of the security.
- b. The transaction time;
- c. The transaction price;
- d. The account number(s) of the client(s);

- e. A brief description of why the Trading Member believes that the transaction falls under the obvious error definition, e.g., wrong account number, wrong trade type (buy or sell), excess quantity, etc.; and
- f. Transaction volume.

The Trading Member request for trade cancellation or amendment as a result of the error trade, must obtain the written consent of the counterparty Trading Member to the transaction before the transaction is cancelled or adjusted. In addition, the written consent must be submitted to The Exchange at least thirty (30) minutes before the market closes for the day.

Further to Rule 5.5. Obvious Error Procedure: In reviewing the request for trade cancellation or amendment as a result of the error trade, where The Exchange or its designee determines after a review of the circumstances that an Obvious Error has occurred, The Exchange shall correct the trade as requested and the CSD will be notified immediately.

The Exchange at its discretion may take further actions as stated in sub-rule (4.) captured below.

*“Errors as to volume and price will be corrected and an administrative charge of amount as may be determined by The Exchange may be imposed on the Trading. Notwithstanding any administrative charge or fines that are assessed, The Exchange reserves the right to take further disciplinary action against the Trading Member responsible for the erroneous order entry, including compulsory training for the Trader, in accordance with The Exchange’s rules regarding disciplinary proceedings”.*

Accordingly, the CSD and the requesting Trading Member shall be notified of the Exchange’s decision for their respective actions and updates

To determine materiality, ESX will consider factors such as the extent of the price deviation from the prevailing market price at the time of execution, the volume of the erroneous trade and its impact on market liquidity, and the underlying cause of the error, whether human input mistakes, system malfunctions, or external factors affecting execution. This will be considered on a case-by-case basis with necessary guidance by precedents and regulatory intent.

To ensure consistency and fairness in applying the rule, ESX will adopt transparent and well-documented standards when determining whether an erroneous trade requires correction or cancellation. Where uncertainty arises, ESX may resort to engagement with relevant stakeholders, including regulatory authorities and market participants, to help establish a uniform approach and enhance market confidence.

Finally, to minimize the occurrence of obvious errors, Trading Members are expected to implement strict internal controls, such as order confirmation alerts, price limits, and pre-trade validation checks as well as educate and oversee clients with direct access to the exchange’s trading system to prevent erroneous trades.

## **Prohibited Activities**

- **Rule 6.1. Prohibition of Business Relationship Based on Guarantee (Trading Rules)**

Trading Members are strictly prohibited from promising fixed or guaranteed returns or profit margins to investors, recognizing that security prices are influenced by market forces and investor sentiment, making returns inherently volatile and unpredictable. As such, Trading Members are also required to clearly communicate this prohibition to their clients.

The rule specifically applies when a Trading Member makes misleading claims about guaranteed returns or profit margins in entering a business relationship. For instance, it is prohibited to promote investment schemes that suggest returns are assured, including those that fail to disclose associated risks or claim to have access to price-sensitive information or predictive tools that promise guaranteed returns.

The rule highlights that guaranteeing returns or profit margins on securities investments is unethical and cannot realistically be fulfilled by Trading Members. Consequently, Trading Members must refrain from such claims in their dealings with clients.

Providing investment advice does not violate Rule 6.1, as long as the Trading Member has a relevant license or obtained authorization from ECMA to provide the service, it is not fraudulent or deceptive, does not employ high-pressure tactics, and does not promise guaranteed returns or profits. Statements of opinion in advisory materials should be clearly identified as opinions and backed by reasonable facts.

ESX has the discretion to apply this rule on a case-by-case basis or through a broader market-wide approach and future amendments to the rule will be based on market events and needs.

In addition to compliance with Rule 8.1. General Requirements for Communicating with the Public (Membership Rules), Trading Members are expected to clearly state the limitations of investment research reports or pitches. They must also provide necessary information to clients, ensuring they understand the need for due diligence when making investment decisions.

A clear example of a violation of this Rule is provided below:

*“ABC Trading Limited, a Trading Member on The Exchange, is approached by a potential client, Mr. James. During their discussion, an ABC Trading Limited representative assures Mr. James that he will receive a guaranteed return of 12% on his investment in Company X's shares. Additionally, the representative promises that if the shares incur a loss, ABC Trading Limited will cover the loss, ensuring that Mr. James does not lose any money.”*

To ensure compliance, routine monitoring will be conducted through off-site reviews, on-site inspections, and the examination of public communications such as publications and advertorials.

- **Rule 6.2. Prohibition of Preferential Treatment (Trading Rules)**

Trading Members are strictly prohibited from giving preferential treatment or unfair advantages to any client's account over others. The rule aims to maintain fairness, transparency, and market integrity by ensuring that all client accounts are treated equally, without favouritism.

Preferential treatment undermines the principle of equal access and opportunity for all market participants, leading to market inefficiencies, potential conflicts of interest, and a lack of trust

in the fairness and transparency of the market. It would include any instance where a Trading Member:

- Prioritizes the orders of certain clients (e.g., high-net-worth individuals or institutional investors) over others, resulting in faster execution or more favorable transaction terms, without justifiable reasons based on market conditions.
- Provides access to sensitive or price-sensitive information to select clients before it is made publicly available, thus giving them an unfair advantage.
- Allocates securities in an unequal manner, favoring certain clients over others, especially during oversubscription of new issues or market allocations.
- Engages in practices that disproportionately benefit clients, such as offering them access to more advantageous pricing or investment products, without similar opportunities being available to other clients.

A key scenario in which this rule applies is when a Trading Member gives an unfair advantage to a client in areas such as trade execution, access to information, allocation of securities, or asset pricing. This could be the result of loyalty programs or other affiliated services, where certain clients receive faster or preferential treatment. The rule is designed to prevent these types of preferential practices, ensuring that no client is treated more favourably than others in a manner that would distort the fairness of the market.

ESX may exercise discretion in applying the rule, particularly in cases where specific or customized services offered to certain clients do not put other clients at a disadvantage in achieving their investment objectives. For example, a high-net-worth individual or a large institutional investor may receive specialized services, but as long as these services do not harm the fairness of the market or disadvantage other clients, they may not be deemed a violation of this rule.

In terms of compliance expectations, Trading Members are required to establish policies and procedures that ensure client orders are handled in a way that achieves the best available terms, in line with Chapter 4: Order Handling and Best Execution (Trading Rules). These procedures should be designed to ensure that all clients receive fair treatment when their orders are executed.

To monitor compliance with this rule, Trading Members should periodically review and assess the effectiveness of their Best Execution policies and procedures. This may involve comparing factors such as execution times, prices, and other relevant metrics to ensure that there are no significant discrepancies between clients' experiences.

- **Rule 6.3. Prohibition of Transacting with Clients in Default (Trading Rules)**

Trading Members are not permitted to transact with clients who are in default of their obligations. This includes situations where clients fail to meet their contractual commitments, such as non-payment of debts, failure to settle securities transactions, or instances of negligence, breach of duty, or breach of trust. The rule's purpose is to minimize systemic risk, protect the market from potential abuse, and ensure that all clients uphold their financial

responsibilities. Trading Members are required to notify the ESX of clients in default, with the list of such clients to be published as decided by the Exchange.

ESX may exercise discretion in applying the rule in cases where a client is legally restricted from fulfilling their obligations under Ethiopian law. Furthermore, Trading Members must inform The Exchange in writing about the default, including the reasons and conditions of the default.

A case study for the application of this rule could involve a client who fails to settle their financial obligations after a transaction, such as outstanding debts or unresolved securities trades. In such a case, the Trading Member would be prohibited from engaging in any further transactions with that client until the default is resolved. This rule aims to prevent market manipulation, abuse, and financial instability that could arise from ongoing dealings with clients who have failed to meet their obligations.

The intent of the rule is that Trading Members should notify The Exchange immediately upon identifying a default. Hence, they are required to maintain vigilance in monitoring their clients' obligations and notify The Exchange promptly when a default is identified. Regular monitoring and filing updates on client defaults, such as outstanding debt and margin calls, are essential for effective enforcement. Where a resolution attempt is underway, the Trading Member may provide an initial notification and subsequently update The Exchange on remedial actions.

Additionally, default will ordinarily apply to trading and settlement transactions. However, advisory or ancillary may be covered, especially where such activities would facilitate further exposure.

Finally, clients who are actively working to meet their obligations (such as through debt restructuring or recovery plans) may not be immediately listed as defaulters provided, they adhere to an agreed repayment schedule. However, Trading Members must notify The Exchange of such arrangements and provide ongoing updates.

- **Rule 10.7. Prohibition of Market Manipulation and Illegal Market Dealing (Trading Rules)**

Under no circumstance shall a Trading Member engaging in any deliberate action or series of actions intended to artificially affect the supply, demand, or price of a security, or to mislead and deceive other market participants. The objective is to uphold fairness, transparency, and investor confidence, in alignment with the ESX's mandate and the relevant directives of the ECMA.

These activities may take various forms, including information-based and transaction-based manipulation.

- a. Information-based Manipulation: This occurs when false or misleading information is disseminated to induce trading activity. A common example is the "pump and dump" scheme, where misleading positive information is spread to inflate a security's price, allowing perpetrators to sell at a profit before the price collapses.

- **Pump and Dump Illustration:**



**Stock Pick:** The Participant identifies Stock A, an inactive stock (usually low-priced, illiquid stock) trading at 1Birr. The Participant buys 10million units of Stock A at 1Birr.amount to 10million Birr in value

- **The Pump:**

- The Participant spreads or sponsors false positive news about the company's growth potential, upcoming corporate actions, or success of a new product line, etc. These false claims are spread through social media, direct campaigns, or chart rooms, clubs to promote the stock to admiration of unsuspecting investors.
- The false news and campaigns would increase demand for the stock and trigger positive price rally in the market and could get up to 100Birr.

- **The Dump:**

- The Participant, with 10million unit early on, sells off his/her holdings in stock A at the inflated price of 100Birr.
- This sudden sell-off would trigger other sell-offs and causes the stock price to drop, potentially back to 1Birr since there is no fundamental to support the price drop.

- **Result:**

- Stock A drops back to 1Birr, leaving the unsuspecting investors stuck with the stock and significant losses
- Meanwhile, the Participant records substantial profits as a result of Pump and Dump.

- b. Transaction-based Manipulation: This involves trading practices that artificially distort security prices or trading volumes. Examples include executing trades to create an illusion of high market activity, engaging in wash trades, or acquiring a controlling position in a security to manipulate the price of related derivatives or underlying assets.

Such schemes distort the expectations of a fair and efficient market and constitute a breach of this rule.

This rule applies where a Trading Member disseminates misleading information disguised as independent analysis or adopts trading strategies designed to artificially impact security prices.

To address the issues of the potential for legitimate market activities by institutional investors or market makers to be misinterpreted as manipulation as well as the impact of market inefficiencies on price discovery, which may lead to wrongful allegations of manipulative conduct, ESX will assess cases on a contextual basis to distinguish between legitimate trading strategies and manipulative conduct.

To ensure compliance, Trading Members must implement robust internal policies and controls to prevent manipulative or illegal market activities, including:

- Procedures to prevent deceptive order placements and cancellations that create artificial pricing effects.
- Generating Trade Exception Reports whenever a trade exhibits manipulative characteristics and reporting such cases to ESX in accordance with Rule 10.2 on the Duty of Reporting to the Exchange.
- Promptly notifying ESX if a Trading Member suspects or identifies any attempted market manipulation, illegal trading, or other prohibited conduct.

- **Rule 10.8. Prohibition of Insider Dealing (Trading Rules)**

Trading Members are strictly prohibited from trading or assisting others or insiders in trading securities based on material non-public information i.e. information which is specific or precise, has not been made public, and, if it were made public, would likely have a material effect on the price of any securities.

For the purpose of this Rule, Article 94 of the Capital Market Proclamation No. 1248 /2021 has provided thus;

- 1/ *For the purpose of this Part, an “insider” means a person in possession of inside information.*
- 2/ *For the purpose of Sub-Article (1) of this Article, a person has information from an inside source if that person has it through:*
  - a) being a director, employee or shareholder of an issuer of securities;*
  - b) having access to the information by virtue of his or her employment, office or profession; or*
  - c) direct or indirect relationship with a person under paragraph*
    - (a) and/or*
    - (b) of this Sub-Article*

By virtue of this Rule, prohibited Insiders' activities shall include

- a. Trading (buying or selling);
- b. Tipping (i.e., communicating material non-public information to a second party to enable that party either to trade in the relevant securities or to tip another party); and
- c. Misuse of inside information for self-benefit or benefit of another person

Engaging in the above activities or aiding others when in possession of non-public material information undermines investor confidence in the fairness and integrity of the markets, hence Trading Members are prohibited from such activities.

The material information is confidential until it is made public. Once material information is publicly disseminated, it ceases to be classified as inside information, and trading on it no

longer violates this rule. The rule does not apply when inside information is legitimately shared for due diligence purposes in business transactions such as mergers, credit ratings, or securities offerings. However, any trading or inducement to trade based on such information constitutes a violation.

As a matter of compliance, Trading Members are expected to implement robust internal policies and safeguards to prevent the misuse of material non-public information

## **Clearing and Settlement Process**

- **Rule 9.3. Duty to Report Failed Transaction (Trading Rules)**

This rule establishes the duty of Trading Members to report failed transactions on ESX. When a trade does not settle as expected due to one party's failure to fulfil its obligations, the Trading Member that is not in default must report the issue to The Exchange as soon as they become aware of the counterparty's default. This requirement helps to maintain transparency in the settlement process, mitigate risks associated with trade failures, and uphold market integrity.

A failed transaction occurs when either the seller does not deliver the securities as agreed or the buyer does not make the required payment. Such failures can disrupt the overall settlement process, affecting multiple market participants and potentially leading to liquidity and systemic risks. Under this rule, the Trading Member that has fulfilled its obligations—whether as a buyer or a seller—must promptly report the issue in accordance with ESX's reporting requirements.

A trade would be officially deemed “failed” if it remains unsettled at the close of business on the expected settlement date (in line with ESX's rules and regulations). The Exchange will coordinate with the CSD and settlement banks to resolve failed transactions that arise due to factors beyond a Trading Member's control.

To ensure compliance, Trading Members must have robust internal systems to monitor trade statuses, track settlement dates, and promptly escalate potential failures to The Exchange within the trade settlement cycle. The Exchange will maintain clear communication channels with the CSD and Settlement Banks to facilitate the swift resolution of failed transactions. A strong monitoring mechanisms and predefined reporting protocols will also be established for effective enforcement and mitigation of settlement risks.

- **Case Study/Scenario Analysis**

- **Scenario:** A trade is executed between two Trading Members: Member A (the buyer) and Member B (the seller). The transaction involves the purchase of government bonds on February 10, with an assumed settlement date of T+3 (February 13), meaning that Member B, the seller, must deliver the securities to Member A, the buyer, and Member A must transfer the corresponding payment.

On February 13, when the transaction is due for settlement, Member A, having already prepared the required funds, completes the necessary payment to Member B. However, Member B fails to deliver the securities, citing an internal delay in securing the required bonds. As a result, the trade remains unsettled.

- **Compliance Issues**

- a. **Transaction Failure:** The failure to deliver the bonds on the settlement date constitutes a failed transaction because one party (Member B) has not met its obligations, leading to a disruption in the settlement process.
- b. **Notification to the Exchange:** Under Rule 9.3, Member A, the party that has fulfilled its obligations by making the payment, is required to report the failure to the Exchange (ESX) as soon as it becomes aware of the default.
- c. **ESX's Response:** ESX reviews the report, verifies the failure with CSD and settlement banks. If the failure is due to market infrastructure or systemic disruption issues, ESX coordinates with these entities to resolve the issue and marks it as same in its system.

- **Rule 9.4. Defective Transfer (Trading Rules)**

This rule establishes the obligations of a transferor in situations where the transfer of securities to a transferee is deemed defective due to issues related to ownership or good title. In such cases, the transferor bears the responsibility of rectifying the defect within five (5) trading days upon receiving notice of the defective transfer from the transferee or the Exchange. This requirement ensures that all securities transactions maintain integrity, reducing the risks of ownership disputes and promoting confidence in the market.

A case study for the application of this rule may arise when encumbrances on securities prevent the transferee from receiving a clean and legally recognized transfer of ownership. Such encumbrances could be due to the transferor's failure to fulfil legal or regulatory requirements, insufficient documentation, fraudulent activities, or internal processing inefficiencies. In such cases, the rule mandates the transferor to take corrective action within the stipulated timeframe. This rule applies where a transferee fails to obtain a good title to securities due to avoidable encumbrances caused by the transferor. In such circumstances, the transferor is required to take all necessary steps to perfect the transfer within the prescribed five (5) trading days. ESX may exercise discretion in determining whether a minor irregularity constitutes a defective transfer and whether corrective action beyond the five-day period is permissible in specific circumstances. Additionally, ESX may consider whether exceptional cases, such as legally mandated restrictions, require a different resolution approach.

Trading Members must implement effective internal systems to track transaction statuses, monitor settlement and delivery timelines, and promptly report any potential transaction failure or invalidity. In cases where a defective transfer is identified, Trading Members must ensure that appropriate rectification measures are taken within the designated period.

The monitoring of securities transfers to prevent unauthorized or defective transactions requires collaboration between ESX and Trading Members. Key monitoring mechanisms include:

- a. **ESX:** Implementing real-time tracking of transactions across trading accounts to detect errors and take proactive remedial actions.

- b. The Exchange: Establishing clear reporting protocols and maintaining close communication with the Central Securities Depository (CSD) and Settlement Banks to facilitate the swift resolution of defective transfers.
- c. Trading Members: Adopting self-reporting mechanisms, making timely disclosures, and enforcing whistle-blowing policies to report discrepancies, fraud, or misrepresentations that may result in defective transfers.

## **SECTION 5 – VOLUME E (DISCIPLINARY PROCEDURES AND DISPUTE RESOLUTION RULES)**

### **Background**

The Disciplinary Procedures and Dispute Resolution Rules establish the framework for handling complaints, investigating misconduct, and resolving disputes among market participants on ESX, in alignment with the Capital Market Proclamation and directives issued by the ECMA. The rules address scenarios such as breaches of trading rules and disputes over market conduct or contractual obligations, emphasizing fairness, transparency, and adherence to due process in managing disciplinary actions and disputes.

As part of this framework, guidelines have been included in this document to provide specific clarity on Production of Evidence and Appearance before the Business Conduct Panel. This seeks to ensure that participants fully understand their roles, responsibilities, and expectations during disciplinary proceedings. This minimizes ambiguities that could lead to procedural delays or misinterpretations, ensuring a smooth and transparent process.

### **Production of Evidence and Appearance before the Business Conduct Panel**

This Section outlines the types of evidence required under Rule 2.6: Production of Evidence and Appearance Before the Business Conduct Panel (Disciplinary Procedures and Dispute Resolution Rules). For a comprehensive understanding of the applicable procedures and requirements, the full Disciplinary Procedures and Dispute Resolution Rules should be consulted, along with other relevant laws, directives, and rules governing the market.

These sources collectively provide the necessary context and guidance for addressing matters under investigation, while this section focuses specifically on evidentiary requirements.

- **Clarification on the Composition of the Business Conduct Panel**

In accordance with the provisions of the rules, the Panel shall constitute:

1. Three (3) Officers of The Exchange; and
2. Two (2) market representatives/experts appointed by The Exchange. These representatives/experts may be drawn from various groups, including:
  - a. Members of The Exchange;
  - b. Representatives of Issuers;
  - c. Other Capital Market Service Providers Licensed by ECMA; and/or
  - d. Other independent experts.

- **Scope of Matters Heard by the Panel**

The Panel shall address the following matters in cases involving breaches of the Rules and Regulations of ESX or any other applicable legislation that may result in:

1. Public warnings;
2. Suspension or revocation of a Trading Member's Membership Certificate; and/or
3. Pecuniary penalties exceeding ETB 100,000.

Specific matters handled by the Panel include:

- Complaints made by investors against Trading Members: These may involve disputes or grievances related to trading practices, compliance, or other actions.
- Recommendations for enforcement actions by The Exchange: Based on the findings, the Panel may suggest appropriate measures to address violations and uphold market integrity.

- **Types of Evidence Required**

Under Rule 2.6: Production of Evidence and Appearance Before the business conduct Panel (Disciplinary Procedures and Dispute Resolution Rules), Trading Members are required to provide The Exchange with all relevant documents and information necessary for investigations. This includes, but is not limited to, transaction records, financial statements, bank statements, email communications, letters, and recordings. Both Trading Members and their employees must appear before the Business Conduct Panel when requested, to supply pertinent information and documents.

The computer records of transactions maintained by The Exchange serve as admissible evidence. Should an investigation result in a written report, the concerned Trading Member has the right to request a copy.

The nature of the evidence required will vary depending on the specific complaint or matter under investigation and will be determined by the Business Conduct Panel or The Exchange as needed.

## **SECTION 6 – APPLICATION OF ADMINISTRATIVE SANCTIONS**

### **Compliance and Administrative Sanctions**

The Rulebook of the Ethiopian Securities Exchange establishes a structured approach to ensuring compliance with market regulations by prescribing administrative sanctions for violations of the Membership Rules, Listing Rules and Trading Rules. These administrative sanctions, ranging from financial penalties to suspension of trading or other rights, address violations such as market misconduct, fraudulent activities, the misappropriation of client funds, and failures in financial reporting, which are vital for preserving market integrity.

These sanctions adhere to international best practices and guidelines, which emphasize market integrity, transparency, and effective enforcement.

- **Schedules of Administrative Sanctions**

The Schedules of Administrative Sanctions, as contained at the end of each volume of the ESX Rulebook, addresses violations by market participants related to their various activities and the sanctions are applied based on the nature and severity of the violation.

### **Primary Sanctions**

- **Sanctions Applicable Under Volume B (Membership Rules)**

One of the primary sanctions is Suspension, which temporarily removes a Trading Member's or Appointed Representative's ability to operate until the violation is remedied. This sanction is particularly relevant in cases where the breach concerns the categories of Trading Members under Rule 1.3. Categories of Trading Members (Membership Rules) and the status of a Trading Member under Rule 2.7. Status of a Trading Member (Membership Rules). Where the breach is severe or persistent, the ESX may impose Revocation of Membership Certificate, leading to the permanent cancellation of a Trading Member's membership, resulting in their removal from the Register of Trading Members. Similarly, for individual representatives, a Withdrawal of Registration may be enforced.

In cases of serious misconduct, the ESX may impose Blacklisting, restricting an entity or individual from future participation in the securities market. Additionally, Financial Penalties may be imposed as a deterrent for non-compliance, with monetary fines ranging from 5,000 Birr per day to 750,000 Birr per violation. For more severe violations, the ESX may escalate matters beyond administrative enforcement by referring cases for criminal prosecution, particularly where fraud, market abuse, or other legally actionable misconduct is involved. Additionally, referrals may be made to relevant professional bodies or industry associations for further disciplinary action. To reinforce compliance, Additional Daily Fines for Non-Compliance may be imposed, accruing per day until the violation is rectified.

Where continued participation in the market is deemed untenable, the ESX may impose Temporary or Permanent Deregistration or Removal, effectively barring an entity or individual



from operating within the securities exchange. In less severe cases, the ESX may issue a Written Warning or Caution, which may be accompanied by suspensions and daily fines.

Regardless of the specific sanction imposed, all entities and individuals subject to enforcement actions must fulfil their obligation to remedy the violation before any suspension can be lifted. The application of these sanctions depends on whether the violation pertains to the categories of Trading Members, governance requirements, risk management obligations, operational requirements, or broader market conduct provisions.

In determining the exact amount of financial sanctions, the duration of suspensions, or the combination of sanctions, ESX would carefully evaluate multiple factors to ensure proportionality, fairness, and effectiveness in upholding market integrity. The key factors include:

**a. Nature and Gravity of the Violation:**

The type and severity of the violation heavily influence the choice of sanction. For example, a first-time failure to meet reporting obligations under Rule 4.3. Submission of Reports (Membership Rules) may result in a Written Warning or a Financial Penalty. However, a deliberate or repeated failure to comply with AML/CFT requirements under Rule 5.5. Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) (Membership Rules) could attract Suspension, Blacklisting, or even Referral for Criminal Prosecution. Similarly, misconduct that endangers market stability or investor funds may lead to Revocation of Membership or Withdrawal of Registration in accordance with Rule 2.6. Cessation of Trading Rights (Membership Rules).

**b. Financial and Market Impact:**

The Exchange will also assess the scale of financial loss and market disruption caused by the breach of its Rules. For example, if a Trading Member fails to maintain minimum capital requirements under Rule 4.1 or liquidity obligations under Rule 4.2, a Financial Penalty ranging from 5,000 Birr per day to 750,000 Birr per violation may be imposed. However, if non-compliance with liquidity requirements jeopardizes multiple investors or the broader market, ESX may escalate the sanction to Temporary Suspension or Revocation of Membership.

**c. Compliance History and Pattern of Violations**

Trading Members and Appointed Representatives with a history of repeated breaches face harsher penalties. For instance, failure to submit reports on time (Rule 4.3) once may result in a fine, but persistent non-compliance could lead to Suspension or Additional Daily Fines for Non-Compliance. Similarly, firms that fail to supervise their Appointed Representatives under Rule 5.1 could face Blacklisting or Deregistration of such Appointed Representatives if violations persist.

**d. Level of Cooperation and Corrective Actions**

Entities that promptly rectify violations and demonstrate good faith compliance efforts may receive lower sanctions. For instance, a Trading Member that fails to obtain approval for an Appointed Representative under Rule 6.2 but immediately corrects the

error may only receive a Written Warning. However, if the violation is deliberate or repeated, the ESX may impose a Suspension.

**e. Governance Failures and Internal Control Weaknesses**

When breaches result from systemic weaknesses in internal controls, ESX applies stricter sanctions. For example, failure to implement effective risk management (Rule 5.3) or inadequate internal controls (Rule 5.1) may result in Financial Penalties, Suspension, or Blacklisting, depending on the severity and impact.

**f. Systemic vs. Isolated Violations**

An isolated lapse in AML/CFT compliance under Rule 5.5 may lead to a Financial Penalty, while a broader pattern of AML violations could trigger referral to the ECMA.

**g. Impact on Market Integrity and Transparency**

Violations that distort market information or investor confidence are met with stronger sanctions. A Trading Member engaging in misleading disclosures, fraudulent activities, or price manipulation could face Revocation of Membership, Blacklisting, or Referral for Criminal Prosecution.

**h. Aggravating and Mitigating Factors**

Aggravating factors, such as intentional misconduct, fraud, large-scale investor harm, or repeated violations, typically lead to higher financial penalties, extended suspensions, or Revocation of Membership.

Conversely, mitigating factors, including voluntary disclosure, full cooperation, and immediate remediation, may result in lower fines, shorter suspension periods, or only a Written Warning.

**i. Obligation to Remedy Violations:**

Sanctions such as Suspensions are not lifted until the Trading Member or Appointed Representative fully addresses the violation. For instance, a firm suspended for failing to meet risk management standards under Rule 5.3 must demonstrate compliance before reinstatement.

• **Sanctions Applicable Under Volume C (Listing Rules)**

In the Schedule of Administrative Sanctions to Volume C (Listings Rules), the type and severity of the sanctions imposed by ESX will depend on whether an issuer is a first-time, second-time, or third-time offender. The sanctions escalate in severity to promote compliance and deter repeated violations.

The approach ensures that issuers are given an opportunity to correct initial lapses while holding repeat offenders accountable for continued disregard of the rules governing the securities market.

In determining the exact duration of suspension, or the combination of sanctions under the Listings Rules, ESX considers several key factors to ensure proportionality, deterrence, and market stability. The severity of the sanction is influenced by the nature of the violation, the impact on investors and market confidence, and whether the issuer is a repeat offender.

Where a violation is a first-time offense, such as a failure to comply with Disclosure Obligations, Financial Reporting Obligations, or Corporate Governance Requirements, ESX may issue a Written Warning or Caution. This sanction is typically applied where the breach is minor, unintentional, and has minimal impact on investors or market confidence. However, if the same issuer repeats the violation, ESX may impose Mandatory Compliance Training to reinforce regulatory expectations and prevent further breaches. The need for such training is assessed based on whether the breach resulted from a misunderstanding of the rules or a lack of adequate internal compliance mechanisms. Note that the cost of such Mandatory Compliance Training, as may be determined by The Exchange, shall be borne by the Issuer.

For issuers who commit a third violation, ESX escalates the sanction to Public Censure and a Compliance Status Indicator, making the non-compliance publicly known. In deciding whether to apply this sanction, ESX would consider the extent of harm caused by the violation, whether the issuer has made efforts to correct past infractions, and the degree of negligence or recklessness involved. If the repeated breach significantly misleads investors, affects market integrity, or creates a pattern of non-compliance, a Suspension may be imposed, particularly in cases involving Disclosure Obligations. The duration of suspension depends on the severity of the violation, the issuer's responsiveness in remedying the breach, and the potential risk posed to the investing public.

Ultimately, ESX assesses aggravating and mitigating factors before deciding on the appropriate combination of sanctions. Aggravating factors include intentional misconduct, repeated non-compliance, concealment of breaches, or failure to cooperate with regulatory directives, which may warrant more severe penalties. Conversely, mitigating factors such as voluntary disclosure, prompt corrective action, and a strong prior compliance record may lead to a more lenient sanction within the available range.

- **Sanctions Applicable Under Volume D (Trading Rules)**

*Readers/users should refer to the provisions of the rules as well as the general guide provided in section above on "Sanctions Applicable Under Volume B (Membership Rules)"*

- **Sanctions Applicable Under Volume E (Disciplinary Procedures and Dispute Resolution Rules)**

*Readers/users should refer to the provisions of the rules as well as the general guide provided in section above on "Sanctions Applicable Under Volume B (Membership Rules)"*

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