AMAN & PARTNERS

LEGAL
UPDATE

ISSUE 14

# REFLECTIONS ON THE FOREIGN EXCHANGE DIRECTIVE NO. FXD/01/2024

AUGUST 2024

BOWMANS
ALLIANCE FIRM

Aman & Partners

## Brief Overview

# Reflections on the Foreign Exchange Directive No. FXD/01/2024

*On 29 July 2024, the National Bank of Ethiopia (the "NBE") announced the long-anticipated reform of the country's foreign exchange regime. As part of operationalizing this reform, the NBE has issued the Foreign Exchange Directive (FXD/01/2024) ("Forex Directive").*

*The Forex Directive repeals and replaces all foreign exchange directives and circulars that were previously issued by the NBE pertaining to issues regulated therein. While the directive covers a wide range of matters, this legal update focuses on rules governing foreign exchange rate determination, retention and utilization of foreign currency accounts, external loans and repatriation of capital.*

## Foreign Exchange Rate Determination

Unlike the previous legislation where the NBE had the authority to set the daily exchange rate, the Forex Directive permits banks and authorized foreign exchange dealers to buy and sell foreign currencies at freely negotiated rates. Allowing authorized foreign exchange dealers to engage in buying and selling foreign currencies is a new development in the foreign exchange regime in Ethiopia as non-bank entities were not previously permitted to engage in such transactions.

Banks and authorized foreign exchange dealers are required to report to NBE the exchange rates used in their transaction daily. Based on these reports, the NBE issues an Indicative Daily Exchange Rate for the next business day. The Indicative Daily Exchange Rate, however, will only serve as a reference price rather than a mandatory transaction price for banks and authorized foreign exchange dealers. That said, the NBE has noted that it may make some 'limited' intervention in the foreign exchange market to "support the market in its early days and if justified by disorderly market conditions".

## Retention & Utilization of Foreign Currency Accounts

The Forex Directive classifies foreign currency accounts into three categories as outlined below:

a. Foreign Currency Accounts for Foreign Entities

This type of account is permitted to foreign direct investment companies, international organizations, embassies, and foreign non-governmental organizations (Foreign NGOs). This account is also permitted to foreign nationals who are employees of these institutions. No surrender requirement is applicable to this account and the account holders are entitled to retain 100% of the foreign exchange. The major changes introduced under the Forex Directive to the foreign currency account are:

- Foreign NGOs Related: Under the previous law, foreign NGOs registered in Ethiopia were allowed to open forex retention accounts (following approval by the NBE). They were required to surrender 70% of their foreign currency remittances while they could retain 30%. However, they were not allowed to open foreign currency accounts. The Forex Directive now removes this restriction and now allows foreign NGOs to retain 100% of their foreign exchange in their foreign currency account.
- Number of Accounts: Previously a foreign entity was allowed to open only one foreign currency account at a bank of its choice. The opening of an additional foreign currency account required special permission from the NBE. The Forex Directive lifts this restriction and permits maintaining multiple foreign currency accounts at more than one bank.

b. Foreign Currency Accounts for Resident and Non-Resident Ethiopians

Allowing the opening of foreign currency accounts to residents of Ethiopia is a major departure as this type of account was previously permitted to be opened only by non-resident foreign nationals of Ethiopian origin and non-resident Ethiopian individuals. Foreign currency accounts for resident and non-resident Ethiopians can be credited, among others, with foreign currency transferred through International Remittance Service Providers and a transfer from any foreign currency account within Ethiopia. Transfers to a foreign currency account of resident of Ethiopia can be on account of salary, rental, or other income.

c. Retention Accounts for exporters of goods and services

Foreign exchange retention accounts are opened for eligible exporters of goods and services. The Forex Directive has introduced major changes in relation to surrender obligation and retention rights. While the previous law on foreign currency required exporters to surrender 50% to NBE and 10% to commercial banks of the foreign currency earned from the export of goods and services, exporters are no longer required to surrender to the NBE under the Forex Directive. Foreign exchange retention account holders are now only required to surrender 50% of foreign currency earnings to respective commercial banks at a freely negotiated rate while keeping the remaining 50% in their account. That said, the Forex Directive stipulates that the retained 50% foreign exchange earnings in a retention account will still have to be sold to the transacting bank used for that forex inflow after a period of no more than 30 calendar days. According to the Forex Directive, this requirement is not permanent but is being introduced as a temporary measure to support the development of an interbank foreign exchange market. The NBE needs to be cautious on the impact of the duration of the temporary measure so that it does not disincentivize exporters who wish to retain their foreign currency earning beyond the 30 days period.

## Removal of Waiting List System

The Forex Directives removed requirements of allocation of foreign exchange based on priority list of imports that was in place under previous NBE's rules. Customers can now request their respective commercial banks to allocate foreign exchange for imports on demand provided that they meet import related requirements. The implementation of this is likely to be determined by market forces and availability of foreign currency with the respective bank.

## External Loan

The approval requirements of external loan by the NBE under the Forex Directive are similar with the requirements under the repealed External Loan and Supplier's Credit Directive ("Repealed Directive"). That said, the Forex Directive removes interest rate ceilings on external loan while the Repealed Directive provided interest rate ceilings of six-month SOFR/ESTR for Euro/SONIA for GBP plus 2% to 5% (depending on the maturity period of the loan). This is likely to give freedom to lenders and borrowers to freely negotiate commercial terms reflecting market realities.

## Repatriation of Capital

The Forex Directive allows 'on demand' repatriation of capital including dividends and proceeds from sale of business, among others. With respect to dividends whose repatriation has been approved by NBE before the issuance of the Forex Directive but pending transfer by banks, the Directive envisages the stipulation of a special repayment schedule to address backlog. It is critical that NBE considers an expedited repayment schedule/arrangement for foreign investors that will lose the dollar value of their dividends against the backdrop of the devaluation of Ethiopian Birr.

## Concluding Remarks

The Forex Directive is a significant departure from the decades old NBE rules governing foreign exchange rate, foreign currency surrender and retention, letters of credits, and external loan, among others. These measures are not isolated and are expected to be complimented by other economic reform initiatives in the pipeline including the liberalization of the banking business and amendment of the NBE re-establishment proclamation. That said, the market reaction arising from the foreign exchange regime reform is yet to be seen.