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The South African forex market is a changing landscape for financial advisers

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Never in history has the environment and market for the exchange of money between currencies changed in such a short period of time! Internationally, we've seen the emergence of fintech companies like Wise (formerly TransferWise) and fintech mobile banks like Revolut, Starling, N26, Monzo, and quite a few more. These fintech companies were all started on the back of efficient, fast and cheap currency transfers all over the world. With the investment universe for the South African investor expanding to the global market over the past 25 years, it has become important for both financial advisers and investors to take note of the South African foreign exchange market and its ever-changing landscape, with the various factors that can influence the process and value of sending money into and out of South Africa.

When transferring any form of value (mainly through money) across an international border, there are normally factors such as tax, financial intelligence reporting and exchange rates that come into play. In South Africa, we have the added complication of exchange control regulations to deal with.

So, it's important to know what to look out for when it comes to each of these factors:

Exchange control

The introduction of exchange control regulations in 1961, and the full limitations in 1985, were intended to limit the flow of capital out of South Africa. Since 1994, these regulations have seen regular relaxations, right up to the present where every individual can send up to R11 million annually (through their Single Discretionary Allowance and Foreign Investment Allowance). Should an individual want to externalise more than the allowed R11 million, they can do a special clearance application for any amount above R11 million.

To add, regulations that prohibit the transfer of foreign currency between residents have been lifted, looping structures are now allowed through approval from the SARB, and inheritance and gifts from offshore can now stay offshore without South African Reserve Bank (SARB) approval. It is, therefore, easy to see that Treasury is committed to its journey of minimising stringent limitations, and making the average South African resident part of the international financial community. Reporting of international transactions will, however, always be important and a requirement, but this function has become more sophisticated and effective through advanced information technology.

SARS and tax

The role of SARS has increased during recent years. It seems Treasury is not only seeing SARS as a watchdog to ensure taxpayers pay their due, but also as an organisation to whom reporting of foreign income and asset movements must be done. Interestingly, all the latest changes to Exchange Control Regulations are "subject to full disclosure and tax compliance". This disclosure will be done annually through your annual income tax return.

It is also important to note the consequences of some offshore transactions, like the transfer of foreign currency between residents that can lead to donations and capital gains tax (CGT), or the set-up of an approved looping structure that can lead to dividends withholding tax. These considerations, the calculations, and reporting and administration of these taxes will be extremely important for investors.

Financial Intelligence Centre (FIC)

The international fight against crime and money laundering has touched every financial transaction in the world, especially the banking industry. The Financial Intelligence Centre Act (FICA) introduced checks and procedures for financial transactions that have led to huge frustration for financial advisers, institutions and their clients. Non-compliance with these procedures has consequences for the South African financial services industry.

In 2003 South Africa joined the Financial Action Task Force (FATF), an intergovernmental organisation acting as the global organisation overseeing global compliance to a set standard of anti-money-laundering regulations and procedures. Being a member of FATF makes the acceptance of financial transactions from a member country easy. South Africa is the only country in Africa that is a full member of FATF.

In 2019, FATF conducted a check on the South African financial industry and published their findings in October 2021. Drastic measures and changes need to be undertaken. The findings showed non-compliance from both the banking and non-banking sector. FATF gave the South African financial services industry until October 2022 to implement corrective measures, failing which the country will be placed on the so-called “grey list”. This would impact the way international payments and transactions into and out of South Africa would be conducted and accepted. Joining the FATF grey list would limit certain transactions out of South Africa, and raise the compliance requirements and cost per client significantly. This can, and will, reshape the landscape for international transactions from South Africa.

The exchange rate – what’s the value of the rand?

Some of the key motivators for the South African investor in non-rand international investments are diversification, access to a bigger investment universe, security against local economic and political upheaval, and protection against the devaluation of the local currency. When converting from rand to an international currency, investors take a ‘snapshot’ of the rand value at a specific time. The value of the rand (determined by the exchange rate) has a significant influence on the future valuation of the investment. Investors and their advisers need to ensure that at the point that the exchange takes place it is done at a good value or exchange rate from which the investment can grow.

We have seen major volatility in in the exchange rate over the past three years, with COVID-19 and the global lockdowns, the war in Ukraine, global inflation and rising interest rates playing their part. There is also the belief in South Africa that the value of the rand will always depreciate, but the past five years showed us that the exchange rate can move in both directions. It is very difficult to "time" when the value of the exchange rate will be good in the short term. Like the equity market, it is a better strategy to have a long-term view on the value of the rand.

The landscape of foreign exchange in South Africa is constantly changing. Certain aspects are becoming easier, through technology, and in some respects more complicated, through the procedures and regulations of FICA. It has also become more competitive and efficient, with the emergence of foreign exchange intermediaries. The aspect, however, that is irreversible and most visible, is that foreign exchange is playing a much bigger and more important role in the personal investment planning of South African citizens. It is, therefore, incredibly important for advisers and investors to take note of the changing landscape of foreign exchange.

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