ETHIOPIA'S ISLAMIC CAPITAL MARKET: POLICY FRAMEWORK WHITE PAPER

APRIL 2025

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ETHIOPIAN CAPITAL MARKET AUTHORITY

ACKNOWLEDGEMENT

This White Paper on the Islamic Capital Market Policy Framework (the 'White Paper'), as part of the deliverables under the "Developing Regulatory Framework and Promotion of Islamic Capital Market Project in Ethiopia" (the 'Project'), has been prepared by IFAAS (www.ifaas.com) for the benefit of ECMA (Ethiopian Capital Market Authority – www.ecma.gov.et), and other stakeholders including the policy makers and authorities of the Ethiopian federal government, amongst others.

We extend our sincere gratitude to the members of Project Steering Committee (the 'PSC'), comprised of senior representatives from ECMA, FSD Ethiopia, FSD Africa, and UNDP Ethiopia Country Office, leadership and advisory teams for their vision, guidance, and unwavering support in advancing the development of this White Paper. This support reflects the commitment to fostering an inclusive financial system in the country.

This White Paper developed by IFAAS is intended as a foundational guide to support informed decision-making. It is important to note that Islamic finance remains a specialised field requiring tailored expertise. While the White Paper draws on reliable public resources and best practices, complexities in implementation may necessitate supplementary technical assistance, Shariah guidance, or professional advice.

The preparation of this White Paper aligns with broader efforts to advance Islamic finance in Ethiopia. In such projects, information is compiled from credible public sources and official statistics, though independent verification of all data remains beyond the scope of such work. While every effort has been made to ensure accuracy, uncertainties inherent to market dynamics mean outcomes cannot be guaranteed. Recommendations within this White Paper should not be interpreted as definitive legal, Shariah, regulatory, or financial advice. Stakeholders are encouraged to exercise due diligence, consult experts, and adapt guidance to their unique contexts. IFAAS accepts neither liability nor responsibility for the success or failure of any such decisions.

For the purpose of this White Paper, the terms "Islamic Finance," "Islamic Banking," "Islamic Microfinance," and "Islamic Capital Market" are used as standard terminologies throughout the document. However, it is acknowledged that in the Ethiopian context, "Islamic Banking" is often referred to as "Interest-Free Banking," and other terminologies may be used to describe the other sectors. While this document uses these terms, it acknowledges the importance of the local context; therefore, in implementing the White Paper, alternative terminologies may be adopted to better align with Ethiopia's context and legislation.

ABBREVIATIONS AND ACRONYMS

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions	**IREITS**	Islamic Real Estate Investment Trust
CBE	Commercial Bank of Ethiopia	**LRS**	Legal, Regulatory, and Supervisory Framework
CSAB	Central Shariah Advisory Board	**MoF**	Ministry of Finance
DBE	Development Bank of Ethiopia	**NBE**	National Bank of Ethiopia
ECMA	Ethiopian Capital Market Authority	**PCS**	Project Steering Committee
EIH	Ethiopian Investment Holdings	**PSSSA**	Public Servants Social Security Agency
ESX	Ethiopian Securities Exchange	**POESSA**	Private Organizations Employees Social Security Agency
FSD Africa	Financial Sector Deepening Africa	**SGF**	Shariah governance framework
FSD Ethiopia	Financial Sector Deepening Ethiopia	**SME**	Small and Medium-sized Enterprises
ICM	Islamic Capital Market	**SOEs**	State-Owned Enterprises
ICM-SC	Islamic Capital Market Steering Committee	**SPV**	Special Purpose Vehicle
IFAAS	Islamic Finance Advisory & Assurance Services	**SSA**	Securities Shariah Advisor
IFSB	Islamic Financial Services Board	**SSB**	Shariah Supervisory Board
IFSPs	Islamic Financial Services Providers	**UNDP**	United Nations Development Program
IFTF	Islamic Finance Task Force		

ARABIC TERMINOLOGIES

Gharar	Ambiguity, uncertainty or risk
Ijara	Lease
Istisna	Sale of an asset to be manufactured
Kafala	Guarantee
Maysir	Speculation
Mudaraba	Business partnership where one party (or more) provides the funds and the other provides expertise
Murabaha	Profit-disclosed sale of an existing asset
Musharaka	Business partnership where two or more parties co-fund a specific Shariah compliant project/asset and share the profit and loss
Qard Hasan	Islamic interest-free loan
Riba	Interest
Salam	Sale of a commodity with full spot payment for future delivery
Sukuk	Islamic Bonds
Takaful	Islamic Insurance
Wakala	Agency

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1. EXECUTIVE SUMMARY

1.1. Introduction

Ethiopia's capital market is undergoing a transformative shift, driven by economic reforms aimed at liberalising the financial sector. These reforms have laid the foundation for the establishment of a formal capital market, offering new investment opportunities for individuals, businesses, and other market participants. The formation of the ECMA marked a crucial step forward, ensuring that the market operates with robust regulatory oversight, fostering transparency, investor confidence, and consumer protection.

Since the inception of the ECMA, the management has recognised the importance of developing the local Islamic Capital Market (ICM) and introducing Islamic products to strengthen Ethiopia's financial landscape. In pursuit of this objective, and with the support of FSD Ethiopia, FSD Africa, and the UNDP Ethiopia Country Office, ECMA has partnered with IFAAS[1] to design this White Paper on the Islamic Capital Market Policy Framework (the 'White Paper') as part of the deliverables under the "Developing Regulatory Framework and Promotion of Islamic Capital Market Project in Ethiopia" (the 'Project').

This White Paper provides strategic guidance and direction for the development of Ethiopia's ICM. It presents a series of policy recommendations designed to create an enabling environment that supports the introduction, regulation, and sustainable growth of Shariah compliant capital market products and services within the Ethiopian capital market.

1.2. The Case for Change

The case for developing an ICM in Ethiopia is both timely and compelling, given its potential to deliver wide-ranging benefits for the country's economic growth and financial resilience. As a strategic enabler, the ICM can diversify Ethiopia's financial markets, unlock alternative sources of funding for the public and private sectors, and enhance financial inclusion. Additionally, it offers a mechanism for mobilising domestic savings and attracting international capital to finance priority sectors such as infrastructure, education, and agriculture.

Reinforcing this case is the presence of a sizable Muslim population in Ethiopia, a community known for its entrepreneurial dynamism and the growing need for financial services aligned with Islamic principles. By offering Shariah compliant products, the ICM can empower this population to duly and properly participate in the formal financial system, in a manner consistent with their values. Moreover, the ethical foundation and unique features of Islamic financial products have proven attractive across broader markets. In countries like the United Kingdom, Malaysia, and Kenya, Islamic finance has gained impressive traction among non-Muslim clients, demonstrating its wider market potential.

The rapid growth of Islamic banking in Ethiopia further underscores the readiness of the market for ICM products[2]. Indeed, this indicates a strong potential appetite for ICM instruments such as sovereign, corporate, and retail Sukuk, Shariah compliant equities, and Islamic investment funds. This momentum presents a valuable opportunity to deepen Ethiopia's financial ecosystem while aligning with both domestic demand and global best practices.

1 IFAAS is an international Islamic finance advisory firm headquartered in the UK, with an exceptional track record of delivering consultancy projects in 60+ countries.

2 According to the Official Statistics of NBE as of December 2024, Islamic banking providers hold 10% of the total deposits in the banking system. Out of the 162.7 million deposit accounts in Ethiopia, 24.7 million are Islamic deposit accounts, representing 15% of the total deposit accounts in the banking system. In addition, 8% of the total outstanding credit in the banking sector is held by Islamic banking providers.

While the case for establishing an ICM in Ethiopia is compelling, its successful development will require deliberate policy action to address key constraints. Creating an enabling environment demands overcoming a range of challenges, from legal and regulatory gaps to limited institutional capacity and low market awareness. If not adequately addressed, these barriers could significantly impede the establishment and sustainable growth of the ICM in Ethiopia. The key challenges are outlined below:

- **Government Support and Coordination**: despite the commendable efforts of various government stakeholders to advance Islamic finance, their initiatives remain fragmented, highlighting the absence of a coherent government vision and policy for integrating Islamic finance into Ethiopia's broader financial ecosystem.
- **Legal, Regulatory and Supervisory Frameworks**: the current Legal, Regulatory and Supervisory Frameworks (LRS) does not duly and fully accommodate the unique requirements of various ICM products particularly Sukuk, and there are several critical gaps that need to be addressed to foster the sector's development. Furthermore, the existing LRS does not define or provide the legal foundation for establishing an effective Shariah governance system, which is essential for ensuring the integrity and credibility of the ICM sector.
- **Taxation**: the existing taxation legislation does not accommodate ICM products, potentially leading to additional tax burdens that could impact the cost and competitiveness of ICM instruments and activities[3]. Addressing this challenge is important to ensure tax neutrality, reduce the cost burden on ICM products, and create a level playing field that allows ICM instruments to compete fairly with conventional capital market instruments.
- **Human Capital**: the shortage of skilled human capital in Islamic finance poses another challenge to the development of the ICM sector, as its success relies on having qualified professionals equipped with the necessary knowledge and expertise to advance the industry forward.
- **Public Awareness**: the limited public awareness of Islamic finance and ICM, coupled with prevalent misconceptions among Muslims and non-Muslims alike, could potentially impedes broader acceptance and adoption.
- **Branding**: the use of the term "interest-free" to describe Islamic finance has potentially contributed to public misconceptions, most notably, the mistaken belief that such products are always cost-free. Moreover, the term "interest-free" does not clearly convey that these products are Shariah compliant, which is a fundamental aspect intended to attract financially excluded Muslims. To address this, there is a need for a more accurate and inclusive branding approach, one that reflects both the ethical and Shariah foundations of Islamic finance, positioning it as a financial offering that serves the needs of all consumers, regardless of faith or background.

3 Since a number of ICM instruments and activities, particularly Sukuk, are structurally different from their conventional counterparts as they are based on contracts of sale, lease, agency, profit-sharing etc., instead of the standard interest-based lending and borrowing in conventional finance. This structural difference may imply that ICM instruments and activities are likely to incur additional taxes that may make them more expensive compared to conventional alternatives.

Key Policy Recommendations

The following are the key recommendations of the White Paper that aim to address the identified challenges and create an enabling environment for the successful development of ICM in Ethiopia:

- Establish a national Islamic Finance Task Force (IFTF)[4] tasked with driving the development of a cohesive and sustainable Islamic finance ecosystem in the country at the policy level.
- Design a National Islamic Finance Policy to align stakeholders, integrate Islamic finance into Ethiopia's development agenda, and establish an enabling infrastructure across industry sectors.
- Set up an ICM Steering Committee (ICM-SC)[5] to lead the implementation of these recommendations, focusing on technical and operational aspects, and addressing practical challenges to build a robust ICM.
- Consider implementing key government strategic initiatives under the national policy to develop Ethiopia's ICM. These include launching a Retail Sukuk program to fund critical development projects; establishing infrastructure for Islamic Treasury instruments and Government Sukuk; introducing Islamic pension schemes for public and private sector employees; and mandating SOEs and government-related entities to raise a specific portion of their funds through Sukuk, and deposit a minimum portion of their funds in Islamic banking accounts to strengthen sector growth and investment in ICM.
- Introduce legal, regulatory, and supervisory reforms to fully integrate ICM into Ethiopia's capital market, ensuring a level playing field with the conventional capital market[6].
- Conduct a detailed review of tax legislation to identify necessary amendments for ICM and potentially other Islamic finance sectors, ensuring a level playing field with conventional finance.
- Establish a Central Shariah Advisory Board (CSAB) as an independent, legally empowered advisory body to support ECMA in overseeing Shariah governance and providing sector-wide compliance guidance and assurance for Ethiopia's ICM stakeholders[7].
- Launch a comprehensive Islamic finance capacity building program for policymakers, regulators (ECMA, NBE, and MoF), and key market participants (ESX, EIH, CBE, and DBE).
- Launch a national sensitisation campaign to raise public awareness, link Islamic finance to national development goals, and address misconceptions among Muslims and non-Muslims.
- Adopt industry best practices by using "Islamic Capital Market Products" as the standard terminology in all official communications, legislative texts, and regulatory documents, or consider using terms such as "Participatory Capital Market Products" or "Non-Interest Capital Market Products" to ensure inclusivity and avoid any potential misunderstandings, making the market accessible to all Ethiopians, regardless of religious affiliation[8].

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4 The IFTF, chaired by a Senior Government Official, will include MoF, NBE, and ECMA as voting members, an Executive Director to manage IFTF's operational issues, and an advisory panel of technical experts from public and private sectors.

5 ICM-SC to be comprised of senior representatives from key stakeholders, including but not limited to NBE, MoF, ESX, and EIH.

6 Key areas to be covered include defining Islamic finance contracts, recognising ICM products like Sukuk, providing legal anchoring for Shariah governance requirements, developing an enabling Sukuk regulatory framework covering structuring, issuance, governance, trading, settlement, oversight, disclosures, integration of Sukuk into the public debt system, etc. A regulatory sandbox may be considered as an interim mechanism to facilitate the accelerated issuance of Sukuk, particularly sovereign Sukuk. However, its implementation must be supported by a comprehensive legal assessment to determine whether the sandbox can override potential taxation impediments, and/or provide temporary exemptions from existing tax legislation, and other conflicting legislative provisions

7 The IFTF may also consider either expanding the mandate of the CSAB into a standalone body responsible for overseeing Shariah matters across the entire Islamic finance industry, including Islamic banking, microfinance, insurance, and others, or establishing dedicated sub-committees under the CSAB for specific sector(s) such as Islamic Banking and Microfinance Shariah Committee, ICM Shariah Committee, etc.

8 It is advised to avoid using the term "Interest-Free", which is currently used in the banking sector, as it has proven to be confusing and potentially misleading in the context of commercial (non-charitable) financial products. In all cases, this matter can be further discussed and evaluated by relevant stakeholders within the IFTF, as part of the development process for the national Islamic finance policy.

2. PREAMBLE

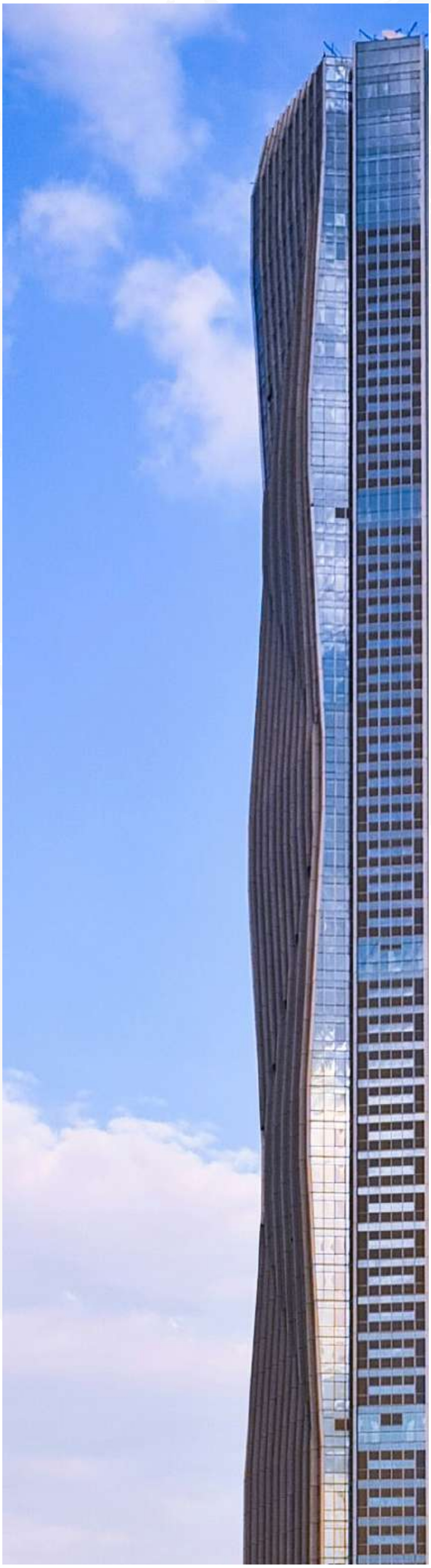
The landscape of Ethiopia's capital market is currently undergoing a transformative phase, with significant reforms and efforts underway to establish a formal and structured market. The establishment of ECMA in 2021, as the capital market regulatory authority, marked a pivotal step in ensuring a well-regulated and supervised market. Since then, the authority has issued multiple regulatory directives, granted licenses to a number of market participants, and launched a regulatory sandbox to facilitate the testing and development of innovative products and services.

The launch of the Ethiopian Securities Exchange (ESX) in January 2025, as the country's first securities exchange, marked another significant milestone in the development of Ethiopia's capital market. The establishment of ESX enhances the nation's financial infrastructure and provides a crucial platform for businesses and investors to engage in trading stocks, bonds, and other securities.

As Ethiopia advances the development of its capital market, the establishment of an ICM has been identified as a key objective in ECMA's 2024-2026 strategic plan to enhance the country's financial ecosystem. Through the development of an ICM, ECMA aims to promote the diversification of capital market products and attract new investments by introducing Islamic finance instruments for capital mobilisation.

In pursuit of this objective, ECMA has developed an Islamic Capital Market Roadmap (hereinafter referred to as the "Roadmap"). The Roadmap outlines the necessary steps, policies, and reforms needed to establish and grow the ICM, addressing key challenges and ensuring alignment with Ethiopia's broader economic and financial goals. The Roadmap also presents a number of policy recommendations to support the development of ICM in Ethiopia.

This White Paper on the Islamic Capital Market Policy Framework (hereinafter referred to as the "White Paper") is built upon the findings and recommendations outlined in the Roadmap. It synthesises key insights from the Roadmap to provide strategic guidance and actionable policies that will support the establishment and growth of the ICM in Ethiopia.



3. METHODOLOGY

The development of this White Paper was guided by a structured methodology, building on the comprehensive Roadmap designed for the development of ICM in Ethiopia. The methodology began with extensive desk research and documentary reviews to understand the current landscape of Ethiopia's capital market and its broader financial ecosystem. This provided a foundation for identifying the gaps and opportunities in developing the ICM.

Following the initial research phase, a key element of the methodology involved onsite and online stakeholder engagement. These consultations included policymakers, regulators, market participants, and representatives from the broader community, including Shariah scholars. The engagement aimed to ensure inclusivity and gather diverse perspectives on the challenges and opportunities for ICM development in Ethiopia.

Another key aspect of the methodology was benchmarking against international standards like AAOIFI[9] and IFSB[10], alongside best practices from leading global and regional jurisdictions, and identifying tried and tested strategies for ICM development. These benchmarks informed the identification of successful strategies and provided valuable insights into how ICM could be successfully developed in Ethiopia. Insights from these engagements and benchmarks informed a gap analysis, highlighting regulatory, institutional, and market enablers and barriers. The methodology also included independent reviews and validations by PSC[11] members to refine findings, ensuring alignment with Ethiopia's context.

To ensure stakeholder buy-in and refined recommendations, the final stage of the methodology involved presenting the findings and refined recommendations in an onsite Stakeholder Workshop. This workshop serves as a platform for offering detailed explanations, answering questions, and fostering alignment among key stakeholders, ensuring that the recommendations were well-supported for informed decision making and implementation.

9 AAOIFI has issued more than 100 standards in the following technical areas: Shariah, Governance, Auditing, Accounting, and Ethics

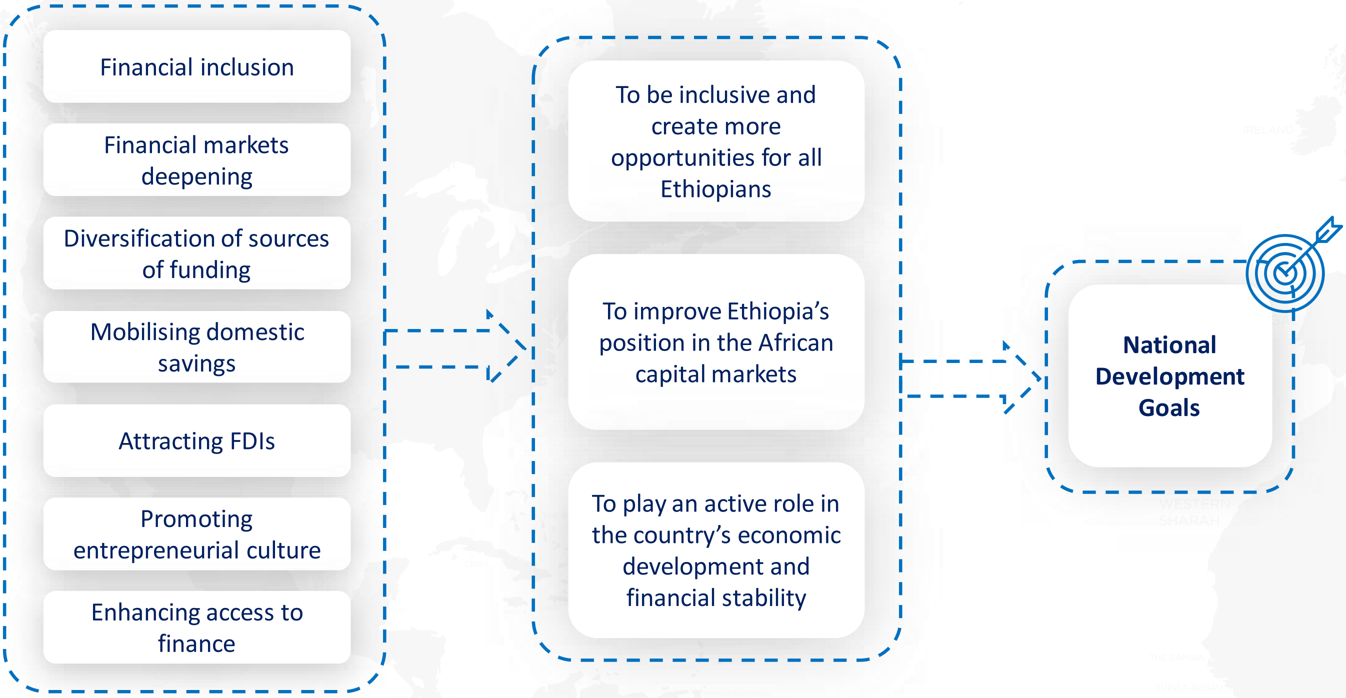
10 IFSB has issued over 37 standards, guidance notes and technical notes primarily focused on prudential and regulatory areas including risk management, capital adequacy, solvency requirements, supervisory review process, liquidity management, corporate governance etc.

11 The Project Steering Committee comprised of senior representatives from ECMA, FSD Ethiopia, FSD Africa, and UNDP Ethiopia Country Office.

4. POLICY AIM AND OBJECTIVES

The overarching policy aim of this White Paper is to establish a conducive environment for the development and sustainable growth of an ICM in Ethiopia. This involves creating supportive legal, regulatory, and institutional frameworks that enable the introduction and expansion of ICM instruments, while integrating the ICM into the broader capital market and economic development agenda.

The policy objectives and principles guiding the development of Ethiopia's ICM are summarised in the diagram below. These objectives are closely aligned with national development priorities, including financial inclusion, economic resilience, and capital market deepening.



To realise the illustrated objectives, the timely and structured implementation of the recommendations in this White Paper is essential. Doing so will help in unlocking the full potential of Islamic finance, positioning it as a key pillar in diversifying and strengthening Ethiopia's economy while supporting the country's long-term development aspirations.

5. ISLAMIC CAPITAL MARKET AT A GLANCE

ICM is an integral part of the broader Islamic finance ecosystem, which operates under a distinctive set of rules drawn from Shariah (Islamic law). These rules govern financial institutions offering Islamic financial products, alongside the standard industry regulations. Before delving into the specifics of ICM and exploring how it differs from conventional capital markets, it is essential to first understand the foundations of Islamic finance, its unique characteristics, and the key principles that distinguish it from traditional finance.

5.1. Foundations of Islamic Finance

a) Shariah

Shariah provides a governing framework that covers all parts of Muslims' lives, including, among others, worship, spiritual, social, intellectual, and financial aspects. Shariah rules and principles are mainly derived from the Holy Quran and the Sunnah (teachings of the Prophet Muhammad (Peace Be Upon Him). Based on the abovementioned two primary sources, Muslim scholars have developed the tools of Islamic jurisprudence expressed through different processes including interpretation, analogical reasoning, and consensus, to opine on contemporary issues including financial matters.

Shariah scholars define the objectives of Shariah as being aimed at promoting the wellbeing of all mankind and greater justice in human society. Consequently, Islamic financial transactions must comply with Shariah requirements, and the outcome of these transactions should contribute positively to achieving the objectives of Shariah.

There are five main elements that Shariah aims to protect, namely: faith, life, intellect, lineage, and wealth. Preservation of these five elements is seen as an absolute requirement for the survival and overall well-being of individuals and society. Preservation of wealth is one of the essential objectives, which can be achieved by investing wealth in legitimate transactions permitted under Shariah and prohibiting negative means such as hoarding, interest, gambling, and concentration of money in the hands of the few.

b) Key Founding Principles of Islamic Finance

I. Prohibition of Interest

Shariah scholars generally consider money as a 'medium of exchange', not a 'commodity'. Money has no intrinsic utility but is rather used to purchase or acquire goods and services. Based on that, money cannot be sold for more or less than its face value[12].

When money is used to generate money, as in the case of extending a loan for a certain period in return for an additional amount of money, this increment is considered interest (Riba[13]) which is prohibited in Shariah, regardless of whether this addition is excessive or not.

II. Prohibition of Excessive Uncertainty and Gambling

Commercial arrangements and contracts that entail excessive uncertainty, ambiguity, or risk (Gharar[14]) are prohibited in Islamic finance. Prohibited levels of Gharar are typically manifested when there are detectable, preventable, and disputable high levels of ambiguities, uncertainties, and risks in the fundamental conditions of a commercial transaction at the time of executing the contract (e.g., subject matter, price, or date of delivery/performance are not clearly specified/defined in a sale contract).Therefore, Islamic financial transactions and instruments should be clear, and transparent with full disclosures by all the contracting parties on the key terms and conditions of the underlying agreement.

Islamic finance also prohibits commercial transactions that are based on gambling (Maysir[15]), chance, or speculation, or sometimes referred to as zero-sum transactions where one party's gain in a transaction must lead to the other's loss, rather than creating a mutually beneficial outcome.

III. Creation of Asset-Backed Financial Transactions

In Islamic finance, money is considered as a necessary lubricant to the engine of the real economy to facilitate the production and exchange of assets, goods, and services. Therefore, money can only grow and generate a return if deployed into real economic activities such as trading, leasing, investing and other Shariah compliant transactions that are backed, based, or linked to real assets, goods, and services.

Based on the above, Islamic finance is essentially believed to be an asset-backed form of finance that assists in connecting the financial sector with the real economy.

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12 Except in currency exchange that is subject to certain Shariah conditions

13 Riba is an Arabic word which could be translated as interest/usury.

14 Gharar is an Arabic word for ambiguity, uncertainty, or risk.

15 Maysir or Qimar are Arabic words for gambling.

IV. Promotion of Participation and Risk Sharing

The prohibition of interest does not necessarily create a cost-free Islamic financing system but rather necessitates linking profitability in Islamic finance with involvement in asset-backed commercial transactions that may, as in the case of certain participatory products and instruments, require sharing of the resulting rewards and risks related to such transactions and their underlying assets. Thus, sharing risks and rewards is one of the key foundations of a fair and functional Islamic financial system.

V. Abiding by a Comprehensive Ethical Framework

Islamic finance urges the creation and distribution of wealth in an ethical manner that is fair and equitable with the money under an incentive to remain in circulation, spinning the wheel of economic activities for the benefit of all members of the society. Islamic finance also promotes ethical financial transactions encouraging trade, labor, entrepreneurship, transparency, honesty, righteousness, integrity and fairness, which also inspires kindness, charitable donations, and social welfare among the participants of the Islamic finance industry, benefitting the society at large.

Therefore, Islamic financial products cannot be interest-based or speculative financial products, have excessive uncertainty in their terms and conditions that may lead to disputes between the contracting parties, omit or avoid necessary disclosures, present wrong declarations, provide misleading information, or engage in other types of unethical practices.

Islamic financial products cannot be used to support any activity that is deemed unlawful in Shariah. For example, any transactions that are detrimental to society, the environment, animals (e.g., funding businesses that trade in alcoholic beverages, tobacco, gambling, pornography, animal poaching or weaponry etc.)

c) Main Contracts

As it is forbidden in Islamic finance to pay or receive interest, money should be used to create real economic value where it may earn a return by having it invested in permissible commercial transactions and activities.

To comply with Shariah principles, a variety of alternative contracts are employed to structure Islamic financial products and instruments[16]. These contracts are designed to meet various financial needs while adhering to Islamic law. Some of the most commonly used contracts in Islamic finance include Murabaha (cost-plus financing), Mudarabah (profit-sharing), Musharakah (joint venture), and Ijarah (leasing). These structures allow Islamic finance to achieve economic objectives such as asset-backed financing, risk sharing, and profit and loss sharing, all while ensuring compliance with Shariah principles.

d) Shariah Governance

Compliance with Shariah principles is a defining feature of Islamic financial products and a critical factor influencing customer trust. Therefore, stakeholders in the Islamic finance industry require reasonable assurance that claims of Shariah adherence made by Islamic Financial Service Providers (IFSPs) are genuine and credible. Shariah governance forms an integral part of the overall governance framework of the Islamic finance sector and works to ensure they are in compliant with Shariah.

A strong Shariah governance provides a solid layer of trust and confidence to all stakeholders, including investors, shareholders and regulators, that the IFSPs are operating in full conformity with the Shariah requirements. To achieve this objective, the Islamic finance industry in any country should have the Shariah governance framework (SGF) and supporting infrastructure that ensure a proper conduct of business for IFSPs based upon strong conviction, ethical principles and practices in line with the legal, regulatory and Shariah requirements.

SGF can be described as a comprehensive system that defines a set of appropriate national and institutional measures, arrangements, requirements, organs, and policies for the Islamic finance industry. The overall objective is establishing an effective and independent oversight of Shariah compliance over IFSPs' activities to duly mitigate their exposure to Shariah non-compliance risk[17].

It is critical to emphasize that the requirements of SGF should go hand in hand with other relevant statutory requirements that apply to the banks and financial institutions in a market. Accordingly, IFSPs have a dual governance model to satisfy both Shariah and regulatory requirements.

16 Please refer to the Appendix for the list of main contracts used in the Islamic finance industry

17 Shariah non-compliance risk is defined as the risk of reduction in earnings or value, through financial or reputational loss resulting from Islamic products being Shariah noncompliant. This risk arises from failure to comply with Shariah rules, principles, and requirements, as set out by the respective authorities/bodies nominated for such purpose on both national and institutional levels

e) Shariah Governance Models

Policy makers and regulators in different jurisdictions have adopted different models of Shariah governance to ensure that IFSPs are functioning in line with Shariah principles. Such varied regulatory perspectives on Shariah governance are due to the diverse nature of legal systems, cultures, and religious fabrics in different countries where IFSPs operate and offer their products.

Under the current practices of the Islamic finance industry, there are broadly two prevalent models of SGF as follows:

Centralized model: Presence of national/central Shariah body(s) and institutional Shariah boards. However, institutional Shariah boards might not be required in some jurisdictions and only national/central Shariah body(s) would exist to advise on Shariah matters related to the Islamic finance industry.

Decentralized model: Only institutional Shariah boards are required/encouraged.

Historically, many regulators relied on the decentralized model, and it was standardized by AAOIFI. Tailored guidelines were also issued by the IFSB on the governance requirements of this model.

Nevertheless, the decentralized model during the last decade has, in numerous countries, given rise to conflicting rulings and inconsistent products that have confused clients and affected the credibility of the Islamic finance industry at large. Therefore, the centralized model has later emerged across many jurisdictions to address these issues. It has been also recommended by AAOIFI with the issuance of a dedicated governance standard[18].

5.2. Islamic Capital Market

a) Overview

ICM refer to capital market activities and instruments that raise and invest funds in ways that comply with Shariah. The primary ICM activities include but are not limited to the issuance and trading of Sukuk, Shariah compliant stocks, and Islamic funds. The growing awareness and demand for investing in accordance with Shariah principles on a global scale has created flourishing ICM around the world.

ICM play an important role in generating economic growth for any country. Hence, several Muslim-majority countries including Malaysia, Pakistan, Turkey, Indonesia, UAE, Bahrain and Saudi Arabia have well-established ICM whilst an increasing number of Muslim-minority countries, for example, the UK, Ireland, and Luxembourg, are developing ICM activities within their mature conventional capital markets. With the exception of Sudan and Iran, where the entire financial systems are Shariah compliant, ICM in all other countries function in parallel to the conventional capital markets, playing a complementary role in broadening, deepening and diversifying the financial markets.

The operations of ICM in most jurisdictions are regulated and supervised by the country's capital market regulators, in accordance with the standard regulatory framework in place for conventional capital market operations. However, additional requirements pertaining to compliance with Shariah are applicable to ICM operations.

The scope of the above-mentioned additional framework for Shariah compliance varies across different jurisdictions. The countries with more advanced ICMs have distinct and elaborate frameworks for Shariah compliance of the ICM operations whereas in other countries, the framework is not much sophisticated yet.

Out of USD 4.9tn Islamic finance assets as of 2023, ICMs accounted for 23%, representing 5% for Islamic funds and 18% for Sukuk, of the total, amounting around USD 1.1tn22 . There were around 2,399 active Islamic funds dominated by Islamic equity funds, and 5,268 outstanding Sukuk including both corporate and sovereign.

18 ("Central Shariah Board" – Governance Standard No 8).

b) Sukuk

According to AAOIFI, Sukuk (sometimes referred to as 'Islamic bonds') are defined as "Certificates of equal value representing undivided shares in ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity".

Sukuk are Islamic investment certificates of equal value issued by sovereign, quasi-sovereign or corporate entities to raise funds against underlying assets or a pool of diversified assets of the Sukuk structure, which may be tangible assets (e.g. ownership of property or projects like infrastructure etc.) or intangible assets (e.g. usufruct of a property).

From a Shariah compliance perspective, the underlying asset is the foundation of a Sukuk structure where the asset shall be owned by the Sukuk holders for the duration of the Sukuk term to link the investment with the risk and reward of such asset.

Asset ownership is best achieved/secured by completing a full transfer of legal title of the underlying assets to the Sukuk holders[19] where the Sukuk holders will have direct recourse to the underlying asset that may be sold to recover their investment in case of default.

However, some Shariah scholars may also accept transferring only the beneficial ownership[20] of the underlying assets to the investors particularly in sovereign Sukuk issuances due to legal impediments related to ownership transfers of sovereign assets, though in the event of bankruptcy, the assets may revert back to the originator and the claim of the Sukuk holders for their investments could rank pari passu with other unsecured debtors.

Based on the foregoing, the key similarities and differences between Sukuk and bonds can be summarized as follows:

SIMILARITIES	DIFFERENCES
• Sukuk, like conventional bonds, are investment instruments that are usually marketable, transferable and tradable[21] in the secondary market. • Sukuk may be rated by regional and international rating companies and agencies. • Sukuk may be secured or their credit rating may be enhanced by using Shariah compliant collateral. • The variety of Sukuk structures allows for structuring across different legal and fiscal environments to achieve the objective of the originator. • Sukuk are subject to regulatory requirements as the conventional bonds.	• Sukuk must be issued using Shariah compliant contracts and structures. • Sukuk should be structured to fund Shariah compliant projects / assets / services / activities. • Conventional bonds represent pure debt obligation whereas most Sukuk represent ownership stakes in the underlying assets[22]. • The sale of a bond is the sale of a debt, but the sale of Sukuk is a sale of undivided share in the underlying assets (where applicable). • Sukuk are secured by ownership rights in the underlying assets while conventional bonds are generally unsecured debt[23]. • The principal and return in Sukuk are not always unconditionally and contractually guaranteed, but in conventional bonds, they are guaranteed by the originator at the outset.

c) Example - Ijara Sukuk

Ijara is a lease contract where the usufruct of a certain asset is rented from the owner of the asset (or lessor) to the lessee against payment of rent. Ijara is defined by the following conditions:

- The underlying asset should be Shariah compliant and used according to Shariah principles.
- Ijara term must be specified with clear start/end dates.
- The underlying asset or its usufruct must be owned by the lessor and remain the property of the lessor throughout the Ijara term.
- Lessor is responsible for major maintenance and insurance[24] of the underlying asset.
- Ordinary maintenance (day-to-day) remains the lessee's responsibility.

19 Through a Special Purpose Vehicle 'SPV' structure.

20 Beneficial ownership is established by providing certain contractual legal rights (usage, economic benefits, or other interests in the asset) to the Sukuk holders even though the legal title of the asset remains with the originator (originator is the original legal owner of the asset which is typically the entity seeking funding through Sukuk).

21 Subject to the Shariah compliance requirements of the Sukuk structure

22 In case of default, the Sukuk holders may have the right to sell the underlying asset while the bondholders will be typically treated like creditors.

23 Except in cases like first mortgage bond, equipment trusts certificates etc

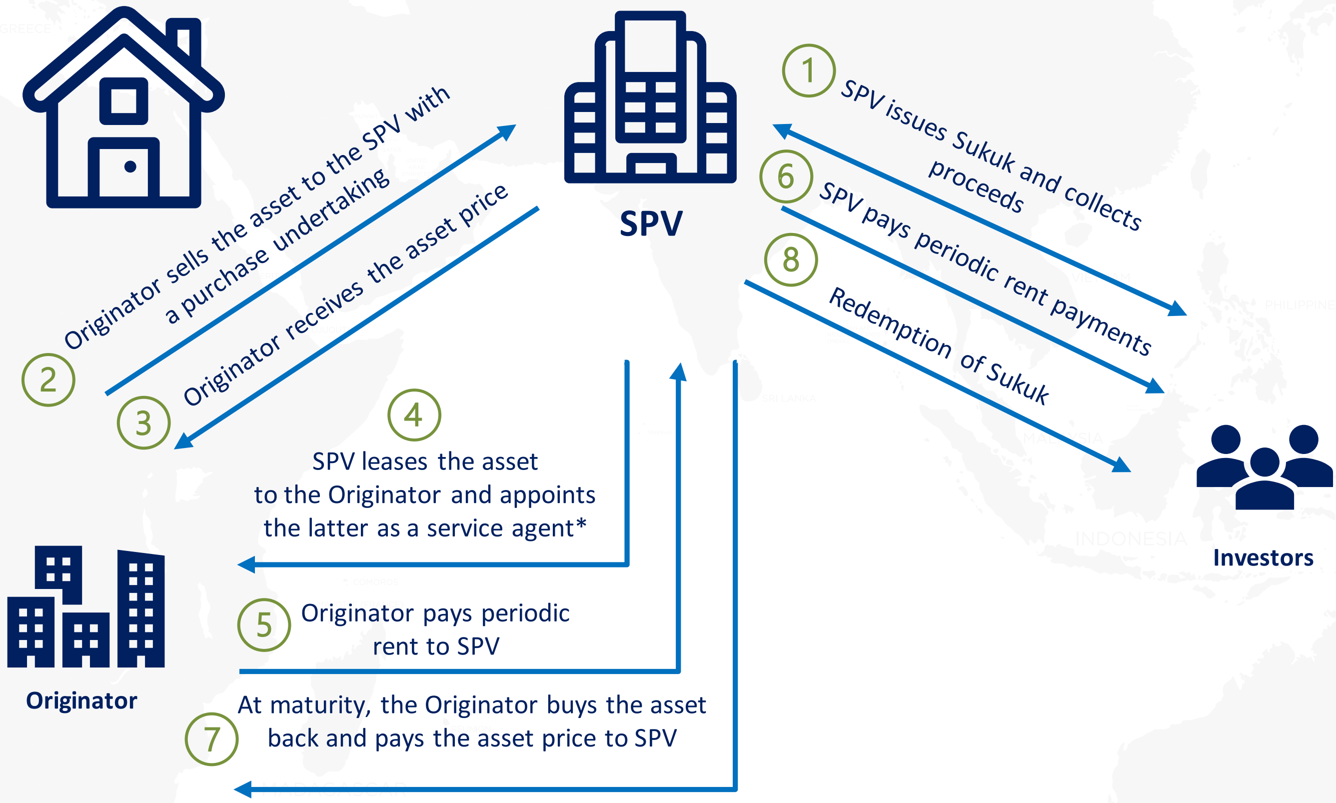
24 Takaful (Islamic insurance) cover shall be used but if not available in the local market, conventional insurance may be used.

The rental amount must be agreed upon in advance (it may be defined using a formula based on an acceptable and independent benchmark e.g. Libor rate).

<u>Ijara Sukuk process involves the following:</u>

- The originator uses a defined set of properties as the Sukuk's underlying assets.
- The originator sets up an SPV to act as the 'issuer' for the purpose of Sukuk issuance, as 'trustee' for the Sukuk holders and as 'lessor' of the properties.
- The SPV issues Sukuk and collects proceeds from the investors to pay the agreed amount of money to the originator as the purchase price of the properties.
- The originator sells the properties to the SPV for an agreed price and with a promise to buy back the properties at the maturity of the Sukuk.
- The SPV (which now owns the properties) leases the properties to the originator for an agreed amount of rent to be paid periodically (which will be the income for the SPV that will be distributed to the Sukuk holders as coupon payments).
- The properties continue to be used by the originator as usual (or could be sub-let by the originator to other entities, if allowed under the Sukuk structure) but the originator, as 'lessee', pays the agreed rent to SPV.
- The SPV also appoints the originator as its agent for the servicing (major maintenance, insurance and payment of taxes, if any) of the properties.
- At maturity, the originator buys back the properties from the SPV and pays the purchase price. This amount is used to pay the Sukuk holders for redemption of Sukuk. The ownership of the properties is transferred back to the originator.

Ijara Sukuk Process Flow



d) Islamic Equity Market

The Islamic equity market operates in a similar way to the conventional equity market with the standard regulatory requirements but with a few exceptions as they remain subject to Shariah requirements. The following are the key prohibited instruments / transactions / practices / activities in Islamic equity markets:

- Investing in Shariah non-compliant companies including those creating any negative/adverse impact on society, the environment, and animals.
- Interest-based leveraging
- Buying on margin
- Short selling
- Sale of debt[25]
- Trading other conventional speculative financial derivatives (e.g. forward, futures, options, swaps etc.)
- Conveying or acting on insider information
- Disseminating misleading statements
- Market manipulations
- Improper disclosures

The Islamic equity market includes but is not limited to Shariah compliant/screened stocks, Islamic stock indices, Islamic funds[26], Islamic unit trusts, and Islamic Real Estate Investment Trust (IREITS).

e) Shariah Compliance Screening

Shariah compliance screening is a critical process for determining whether stocks listed on a stock exchange are suitable for investment according to Islamic principles. The screening is based on a methodology approved by renowned Shariah scholars and organizations like AAOIFI. It typically involves two main filters:

a) **Business Activity Screening** (qualitative or sectoral screening). The business activity filter ensures that companies involved in sectors deemed harmful to society, such as alcohol, gambling, tobacco, and interest-based financial services, are excluded. Companies must derive at least 95% of their revenue from permissible activities.

b) **Financial Ratios Screening** (quantitative screening). The financial ratios filter assesses companies based on their exposure to interest, excluding those with excessive interest-bearing debt, receivables, or income. While the core methodology is uniform across the Islamic finance industry, some variations exist in the specific financial ratios used by different index providers.

f) Islamic Funds

Islamic funds are joint pools or collective investment schemes in which the investors place their funds to earn profit in compliance with the requirements of Shariah principles. Islamic funds can be equity funds, fixed-income funds, money market funds, index funds, real estate funds, fund of funds etc. providing all the aforementioned types are complying with their respective Shariah compliance investment guidelines. Unlike conventional investment funds, which often prioritize profit maximization without restriction, Islamic funds must comply with specific prohibitions and guidelines that dictate the nature of permissible investments.

Islamic funds are typically structured using similar legal structures of conventional funds, but the former will have different investment strategy with certain types of permitted asset classes (such as Shariah compliance stocks, Sukuk, residential properties and commercial real estate etc.). Islamic funds will also have an additional layer of governance that is aimed at ensuring Shariah compliance at all times. To this end, Islamic funds have a Shariah governance framework that is designed and implemented.

25 Malaysia is the only country where Shariah scolars allow the sale of debt based on their own interpretations of the Islamic law, however, such practice is strictly forbidden in all other Islamic finance markets.

26 Islamic funds invest in public and private stocks, using the same strategies of active and passive management as conventional funds and have similar types of risk and return profiles. Islamic funds also include real estate funds, liquidity funds, Sukuk funds, venture capital funds, fund of funds and more recently, hedge funds

6. THE CASE FOR CHANGE

The case for developing an ICM in Ethiopia is both timely and compelling, given its potential to deliver wide-ranging benefits for the country's economic growth and financial resilience. As a strategic enabler, the ICM can diversify Ethiopia's financial markets, unlock alternative sources of funding for the public and private sectors, and enhance financial inclusion. Additionally, it offers a mechanism for mobilising domestic savings and attracting international capital to finance priority sectors such as infrastructure, education, and agriculture.

Reinforcing this case is the presence of a sizable Muslim population in Ethiopia, a community known for its entrepreneurial dynamism and the growing need for financial services aligned with aligned with Islamic principles. By offering Shariah compliant products, the ICM can empower this population to duly and properly participate in the formal financial system, in a manner consistent with their values. Moreover, the ethical foundation and unique features of Islamic financial products have proven attractive across broader markets. In countries like the United Kingdom, Malaysia, and Kenya, Islamic finance has gained impressive traction among non-Muslim clients, demonstrating its wider market potential.

The rapid growth of Islamic banking in Ethiopia further underscores the readiness of the market for ICM products[27]. Indeed, this indicates a strong potential appetite for ICM instruments such as sovereign, corporate, and retail Sukuk, Shariah compliant equities, and Islamic investment funds. This momentum presents a valuable opportunity to deepen Ethiopia's financial ecosystem while aligning with both domestic demand and global best practices.

While the case for establishing an ICM in Ethiopia is compelling, its successful development will require deliberate policy action to address key constraints. Creating an enabling environment demands overcoming a range of challenges, from legal and regulatory gaps to limited institutional capacity and low market awareness. If not adequately addressed, these barriers could significantly impede the establishment and sustainable growth of the ICM in Ethiopia.

The key challenges are outlined below in a thematic manner:

a) Government Support and Coordination

The Ethiopian government has shown a reasonable level of political commitment to fostering the growth of the Islamic finance sector over the last few years. This support is evident in the government's early efforts to create an enabling environment for the introduction of Islamic banking and microfinance, reflecting a broader commitment to economic diversification and financial inclusion.

This commitment is further demonstrated through recent efforts and initiatives by government stakeholders. For example, NBE has made the promotion of interest-free banking a central focus of its 2023-2026 strategic plan, indicating a clear commitment to advance the sector and enhance financial inclusion by providing access to Shariah compliant financial products for a broader segment of the population. In addition, ECMA has committed to fostering an environment conducive to ICM development, with ICM being a central element of its 2024-2026 strategy to diversify the local capital market.

While these efforts are commendable, they remain scattered across different entities and initiatives, highlighting the lack of a unified, coordinated strategy for the development of Islamic finance in the country. The absence of a coordinated approach to integrate Islamic finance into Ethiopia's broader national development agenda may hinder effective growth and strategic planning, potentially leading to less impactful results.

The development of an ICM in Ethiopia will be particularly difficult without a unified vision for Islamic finance in the country. The capital market is an essential component of a larger financial ecosystem, and it cannot function effectively in isolation. Its success relies on the interconnectedness of various financial institutions, regulatory frameworks, and supporting infrastructure. Therefore, a clear and unified government vision is critical to ensure that these efforts align, creating a sustainable and integrated path forward for the development of ICM in Ethiopia.

b) Government-Led Strategic Initiatives

Despite the presence of Islamic finance in Ethiopia for over a decade, there has been a noticeable lack of comprehensive government-led initiatives to support its development. To properly grow the sector, the government, through various stakeholders, must take the lead in driving strategic initiatives that will ensure its advancement. This approach has been successful in several countries that recognized the value of Islamic finance and implemented strategic measures to develop the industry.

For example, countries such as Bahrain, Indonesia, Saudi Arabia, and Malaysia have incorporated Sukuk as a key instrument for government funding and infrastructure development. By adopting this approach, these governments have successfully supported the growth of their ICMs. In Malaysia, in addition to using Sukuk as a primary funding tool, the government has introduced tax incentives for both issuers and investors, stimulating the market and enticing the private sector to issue Sukuk.

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27 According to the Official Statistics of NBE as of December 2024, Islamic banking providers hold 10% of the total deposits in the banking system. Out of the 162.7 million deposit accounts in Ethiopia, 24.7 million are Islamic deposit accounts, representing 15% of the total deposit accounts in the banking system. In addition, 8% of the total outstanding credit in the banking sector is held by Islamic banking providers.

c) Shariah Governance Framework

A robust SGF is essential for ensuring the integrity and credibility of the ICM sector. Given that Shariah compliance is the cornerstone of Islamic financial products, an effective governance system is crucial for ensuring that all transactions and products adhere to Islamic rules and principles. Therefore, to support the proper development of ICM, it is essential to implement a strong SGF and ensure that market participants fully comply with its requirements.

A significant challenge in Ethiopia's existing capital market legal and regulatory framework is the lack of a clearly defined and dedicated SGF for ICM. While ECMA's introduction of licensing for Securities Shariah Advisers (SSAs) and the related guidelines in the Capital Market Service Providers Licensing and Supervision Directive No. 980/2024 is a positive and commendable step, it does not constitute a comprehensive Shariah governance framework. This measure is limited to product-specific Shariah endorsements and does not provide a comprehensive, institution-wide SGF or broader regulatory oversight for the entire industry.

There is currently no formal directive issued by the ECMA to govern Shariah compliance. This gap is understandable, given the sector's infancy stage, but it still presents a major barrier to the development of ICM. The lack of a dedicated SGF for ICM will expose the sector to Shariah non-compliance risk and impede its development. Without proper governance structures in place, the industry faces potential reputational and financial risks that could undermine its credibility and investor confidence. For Ethiopia to foster a thriving ICM, it is critical that a robust Shariah governance framework is established to ensure compliance and safeguard the integrity of the sector.

d) Legal, Regulatory, and Supervisory Frameworks

ICM products, particularly Sukuk, have unique technical specifications and Shariah requirements that necessitate the establishment of enabling Legal, Regulatory, and Supervisory Framework (LRS). For ICM to develop, the LRS must accommodate the unique characteristics of ICM products and ensure that the framework facilitates their introduction into the market. This includes, but is not limited to, recognizing Shariah compliant financial instruments like Sukuk, defining Islamic finance contracts, establishing oversight for Shariah compliance and ensuring adequate investor protection.

While the existing LRS of capital market provides a foundation for potentially introducing ICM in Ethiopia, there are barriers that hinder the recognition and proper treatment of certain ICM products within the LRS. The following outlines the key gaps and barriers that exist within the LRS, which need to be addressed to foster the growth and integration of ICM in the country:

- Absence of legal and regulatory recognition for Islamic finance contracts, their key features, and the treatment of their distinct returns, creating uncertainty in structuring and enforcing transactions.
- Lack of proper definitions for ICM products and instruments[28], limiting market participants from offering or using Shariah compliant investment opportunities.
- Absence of legal anchoring for the Central Shariah Advisory Board (CSAB) for capital market.
- Absence of legal and regulatory basis for Shariah Governance Framework
- Legal, regulatory, and supervisory gaps for enabling Sukuk, preventing its integration into the existing capital market.
- No dedicated and clear provisions in the LRS for integrating Sukuk into Ethiopia's public debt management system, resulting in the absence of government-issued Shariah compliant securities.
- No legal or regulatory provisions to establish a Shariah compliant compensation scheme under the compensation fund.
- Absence of specific disclosure requirements for ICM products, including Shariah compliance certificates, SSB opinions, and other relevant disclosures in the LRS

e) Taxation

ICM instruments are structured differently from their conventional counterparts to ensure Shariah compliance. For example, unlike conventional bonds, which are interest-based instruments, Sukuk are structured using various contracts such as sale, lease, agency, or profit sharing. These structural differences can result in additional tax burdens on ICM instruments, making them more costly compared to conventional alternatives. This potential for higher tax burdens on Issuers and or investors presents a challenge for the development of ICM in Ethiopia, as it could hinder the competitiveness and attractiveness of Shariah compliant financial products.

28 This could be done by either by amending existing definitions and/or introducing new definitions in the LRS depending on the nature of the instruments.

Below are some examples which illustrates the potential additional tax burdens and costs that could impact ICM instruments and activities:

- **Classification of Income:** lack of clarity on the tax classification of income from certain ICM instruments may lead to mistreatment. For example, income generated from an Islamic profit-sharing structured product may be treated as dividends instead of receiving similar tax treatment to interest from a conventional product, potentially resulting in unintended tax burdens.
- **Double or Triple Taxation:** certain Shariah compliant contractual arrangements like Murabaha and Ijara may involve multiple asset transfers, potentially triggering multiple instances of VAT, capital gains tax, or stamp duty.
- **Tax deductibility of Finance Cost:** uncertainty regarding whether finance costs in ICM transactions receive the same tax-deductible treatment as interest expenses in conventional capital market activities may create inefficiencies and higher tax burdens for ICM participants.
- **Tax Implications for SPVs:** the establishment and operation of SPVs, which are essential for structuring Sukuk, among other ICM products, may trigger unintended tax liabilities, such as income taxes, withholding taxes, or stamp duties, potentially increasing costs and reducing the attractiveness of Sukuk issuance.
- **Other State Dues and Levies:** other state dues like notarisation or registration fees, imposed on transactions required for Shariah compliance[29] during the structuring and operation of ICM products, may create higher costs compared to conventional instruments

Currently, Ethiopia does not address adequately and effectively key ICM products and activities within its tax legislation. Therefore, at present, conducting ICM activities in Ethiopia would be more expensive and unduly burdensome for the ICM participants, customers and/or investors.

f) Human Capital

A critical challenge for the successful development of Islamic finance and ICM in Ethiopia is the shortage of skilled human capital. The growth of ICM relies heavily on professional and capable human resources equipped with the necessary knowledge and experience to drive the sector forward. As a new player in the field of Islamic finance, Ethiopia is facing a common challenge experienced by many countries in the early stages of developing Islamic finance, that is an insufficient pool of qualified professionals.

To ensure the successful development of ICM, there must be continuous efforts to build and sustain the required capacity among market participants and stakeholders. Comprehensive capacity-building initiatives are crucial for policymakers, regulators, and key stakeholders, such as ESX and EIH, who will play a pivotal role in the development of the market. Additionally, market participants interested in offering or utilizing ICM products must also engage in these programs to ensure they are fully equipped to operate effectively and contribute to the sector's growth

g) Public Awareness

Another challenge that could impede the development of ICM in Ethiopia is the limited public understanding of Islamic finance in general and ICM in particular. Misconceptions about the sector appear to persist within both Muslim and non-Muslim communities. Engagements with stakeholders revealed that some segments of the Muslim population remain sceptical about the Shariah compliance of financial products offered by institutions that provide both Islamic and conventional services. Additionally, some members of the Christian community perceive Islamic finance as being exclusively for Muslims. These misunderstandings create barriers to the widespread acceptance and adoption of ICM in Ethiopia.

Overcoming these challenges require comprehensive public awareness campaigns to educate the public about the opportunities, benefits, and risks of Islamic finance products, fostering a more informed and inclusive market. Raising awareness Islamic finance is critical to fostering greater acceptance and participation in the market, ensuring that the sector contributes effectively to Ethiopia's economic development.

h) Branding

The use of the term "interest-free" to describe Islamic finance has potentially contributed to public misconceptions, most notably, the mistaken belief that such products are always cost-free. Moreover, the term "interest-free" does not clearly convey that these products are Shariah compliant, which is a fundamental aspect intended to attract financially excluded Muslims.

To address the above-mentioned issues, there is a need for a more accurate and inclusive branding approach, one that reflects both the ethical and Shariah foundations of Islamic finance, positioning it as a universal financial offering that serves the needs of all consumers, regardless of faith or background.

29 Such registration fees for asset transfers, lease arrangements, etc.

7. POLICY RECOMMENDATIONS

No.	Strategies and Recommendations	Key Stakeholder(s)
	Government Support and Cooperation	
1	**Islamic Finance Task Force (IFTF)** The Ethiopian Government is advised to establish the IFTF as the central orchestrator, tasked with driving the development of a cohesive and sustainable Islamic finance ecosystem in the country[30]. The IFTF's mandate is to translate the government's vision into actionable strategies, coordinate stakeholders, and ensure the effective implementation and monitoring of initiatives aimed at fostering the growth of Islamic finance. Backed by a strong political will, the IFTF will play a pivotal role in positioning Islamic finance as a cornerstone of Ethiopia's inclusive economic development agenda. The proposed structure of the IFTF is as follows: • The chairman of the IFTF to be a Senior Government Official, underscoring the strategic importance of Islamic finance for Ethiopia's economy. • Three voting members namely the MoF, the NBE, and the ECMA. • An executive director to manage all operational issues related to the IFTF (a senior official reporting to the chairman, preferably with working knowledge/experience in Islamic finance). • An advisory panel of technical experts drawn from other stakeholders, including but not limited to public and private sector entities.	The Government, MoF, NBE, and ECMA
2	**National Islamic Finance Policy** Having a national Islamic finance policy would provide a strategic framework to align stakeholders and drive the growth of the Islamic finance industry in Ethiopia[31]. By integrating Islamic finance into the country's broader development agenda, the policy would help unlocking its potential to boost financial inclusion, attract foreign direct and ethical investments, and mobilise capital for key economic priorities such as poverty alleviation, building infrastructure, supporting education, and SME development. This policy should establish a consistent and robust approach to key enablers of the industry such as legislation, governance, taxation, and institutional support, fostering an enabling environment for the development of the local Islamic finance industry. With clear targets and the IFTF acting as the national champion to oversee implementation, it would build investor confidence, promote economic resilience, and position Ethiopia as a serious emerging player in Islamic finance, both regionally and globally.	IFTF

30 A number of countries aiming to develop Islamic finance have established similar entities to lead its growth and development. For example, in the UK, the government created the "UK Islamic Finance Task Force," which was given the role of "UK Ministerial Champion" to strengthen London's position as the leading hub for Islamic finance in the West.

31 Several other jurisdictions seeking to develop their Islamic finance industries, including Pakistan, Malaysia and Indonesia, have formulated national Islamic finance policies and plans to advance the sector and ensure a targeted, strategic approach to its development.

No.	Strategies and Recommendations	Key Stakeholder(s)
	Government Support and Cooperation	
3	**Islamic Capital Market Steering Committee (ICM-SC[32])** For the optimal implementation of the recommendations, ECMA is advised to establish an inter-government steering committee comprising senior representatives from key stakeholders, including but not limited to NBE, MoF, ESX, and EIH. The ICM-SC will help coordinate initiatives, align efforts, and ensure a unified approach toward ICM development. While the IFTF provides strategic direction, the ICM-SC will focus on technical and operational aspects, ensuring coordinated efforts, addressing practical challenges, and aligning initiatives to develop a robust ICM.	ECMA, MoF, NBE, ESX, and EIH
4	**Strategic Government Initiatives** As part of the National Islamic Finance Policy, the IFTF is advised to incorporate a number of strategic government initiatives aimed at supporting the development of Ethiopia's emerging ICM. These initiatives may include the following: • MoF, in partnership with NBE, to consider launching special Retail Sukuk Programmes linked to specific infrastructure, education, and agriculture projects with a high profile and significant impact on the economy, aimed at local retail investors[33]. This should help mobilise idle domestic savings, including potentially unbanked funds, finance critical infrastructure projects, strengthen national ownership of strategic assets, and support the emerging ICM market. • NBE, in partnership with MoF, to establish the necessary internal infrastructure and introduce the required legislative amendments to facilitate the issuance of Islamic Treasury Bills, Islamic Treasury Notes, Islamic Treasury Sukuk, and Government Sukuk. This initiative will help diversify the government's funding sources, enhance fiscal sustainability, and promote the growth of Islamic liquidity management tools in Ethiopia[33]. • DBE, EIH, CBE, and SOEs should consider, as a policy, Sukuk issuance as an additional financial tool to complement their existing capital-raising instruments, ensuring a specific portion of all funds raised by them are through Sukuk[35]. This policy will diversify funding sources, enhance liquidity management for local Islamic financial service providers, and attract a broader investor base, including domestic and potentially international Muslim and ethically-oriented investors, while supporting the growth of the emerging the ICM in Ethiopia[36]. • PSSSA and POESSA to develop the required infrastructure to offer Islamic pension schemes, providing both public and private sector employees with the option to choose a Shariah compliant pension[37]. This initiative is important for enhancing financial inclusion among Muslim employees, diversifying pension fund investments, and generating sustained demand for ICM products. • The Government of Ethiopia, along with its affiliated entities and SOEs, should consider implementing a policy that mandates a minimum proportion of their funds to be deposited in Islamic banking accounts with a plan for an annual gradual increase. This initiative would support the growth of the Islamic banking sector, thereby enhancing its capacity to invest in the ICM. Ultimately, it would contribute to the broader development of Ethiopia's Islamic financial ecosystem.	IFTF MoF and NBE NBE and MoF DBE, EIH, CBE, and SOEs PSSSA and POESSA ICM-SC

32 Islamic Capital Market Steering Committee (ICM-SC) is a generic name which has been temporarily given to this body. The name may be altered to suit the Ethiopian context.
33 Similar to the Grand Ethiopian Renaissance Dam Bond
34 NBE management has reported that they are in the process of hiring consultants to explore launching Islamic liquidity instruments
35 It is advised to have pre-approved standardised template documents for a number of Sukuk structures to reduce the costs and time to market by simplifying the process for these government-entities
36 A Shariah compliant government backed guarantee scheme for the Sukuk issued by these entities could be introduced (this scheme will be aimed at giving greater confidence to local and international investors)
37 Setting up an Islamic pension scheme does not necessarily require the creation of a separate legal entity. The key consideration is ensuring that contributions to Islamic pension schemes are pooled and segregated from conventional schemes, which can be achieved through systemic, operational, and accounting measures and controls. Such pooled funds should be exclusively invested in Shariah compliant assets, including ICM instruments such as Sukuk, ensuring compliance with Shariah principles while offering sustainable retirement benefits

No.	Strategies and Recommendations	Key Stakeholder(s)
	Legal, Regulatory, and Supervisory Frameworks	
5	**Enabling Legal, Regulatory, and Supervisory Frameworks for Islamic Capital Market** Introduce the necessary amendments and draft the relevant legal texts to implement the required legal, regulatory, and supervisory reforms for the full integration of the ICM and ensure it operates on a level playing field with the conventional capital market in Ethiopia. The focus shall be on addressing legal constraints, regulatory gaps, and necessary policy adjustments within relevant laws, regulations, and supervisory frameworks[38]. Key areas to be considered in the amendments and reforms are as follows: • Introduce legal and/or regulatory provisions to define Islamic finance related contractual arrangements along with their key features, and clarify the treatment of their distinct returns[39]. • Define and legally recognise ICM products and instruments, with a primary focus on Sukuk, alongside Shariah compliant stocks/shares, Islamic mutual funds, Islamic investment schemes, etc. • Provide the legal anchoring required for CSAB of ECMA, and the legal basis for the Shariah Governance Framework Directive[40]. This will help in creating effective Shariah compliance oversight and harmonisation of ICM practices in Ethiopia. • Develop the necessary legal and regulatory basis to fully integrate Sukuk into Ethiopia's capital market[41]. This should include clear definitions and requirements for the main Sukuk parties, issuance and listing procedures, application and approval processes, Sukuk structures and their main features, eligible asset types for Sukuk structuring, asset ownership and transfer rules, SPV establishment and management, utilisation of proceeds, rating, depository and settlement, audit, reporting, disclosure, penalties and sanctions, risk management, redemption mechanisms, Shariah governance, etc. A well-defined framework for Sukuk will ensure regulatory clarity, investor protection, and market stability, aligning with international best practices while taking into account's Ethiopia's unique context. • Establish the required legal and regulatory provisions for integrating Sukuk into the public debt management system in Ethiopia with parity to conventional bonds, including clear definitions, roles, and governance requirements. • Achieve regulatory parity by extending and/or amending licensing, oversight, disclosure, and other relevant regulatory and supervisory requirements to cover other ICM products and instruments[42].	ECMA and MoF

38 E.g. the Federal Government Financial Administration Proclamation No. 648/2009 and Amendment Proclamation No.970 /2016, Council of Ministers Regulation No. 190/2010 to Provide for the Financial Administration of the Federal Government, Public Debt Management and Guarantee Issuance Directive No 46/2017, Capital Market Proclamation No. 1248/2021, Capital Market Service Providers Licensing and Supervision Directive No. 980/2024, Public Offering and Trading of Securities Directive Number No. 1030/2024, Directive on Licensing, Operation, and Supervision of Securities Exchanges, Derivatives Exchanges, and the Over-The-Counter Market No.1009/2024, the Capital Market Authority's Fee Directive No. 996/2024, Directive on Recognition and Supervision of Self-Regulatory Organizations No. 1031/2024, etc.

39 In this regard, any legal and regulatory amendments should align with, and maintain consistency in terminology and approach with amendments (if any) to the Civil Code, Commercial Code, and tax legislation, ensuring consistency, and clarity across different pieces of the legislation

40 Further details on this are provided in recommendations Nos. 10 and 11

41 A regulatory sandbox may be considered as an interim mechanism to facilitate the accelerated issuance of Sukuk, particularly sovereign Sukuk. However, its implementation must be supported by a comprehensive legal assessment to determine whether the sandbox can override potential taxation impediments, and/or provide temporary exemptions from existing tax legislation, and other conflicting legislative provisions

42 This is related for non-Sukuk products like Shariah compliant stocks, Islamic mutual funds, etc.

No.	Strategies and Recommendations	Key Stakeholder(s)
	Taxation	
6	**Tax Study** Conduct a detailed study of Ethiopia's tax legislation to identify and assess necessary amendments for accommodating ICM products, particularly Sukuk[43]. The primary objective of this review should be to establish a level playing field between ICM products and their conventional counterparts, by identifying and addressing potential tax disadvantages that may hinder their competitiveness and market adoption. This study should evaluate the tax treatment of key Islamic finance structures, such as investment agency, profit-sharing, trade and asset transfers, and lease-based arrangements, which are commonly used in Sukuk issuance and other structured products[44]. It should also examine the tax implications related to the establishment and operation of SPVs, which are integral to structuring Sukuk and ensuring compliance with Shariah requirements. Additionally, other imposed state dues or levies, such as any notarisation or registration fees on transactions required for Shariah compliance during the structuring and operation of ICM products should also be examined to ensure a level-playing field in this regard. The ICM-SC may consider broadening the scope of the aforementioned tax study to include other Islamic financial sectors, such as Islamic banking, microfinance, and Takaful (Islamic insurance). This will help ensure tax neutrality, promote consistency, and facilitate the harmonised development of the overall Islamic finance ecosystem in Ethiopia.	ICM-SC
	Shariah Governance	
7	**Central Shariah Advisory Board for Ethiopia's Islamic Capital Market[45]** To have an adequate and effective Shariah governance framework within Ethiopia's ICM, it is recommended that ECMA establish a Central Shariah Advisory Board (CSAB). The CSAB is an independent, legally anchored and empowered advisory body dedicated to supporting ECMA in developing enabling legal and regulatory frameworks and appropriate Shariah governance standards for the ICM[46]. It will oversee Shariah compliance, resolve Shariah related disputes, advise competent courts in relevant litigation cases, and align interpretations among institutional SSBs. The CSAB will also provide Shariah advisory, in coordination with ECMA, to other government bodies such as NBE, MoF, ESX, and EIH on ICM initiatives. Moreover, it will support research, innovation, and public awareness efforts of ECMA to enhance market credibility and strengthen Ethiopia's position as a promising ICM jurisdiction.	ECMA

43 Many jurisdictions, including the UK, Kenya, and South Africa, have amended tax legislation to ensure neutrality, eliminating disadvantages for Islamic financial products.
44 E.g. potential double taxation on asset transfers, treatment of profit generated under Sukuk versus interest under conventional bonds, tax deductibility of certain expenses incurred in Islamic financial transactions, etc.
45 Central Shariah Advisory Board for Ethiopia's Islamic Capital Market is a generic name which has been temporarily given to this body. The name may be altered to suit the Ethiopian context.
46 The IFTF may also consider either expanding the mandate of the CSAB into a standalone body responsible for overseeing Shariah matters across the entire Islamic finance industry, including Islamic banking, microfinance, insurance, and others, or establishing dedicated sub-committees under the CSAB for specific sector(s) such as Islamic Banking and Microfinance Shariah Committee, ICM Shariah Committee, etc.

No.	Strategies and Recommendations	Key Stakeholder(s)
	Human Capital	
8	**Capacity Building of the Key Stakeholders** The ICM-SC may consider launching, in partnership with the key stakeholders, including government bodies and market players among others, a comprehensive Islamic finance capacity building program[47] that is designed as follows: • Macro-level: targeting policy makers and regulators particularly ECMA, NBE and MoF[48]. • Meso-level: aimed at key market participants (ESX, EIH, DBE, and CBE) and other market players that are interested in offering/using ICM products[49]. The following considerations are crucial to the successful launch of the aforementioned Islamic finance capacity building program: • The program shall focus on the economic benefits and universal ethical values of Islamic finance instead of solely relying on religious arguments. • Regular assessments, refresher trainings, and knowledge-sharing platforms should be established in the market to ensure ongoing skill development and alignment with industry best practices. • The program shall issue a professional qualification certificate that can be a regulatory requirements for those who will have leading position in the ICM.	ICM-SC
	Public Awareness	
9	**Government-Sponsored Islamic Finance Sensitisation Campaign** The ICM-SC to lead on launching a sensitisation campaign, in association with other governmental entities, using a full mix of communication channels, including national TV, newspapers, social media etc. to deliver the following key message to the public on the national Islamic finance policy: • Islamic finance is a financial alternative to conventional finance that has a unique set of ethical values and economic benefits. The messaging shall also be aimed at demystifying Islamic finance and addressing any misconceptions among Muslims[50] and non-Muslims[51]. • Islamic finance has the potential to play a key role in the national economic development of Ethiopia.	ICM-SC

47 Countries like Malaysia have successfully positioned themselves as global hubs for Islamic finance by investing significantly in human capital. Initiatives such as the Malaysia International Islamic Financial Centre (MIFC) and the International Centre for Education in Islamic Finance (INCEIF) reflect this commitment, providing specialised education and certifications to nurture a skilled workforce capable of supporting the growth of the sector.

48 Building the internal capacity of the policy makers and regulators is of key importance for the development of a robust Islamic finance industry (Train-the-Trainer model could be implemented to boost transfer of knowledge and reduce training expenses)

49 The training should be practical and aimed at equipping the relevant staff with knowledge and skills required to discharge their professional duties (Train-the-Trainer model could be adopted)

50 E.g. worries about Shariah permissibility of Islamic financial products, Shariah concerns about the legitimacy of the window model, etc.

51 Proposed amendments to existing legislation to accommodate Islamic finance can sometimes be misunderstood and conflated with concerns about religious influence on the secular governance system. However, successful experiences from countries like the UK and Kenya (non-Muslim majority jurisdictions) demonstrate that governments should navigate such challenges by focusing on the strategic and economic benefits of Islamic finance, rather than being swayed by potential media rhetoric

No.	Strategies and Recommendations	Key Stakeholder(s)
	Branding	
10	**Branding of Islamic Capital Market Products** ECMA is recommended to either adopt industry best practices by using "Islamic Capital Market Products" as the standard terminology in all official communications, legislative texts, and regulatory documents, or consider using terms such as "Participatory Capital Market Products" or "Non-Interest Capital Market Products" to ensure inclusivity and avoid any potential misunderstandings, making the market accessible to all Ethiopians, regardless of religious affiliation[52]. However, ECMA is advised to avoid using the term "Interest-Free", which is currently used in the banking sector, as it has proven to be confusing and potentially misleading[53] in the context of commercial (non-charitable) financial products. In all cases, this matter can be further discussed and evaluated by relevant stakeholders within the IFTF, as part of the national Islamic finance policy development process.	IFTIF

Phased Approach

The figures below illustrate the proposed chronological implementation of the White Paper recommendations in an ideal scenario. This sequencing serves as an illustrative guide to how the policy recommendations could unfold under optimal conditions. However, actual implementation may vary significantly depending on national priorities and other practical considerations.

Importantly, this does not preclude the possibility of initiating certain workstreams in parallel, particularly where such an approach may accelerate progress or align with the readiness of relevant stakeholders. While the figures provide a structured representation of potential sequencing, it is understood that multiple workstreams may be pursued concurrently to fast-track implementation. Despite this flexibility, there remain three foundational prerequisites for the establishment of the ICM in Ethiopia, without which progress on other workstreams may be impeded. These critical enablers are as follows:

- An enabling legal, regulatory, and supervisory framework for the ICM;
- A taxation framework accommodating ICM instruments and activities; and
- A Shariah Governance Framework Directive tailored to the ICM participants and instruments.

52 The term "Participatory Capital Market Products" has been used in countries like Morocco, while "Non-Interest Capital Market Products" has been used to describe ICM products in Nigeria.
53 The public may sometimes perceive ICM products labelled as interest-free to be entirely cost-free

Figure 1: Recommendations in Phase – I

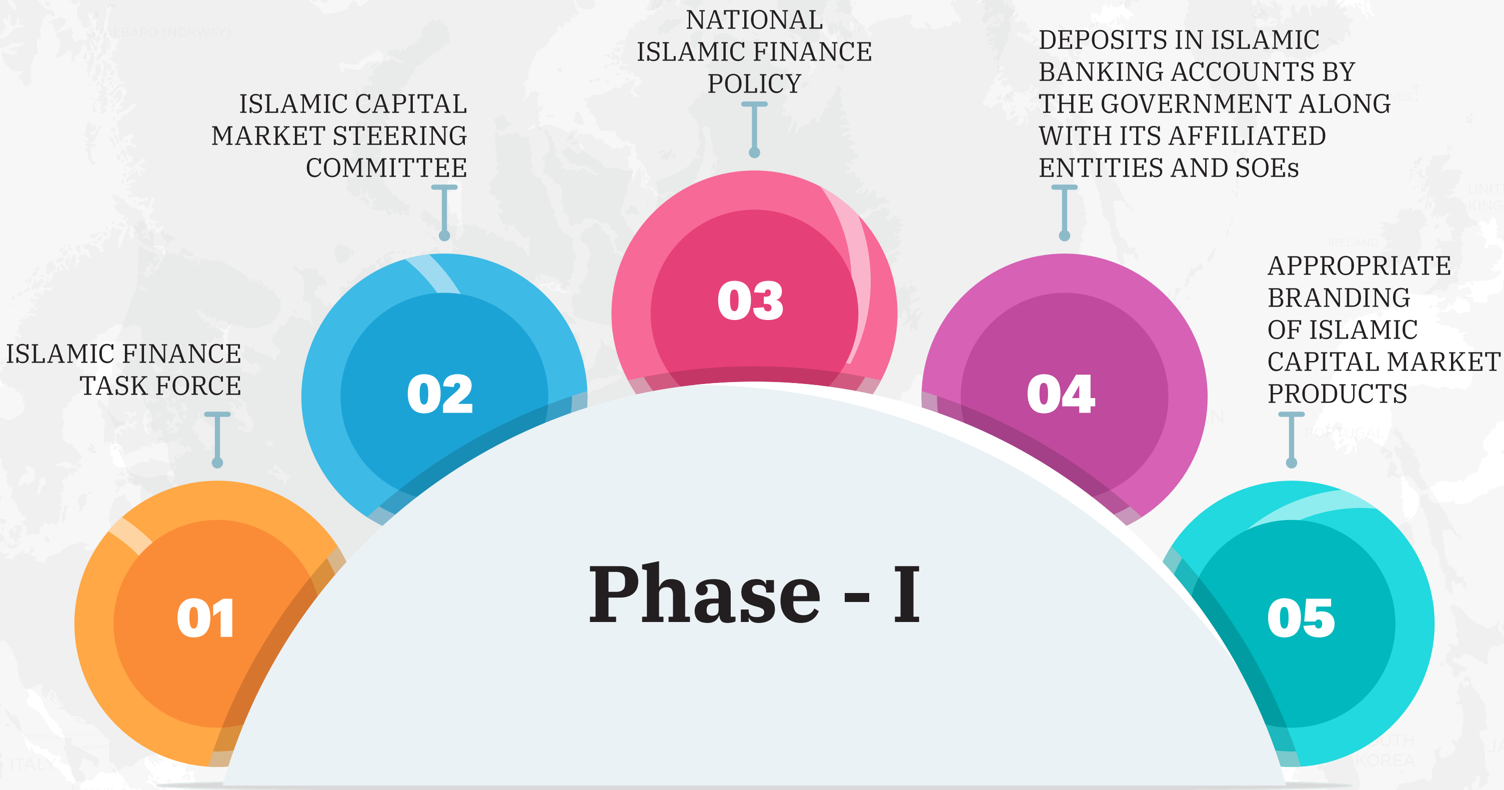
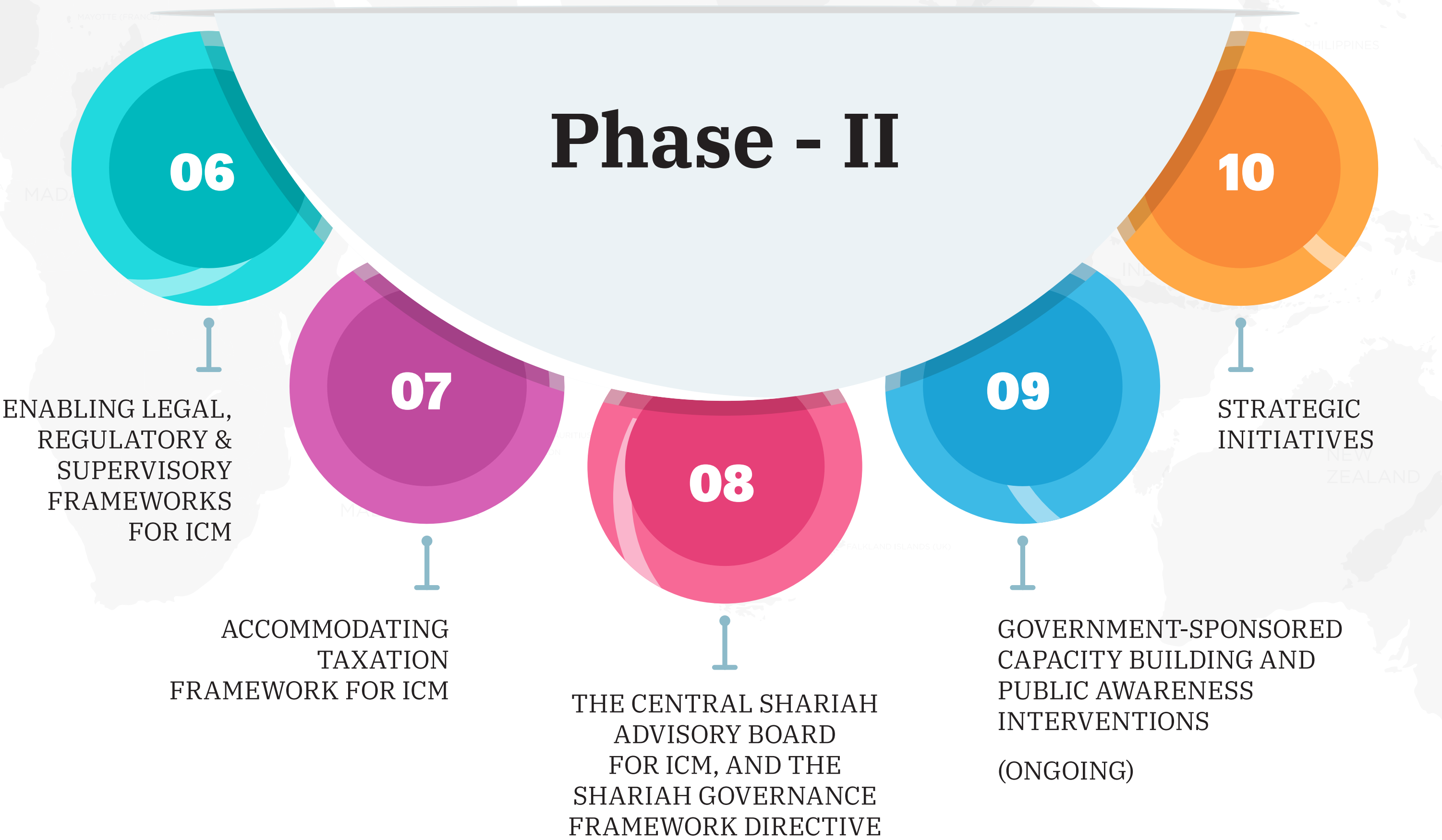


Figure 1: Recommendations in Phase – II



8. APPENDIX

CATEGORY	NAME	DESCRIPTION
Sale contracts	Murabaha	Profit-disclosed sale of an existing asset.
	Salam	Sale of a commodity with full spot payment for future delivery.
	ulf	Sale of an asset to be manufactured.
Lease contract	Ijarah	Islamic lease (could be structured as operational or financial lease).
Loan contract	Qard Hasan	Islamic interest-free benevolent loan.
Participatory contracts	Mudarabah	Partnership where one party (or more) provides the funds, and the other party provides expertise in deploying the funds in a Shariah compliant business activity for profit generation that will be shared between both parties in accordance with a pre-agreed ratio. Any financial loss will be borne by the fund provider(s) unless the other party is guilty of negligence, misconduct, or failure in following the contractual conditions, in which case they will bear the loss.
	Musharakah	Partnership where two or more parties co-fund a specific Shariah compliant project/asset and share the profit in accordance with a pre-agreed ratio and loss in accordance with their capital participation ratios.
Services contracts	Wakala	Wakala is an agency contract where one party (principal) appoints another party (agent) to carry out a Shariah compliant activity on their behalf.
	Kafala	Guarantee that is intended to secure fulfilment of contractual and/or financial obligations.

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ETHIOPIAN CAPITAL MARKET AUTHORITY