CLIENT ALERT

Venezuelan Government Announces Addition to Foreign Exchange System

February 19, 2015

On February 10, 2015, the Government of Venezuela announced the creation of a new foreign exchange platform, called "Marginal Currencies System" (*Sistema Marginal de Divisas* or SIMADI). The new exchange control system, which opened at an average price of 170 bolívares per U.S. dollar, constitutes another attempt by the Venezuelan Government to "improve" its strict exchange controls maintained since 2003. It is expected that SIMADI will cause a substantial devaluation of Venezuela's local currency, which may significantly affect companies' sales and operating profits in 2015.

Three different official exchange rates

In 2014, the government introduced a three-tiered exchange structure as an attempt to reduce the gap between the official and parallel exchange rates. In the past three years, this gap between rates has risen from three times to a difference of nearly nineteen times. The exchange control system in Venezuela was divided into the following official rates: (i) CENCOEX at 6.30 bolívares per U.S. dollar, a fixed rate exclusively for food and health sectors; (ii) SICAD I at approximately 12 bolívares per U.S. dollar, for the rest of "non-priority" sectors; and (iii) SICAD II at approximately 50 bolívares per U.S. dollar, a mechanism that operated as a bond market.

With the government's new announcement, SIMADI will replace SICAD II and increase the complexity of the three-tiered exchange structure. While no further details were provided as to how this new mechanism will operate, the Minister of Economy and Finance and the president of Venezuela's Central Bank have indicated that the new platform will be based on supply and demand. SIMADI opened at an average price of 170 bolívares per U.S. dollar, a rate that is substantially higher than the previous rate under SICAD II.

SIMADI is not the first attempt by the government aimed to "ease" the currency control system. When the government introduced the – now disregarded – SICAD II in 2014, it was announced as a newly implemented exchange rate system that would allow the exchange of currency with fewer restrictions than CENCOEX and SICAD I. Given the failure of SICAD II, it is expected that SIMADI will provide no further relief for investors from dealing with the complex and bureaucratic three-tiered exchange structure. Meanwhile, the parallel market rate remains at nearly 190 bolívares per U.S. dollar.

Amounts owed to foreign investors by Venezuela remain intact:

The significant impact of the strict exchange controls on foreign investors in Venezuela has been to strand billions of U.S. dollars in bolívares awaiting repatriation. As a result, many companies have significantly reduced operations into the country, and the value of revenue that they have in bolívares has been exposed to inflation rates of 56 percent and 64 percent in 2013 and 2014, respectively, among the highest in the world. Even if the government manages to liberalize capital flows immediately, either through SIMADI or another mechanism, Venezuela will still be required to allow the exchange of all pending transfers at the rate of exchange applicable on the date they were requested. Moreover, companies may be entitled to compensation for the losses suffered as a result of the delays in repatriating their earnings.

Venezuela's actions in refusing to allow foreign investors to repatriate their earnings in a timely manner likely implicate its obligations under international investment agreements (IIAs.) Depending on how foreign investors have structured their investments into Venezuela, they may be able to use IIAs to seek a negotiated solution or pursue international arbitration against Venezuela to recover those funds and obtain compensation for damages caused.

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