InvestSense

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The Ins and Outs of Investing Offshore with Asset Swaps

We are often asked about Asset Swaps and Feeder Funds as the terms can be confusing. This article explores these concepts, terminology and how they fit into an investment strategy.

Investors can access offshore markets in two main ways: by investing directly offshore or through a feeder fund or asset swap structure. We are hoping to provide some clarity on this investment jargon.

What Is an Asset Swap?

An asset swap is a rand-denominated offshore investment that is 'swapped' into foreign currency and invested offshore. Investors can access asset swaps through a feeder fund (unit trust fund) that feeds into a direct offshore fund.

Asset swaps are ideal for investors who do not need to physically move their funds offshore but still want exposure to global markets. Since no tax clearance from the South African Reserve Bank (SARB) is required, and minimum investment amounts are lower than direct offshore investments, they provide a more accessible and less complex way to invest internationally. Investors can also make monthly contributions, making it easier to build offshore exposure over time. There is also no fixed term for an asset swap. Asset swaps, by nature of investing in global markets, will be exposed to volatility and currency exchange rate fluctuations (as would direct offshore investments). However, they remain classified as South African assets in the eyes of SARS and the SARB.

How Does an Asset Swap Work?

Asset Swaps vs. Direct Offshore Investing

A key decision for investors is whether to use an asset swap or invest directly offshore. When investing directly, South African tax residents can invest up to R11 million per year offshore using the Single Discretionary Allowance (SDA) and Foreign Investment Allowance (FIA). While the R1 million SDA requires no tax clearance, the FIA (up to R10 million) requires approval from SARB. (Special exemptions for additional funds over R11m may be applied for).

Direct offshore investments provide more control over jurisdiction and fund selection but depending on the structure may require more specialist tax and fiduciary considerations, especially with estate planning.

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Here's a comparison between Asset Swaps and Direct Offshore Investing:

FEATURE	ASSET SWAP	DIRECT OFFSHORE INVESTING
Currency	Rand-denominated	Foreign currency
Regulations	No SARB approval needed	Tax clearance from SARB required for FIA if investing over R1m.
Investment Minimums	Generally lower	Higher minimums
Fund Range	Limited to available feeder funds	Wide range of global investments
Repatriation on exit	Converted back to rands (with a few exceptions)	Can stay offshore

Who Can Use Asset Swaps?

Due to their flexibility, asset swaps are suitable for:

- Individuals seeking offshore exposure who have used their R1 million SDA and don't want to apply for SARB clearance for the additional R10 million allowance, or who have utilised the full R11 million annual allowance and require additional offshore exposure.
- South African companies and trusts looking to access offshore investments without requiring special SARB approval.
- Institutional investors to gain easy access to global markets.
- Minors, as they are not able to invest offshore directly due to exchange control limits.

How to Access Asset Swaps

Asset swap funds are available on all major local investment platforms in South Africa. Local asset managers invest in offshore markets on an asset swap basis according to each fund's mandate. Since these investments use the fund manager's offshore capacity, they are relatively simple to implement. Investors can choose an appropriate asset swap that aligns with their specific investment goals, risk profiles and global market preferences.

Cost Considerations: As a general guideline, companies may charge an asset swap fee in addition to other fund costs. While some do not charge a fee at all, others typically charge between *0.2% and 0.5% per annum*, with some charging even higher amounts.

SARB Legislation and the 45% Offshore Limit

At times, we need to inform clients that certain funds or products have reached their asset swap capacity on specific platforms, so it's important to understand what this means. The South African Reserve Bank (SARB) has set a limit of 45% for offshore exposure for financial institutions, which applies to the following entities:

1. Collective Investment Schemes (CIS)

- This includes unit trust funds and mutual funds registered under South Africa's Collective Investment Schemes Control Act (CISCA)
- Asset managers running these funds can allocate up to 45% of their total retail assets under management (AUM) to offshore investments.
- This applies to both actively managed unit trusts and feeder funds that invest offshore via asset swaps.

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2. Retirement Funds (Regulation 28 Funds)

- Pension funds, provident funds, and retirement annuities fall under Regulation 28 of the Pension Funds Act, which also limits offshore exposure.
- As of the latest amendments in 2022, Regulation 28 allows up to 45% offshore exposure, aligned with CISCA fund restrictions.
- This includes both direct offshore holdings and those acquired through asset swaps.

3. Life Insurance Companies (Linked Investment Service Providers - LISPs)

- Life insurers offering investment-linked products, such as endowments and living annuities, must also adhere to the 45% offshore limit for their retail assets.
- The offshore investment limit applies across their discretionary and policyholder funds.

4. Asset Managers (Category II License Holders)

- Licensed Category II fund managers who manage segregated or model portfolios must also comply with the 45% offshore restriction when investing in regulated retail products.

If the 45% offshore limit is reached for any of these entities, new investments into asset swaps or feeder funds may be temporarily halted until additional capacity is created. Fund managers can increase capacity to invest offshore by:

1. Launching more locally focused funds to grow their local assets, which in turn increases offshore capacity.
2. Transferring a portion of their offshore portfolio to another investment provider or partnering with white-label investment platforms.

3. Exploring JSE-listed Exchange Traded Funds (ETFs) as an alternative. More recently, actively managed ETFs (AMETFs) have gained popularity, with 20 out of the 26 launched in South Africa in the past two years being offshore-focused. These ETFs provide an alternative route for offshore exposure when asset swap limits are reached.

Why ETFs Do Not Count Towards Asset Swap Capacity

A few asset managers have launched ETFs in South Africa. One of the reasons for doing so is that unlike unit trusts and discretionary portfolio management solutions that utilise asset swap capacity, Exchange-Traded Funds (ETFs) listed on the Johannesburg Stock Exchange (JSE) do not count toward asset swap limits. This is because:

1. Regulatory Classification: The South African Reserve Bank (SARB) and the Financial Sector Conduct Authority (FSCA) classify locally listed offshore ETFs as domestic investments, ensuring that they do not fall within the 45% offshore investment cap applied to unit trusts and other offshore investments.
2. Local Inward Listed Structure: Offshore ETFs are available on the JSE and are traded and settled in rands on the local exchange without the underlying fund manager utilising their asset swap capacity.
3. No Offshore Limits: Since ETFs are issued and traded in South African rands, your money doesn't physically leave South Africa, but you gain exposure to offshore markets and foreign currency without being constrained by offshore regulatory limits.

Final Thoughts: Is an Asset Swap the Right Choice for Offshore Investing?

Asset swaps provide an easy and flexible way for South African investors to gain offshore exposure without using their foreign investment allowance. However, they are not a one-size-fits-all solution. Investors should consider their objectives, risk appetite, and the availability of asset swap capacity before proceeding.

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Benefits of Using Asset Swaps

- ✔ No foreign investment allowance used – Investors keep their SARB allowance intact.
- ✔ No SARB approval needed – No need to apply for tax clearance.
- ✔ Lower investment minimums – More accessible than direct offshore investments.
- ✔ Available via trusts and companies – Flexible investment structures.
- ✔ Simple process – Easy to implement via local fund managers and investment platforms.

Limitations and Considerations

- ✘ Regulatory Limits – Asset swap capacity may be restricted due to offshore limits.
- ✘ Limited fund range – Whilst there is a wide range of offshore funds available, investors may not find appropriate funds for specific jurisdiction or investment style they require, or an applicable feeder fund may not be available.
- ✘ Fees – Fees may be higher for an asset swap/feeder fund due to the additional legal, administration and operational costs, as well as potential for company to charge for the use of asset swap capacity.

Financial advisers play a crucial role in helping investors choose the right offshore strategy. By staying informed and proactive, advisers can guide clients through the complexities of offshore investing, ensuring they select the best approach for their long-term financial goals.

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MARKET REPORT

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		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
SA Equity	ZAR	1.9%	2.2%	21.7%	7.4%	14.4%	7.6%	16.1%	14.3%
SA Listed Property	ZAR	-2.3%	-2.7%	19.0%	13.3%	8.3%	1.3%	26.3%	21.3%
SA Bonds	ZAR	0.1%	0.4%	17.0%	9.4%	8.8%	7.7%	9.1%	8.0%
SA Cash	ZAR	1.9%	1.2%	8.3%	7.4%	6.2%	6.7%	0.5%	0.4%
Balanced Benchmark	ZAR	1.6%	1.4%	16.9%	9.2%	12.5%	8.4%	11.3%	9.8%
SA Inflation (1 month lag)	ZAR	0.3%	0.3%	3.2%	5.1%	4.8%	5.0%	1.4%	1.4%
GLOBAL MARKET INDICES BASED TO USD									
Global Equity	USD	0.1%	2.5%	15.7%	10.3%	14.0%	10.0%	17.4%	15.0%
Emerging Markets Equity	USD	2.8%	2.4%	10.3%	0.9%	4.4%	3.3%	18.0%	17.3%
Global Property	USD	-3.4%	4.5%	9.9%	-2.2%	1.3%	2.2%	21.2%	17.1%
Global Bonds	USD	-0.1%	2.0%	2.9%	-2.9%	-2.0%	0.4%	7.8%	6.4%
US Cash	USD	1.1%	0.7%	5.2%	4.3%	2.6%	1.9%	0.7%	0.5%
MAJOR INDICES BASED TO RANDS									
SA Equity	ZAR	1.9%	2.2%	21.7%	7.4%	14.4%	7.6%	16.1%	14.3%
Global Equity	ZAR	2.9%	1.4%	12.0%	17.3%	17.9%	15.2%	15.7%	15.8%
Emerging Markets Equity	ZAR	5.7%	0.8%	6.8%	7.1%	7.9%	8.2%	13.9%	13.8%
Global Property	ZAR	-0.7%	3.4%	6.4%	4.0%	4.7%	7.0%	18.2%	17.3%
SA Bonds	ZAR	0.1%	0.4%	17.0%	9.4%	8.8%	7.7%	9.1%	8.0%
Global Bonds	ZAR	2.7%	0.4%	-0.4%	3.2%	1.3%	5.2%	11.9%	13.8%
COMMODITIES									
Gold (US Dollars)	USD	6.9%	8.5%	38.2%	13.9%	11.8%	8.6%	14.4%	13.6%
Gold (Rands)	ZAR	9.9%	6.8%	33.8%	21.1%	15.6%	13.8%	16.1%	16.7%
CURRENCIES									
Rand / Dollar	ZAR	-3.4%	1.2%	2.8%	-6.5%	-3.5%	-4.8%	13.5%	14.7%
Rand / GBP Pound	ZAR	-2.2%	0.7%	3.0%	-4.4%	-3.2%	-2.7%	11.5%	14.1%
Rand / Euro	ZAR	-1.6%	0.8%	6.5%	-3.9%	-2.3%	-4.1%	11.0%	12.9%

KEY

Asset Class	Represented By:
SA Bonds	Satrix Bond Index Tracker
SA Cash	STeFi
SA Equity	Satrix ALSI Index Tracker
SA Listed Property	Satrix Property Index Tracker
Emerging Markets Equity	iShares Emerging Markets Equity Index Tracker
US Cash	Fidelity Institutional Liquidity The United States Dollar
Global Bonds	iShares Core Global Aggregate Bond ETF
Global Equity	iShares Developed World Index Tracker
Global Property	iShares Developed Real Estate Index Tracker

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Spot Rates		28-Feb-25	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US$	Rand	18.6	18.9	19.2	15.7	11.7	5.8
Rand/GBP	Rand	23.4	23.6	24.3	20.1	18.0	11.2
Rand/EUR	Rand	19.3	19.5	20.8	17.3	13.1	7.7
RATES							
SOFR 6m $	US$	4.5	4.6	5.4	1.7	0.2	2.6
Repo Rate	Rand	7.50	7.75	8.25	6.25	5.75	7.50
Prime	Rand	11.00	11.25	11.75	9.75	9.25	11.00
All Bond Index Yield	Rand	9.8	9.7	11.6	9.6	7.9	9.7
COMMODITIES							
Gold ($/oz)	US$	2,851.3	2,625.4	2,045.5	1,586.7	1,216.6	437.0
Platinum	US$	943.0	914.0	887.0	871.0	1,177.0	864.0
Oil (Brent Crude) $	US$	73.6	74.7	83.8	50.5	61.5	50.0
INFLATION							
SA Inflation	%	3.2	2.9	5.6	4.7	4.0	9.4

data provided by FE Analytics