

## ***International Arbitration by Financial Institutions: Current Practices and Opportunities***

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### I. Introduction

Conventional wisdom, largely borne out by past practice, holds that financial institutions are hesitant to submit business disputes to arbitration. In recent years, however, the landscape has changed, and a new report by the International Chamber of Commerce's Commission on Arbitration and ADR has found not only that financial institutions are much more amenable to arbitration than

previously believed, but also that there is an opportunity for financial institutions to make even more effective use of arbitration as its capabilities continue to evolve.

Historically, financial institutions have preferred to adjudicate disputes in national courts in established financial centers, avoiding not only courts in emerging markets, but arbitration venues as well. The global financial crisis of 2008 did much to change financial institutions' perception of the value of arbitration. The crisis resulted in an increase in claims both among and against financial institutions, including an increase in class actions. In many courts of law, these matters were to be heard by jurors or other triers of fact who were expected to be unfavorably disposed towards financial institutions in the wake of the crisis. In addition, post-crisis belt-tightening brought new rigor to dispute cost management. Financial institutions thus cast a fresh eye upon arbitration as an alternative means of dispute resolution.

In response to these developments, the Commission's Task Force on Financial Institutions and International Arbitration (the "Task Force") conducted an extensive two-year study of financial institutions' use of arbitration, announcing its results in a December 2016 report titled "Financial Institutions and International Arbitration" (the "Report").<sup>1</sup> The Report finds that financial institutions' overall assessment of arbitration is more positive than previously thought, and is rapidly changing. Financial

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<sup>1</sup> The Report is accessible at:  
<https://iccwbo.org/publication/financial-institutions-international-arbitration-icc-arbitration-adr-commission-report/>

institutions do have some unique requirements for dispute resolution, but their opinions regarding the advantages and disadvantages of arbitration are now similar to those held by litigants in general. Accordingly, while financial institutions still do not utilize arbitration by default, they increasingly resort to arbitration in disputes for which it is well-suited.

In addition to describing financial institutions' current position regarding arbitration, the Report contains a prescriptive component as well, offering recommendations as to how financial institutions may make better use of existing arbitration features. The Report also analyzes the state of arbitration and its potential for growth in connection with specific types of transactions and products.

## II. Financial Institutions' Current Use of Arbitration

The Report found that arbitration is increasingly prevalent in cross-border banking and investment dispute resolution, as evidenced by a number of developments in the field. Parties to transactions are increasingly opting in to arbitration as a dispute resolution mechanism. According to the Report, arbitration provisions are becoming much more common in trade, export, and project finance agreements. And even where they do not contract for arbitration at the outset of their relationship, parties are more frequently electing to arbitrate disputes after they have arisen.

Arbitration is also increasingly encouraged by international commercial and finance institutions. Some international market exchanges, such as Euronext, refer

to arbitration as a dispute resolution method. The Task Force also noted several industry-specific arbitration initiatives, including the 2013 introduction of optional arbitration clauses into the International Swaps and Derivatives Association's (ISDA) Master Agreement and the establishment of P.R.I.M.E. Finance in the Hague and the Financial List in London, arbitral institutions focused on disputes concerning complex financial transactions. Arbitration initiatives have also been instituted by bank regulators, with examples including the Financial Dispute Resolution Centre (FDR) in Hong Kong, and DIRIBAN, an interbank dispute settlement mechanism created by the *Spanish Banking Association with the support of Spain's central bank*.<sup>2</sup>

Despite these findings, the Report also concluded that international arbitration in the banking and finance sectors is not yet utilized to its full potential. This can be seen in the slow start experienced by P.R.I.M.E. Finance after its launch, and likely results in large part from the lingering view that arbitration is not well-suited to the financial sector. That view, in turn, has been perpetuated by a lack of awareness within the industry regarding arbitration's benefits and, especially, its flexibility.

## III. Advantages of Arbitration

Ready enforceability of arbitral awards under the New York Convention is cited by financial institutions as a substantial advantage over litigation. While enforcement under the New York Convention is not without its difficulties, even in participating countries, a cross-border

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<sup>2</sup> Report, pp. 5-6.

arbitration award is considered far more likely to be collected than a court judgment.

Survey respondents also highly valued the opportunity to appoint arbitrators with sector-specific expertise. This is another advantage over traditional litigation, where the judge presiding over a matter may lack experience with complex banking and financial issues. Arbitrators may also be selected from outside of either party's jurisdiction, and are thus at least theoretically able to provide politically neutral adjudication. This factor also contrasts favorably with litigation, where the court is typically located in one party's home jurisdiction. Neutrality is particularly attractive to multinational organizations and other parties operating in developing countries.

Arbitration also offers much greater procedural flexibility than litigation. Parties can choose, in advance or at the time a dispute arises, their preferences in arbitrator selection, the language in which proceedings are conducted, and the governing procedures. The Report notes, however, that few financial institutions are aware of the adaptability that current arbitration practice can provide, especially the ability of the parties to tailor procedures to their needs before, or even during, the case. Even those who were aware of the flexibility of arbitration expressed interest in receiving clear counsel on how arbitration procedures may be customized. In particular, financial institutions should be aware of the recent trend toward more robust preliminary and summary procedural options, which are being offered by more and more arbitral institutions and can replicate

some of the most attractive features of national court systems.<sup>3</sup>

While confidentiality is generally seen as a benefit of arbitration, in the realm of international banking and finance, attitudes towards confidentiality vary by sector. In the areas of M&A, asset management, and banking advisory services, confidentiality is paramount. In other areas, however, including derivatives and syndicated lending, financial institutions seek a high level of standardization. In these areas, the desire for controlling precedent often takes primacy over the benefits of confidentiality. These parties may seek agreement with their adversaries to permit the publication, possibly in redacted form, of an award which would otherwise remain confidential.

Finally, arbitration's limitations on appeal are also viewed favorably by users in the sector. Unsurprisingly, survey respondents condition their enthusiasm for finality on whether the underlying proceedings are perceived as fair. But provided that they are, finality of awards is a prized feature, and while some financial institutions did express interest in having some process for appeals from arbitral awards, provided that all parties clearly consent to it, many arbitral institutions are now offering just that capability.<sup>4</sup>

The Commission's conclusions regarding the perceived benefits of international arbitration are in line with those of

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<sup>3</sup> See ICC Rules of Arbitration, Article 28: "Conservatory and Interim Measures."

<sup>4</sup> Report, pp. 9-10; see also International Centre for Dispute Resolution (ICDR) Optional Appellate Arbitration Rules, Effective November 1, 2013.

other commentators. A recent conference of international practitioners and jurists convened by the New York State Bar Association cited arbitrator neutrality and expertise, flexible and streamlined procedures, confidentiality, and enforceability under the New York Convention as advantages of resolving international disputes by arbitration in lieu of litigation. Accordingly, the conference concluded that countries desiring to attract foreign business should enact strong policies in support of arbitration.<sup>5</sup>

#### IV. Perceived Limitations of Arbitration

While the Report identifies a number of financial institutions' reservations toward arbitration, it also notes that these concerns may be addressed by recourse to the appropriate arbitration rules, or by stipulation between the parties.

Financial institutions are wary of the need to file court actions to obtain interim relief at the outset of a dispute that will ultimately be decided by arbitration. However, most arbitral procedures, including the ICC rules, now provide for the appointment of an emergency arbitrator who is authorized to make interim orders.<sup>6</sup>

Arbitration is also disfavored due to a perception that summary or default relief is unavailable, but arbitration tribunals increasingly are moving to consider dispositive

motions or to hear claims on an expedited or limited basis, and such procedures may of course be agreed by the parties in their transactional documents.

Parties to complex transactions worry that they will be subject to numerous separate arbitrations stemming from the same transaction, without recourse to consolidation procedures. However, the ICC rules permit a party to move to consolidate related arbitrations under specified conditions.

While this may come as a surprise to many U.S. practitioners, some financial institutions, located in jurisdictions with streamlined legal procedures, actually view arbitration as a costlier alternative to litigation. The Report notes that there are various cost management techniques available in arbitration, a topic on which the Commission has previously published guidance. The rise of third-party funding has also provided a new means of dispute cost management. Finally, costs of arbitration are now being controlled by the dissemination of arbitration expertise to a wider range of firms and the growth of new entrants in the practice.

Some survey respondents informed the Task Force that they view arbitration as an opaque process operated by an exclusive group of practitioners. Accordingly, they prefer the familiar and relatively transparent process of traditional litigation. The Report states that ICC has recently undergone reforms for the sake of transparency, including a recent decision to publish the names of

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<sup>5</sup> See "Conference Report: What's New in International Arbitration and International Litigation: View from the Bench and International Lawyers," *NYSBA International Law Practicum*, Spring 2015, Vol. 28, No. 1.

<sup>6</sup> See ICC Rules of Arbitration, Article 29: "Emergency Arbitrator."

arbitrators in newly-filed claims, unless there is an objection from the parties.<sup>7</sup>

V. Financial Institutions' Preferences in Conducting Arbitration

Most of the interviewed financial institutions had no set policy or guidelines concerning the use of arbitration. However, a series of preferences were prevalent among the respondents.

According to the Report, most financial institutions prefer institutional arbitration to *ad hoc* proceedings, due to institutions' well-settled procedures and demonstrated experience handling complex disputes. The respondents also generally prefer three-member arbitration panels, in which the tribunal's president is appointed by the two arbitrators initially chosen. The use of a single arbitrator is typically deemed acceptable for simpler claims. Commonly-stated criteria for arbitrators include industry expertise, responsiveness, practicality, language skills, and impartiality.

The Report also noted several types of arbitration clauses which appear to be rarely used by financial institutions. The survey respondents generally disfavor multi-tiered arbitration clauses, in which some other form of alternative dispute resolution, such as negotiation or mediation, is required to precede arbitration. The Report further concludes that asymmetrical or unilateral arbitration clauses, in which one party is bound to a predetermined jurisdiction and the other is free to choose a competent jurisdiction, were previously common but are

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<sup>7</sup> Report, pp. 10-11.

falling into disuse due to legal challenges to their enforceability.<sup>8</sup>

VI. Findings Regarding Specific Transactions and Products

In addition to its general conclusions, the Report addresses in detail a wide range of corporate and investment banking fields, including derivatives, sovereign lending, regulatory matters, Islamic finance, multilateral and development finance, and advisory banking. This section summarizes the Report's findings regarding some common types of commercial transactions, including financial instruments, international financing, and asset management.

a. International Financing

In this field, the Report concludes that financial institutions' approaches to arbitration vary according to the type of transaction at issue. Financial institutions are notably hesitant to use arbitration in disputes arising from syndicated lending or asset finance, preferring national courts unless the governing jurisdiction's courts are deemed to be unreliable. However, the Report notes that there has still been a measurable uptick in international arbitration in this area, and the adaptability of arbitral procedures discussed above holds out the promise of even more development of competencies here..

In trade finance, the Task Force could not identify a consistent preference for either arbitration or litigation. Instead, financial institutions choose a dispute resolution method based on the applicable circumstances. In the

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<sup>8</sup> Id., pp. 8-9.

aggregate, though, it appears that trade finance counterparties are also turning to arbitration in greater numbers, primarily for reasons of expertise and cost. In the field of project finance, financial institutions are more prone to arbitrate disputes, as these transactions often involve parties located in jurisdictions where courts are considered inadequate, and arbitration offers well-developed adjudicator expertise in the field.

With regard to secured transactions, the Report states that financial institutions traditionally avoid arbitration of disputes relating to security agreements, as they assume that they must be heard by national courts. The Report, however, disagrees with the notion that such disputes are generally not arbitrable, noting that wherever the security at issue is self-enforcing, a dispute concerning it may be arbitrated, and only certain types of enforcement proceedings must necessarily take place in court.<sup>9</sup>

b. Asset Management

The Task Force found not only that arbitration is rarely used in the field of asset management, but that few of the financial institutions surveyed were even aware that arbitration was available to their industry. For the respondents who did hold opinions on arbitration, its perceived benefits and drawbacks mirrored those expressed by financial institutions more generally.

The Report offers several benefits of arbitration which the asset management industry should find particularly compelling. In light of the frequent need to make reference to trade usage in disputes arising from asset

management, the specialized expertise offered by arbitrators with a background in the field should provide a marked advantage over litigation. Also, considering the power imbalance between parties to asset management relationships, as well as the potential for political influence on disputes between parties from different countries, the neutrality offered by arbitration venues should be considered attractive. Finally, confidentiality should be valued both by asset management providers, who do not wish to publicize client disputes, and by the clients themselves, who may not want their financial positions revealed in litigation.<sup>10</sup>

c. Financial Instruments

Among other issues in the field of investment arbitration, the Report places a focus on the availability of arbitration regarding financial instruments. As detailed in the Report, investment arbitration has grown exponentially over the past several decades in the wake of the proliferation of thousands of bilateral investment treaties, which commonly refer to financial products and grant important protections that are enforceable through arbitration, including defenses against arbitrary or politically-motivated actions by bank regulators.<sup>11</sup>

In several recent awards, arbitral tribunals have found that various types of financial instruments qualify for protections granted by their applicable treaty, including straightforward loans, negotiable instruments, sovereign bonds, and oil price hedges. Accordingly, disputes

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<sup>9</sup> Id., pp. 17-18.

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<sup>10</sup> Id., pp. 21-22.

<sup>11</sup> Id., p. 13.



related to these instruments may be arbitrated even where their governing contracts do not contain arbitration clauses. The Report, however, cautions financial institutions against assuming that treaty protections apply to their own products, as their applicability will be dependent upon the terms of the treaty and the relevant facts. In addition, the decisions noted in the Report were issued in the last few years, and may be contradicted by subsequent awards, or by treaty negotiations. Parties are advised to monitor the law in this area as it develops.<sup>12</sup>

## VII. Conclusion

Thus, on the whole, the Report sounds an optimistic note regarding the potential for international arbitration to play an increasingly robust role in the resolution of financial disputes. While some participants in the international financial sector remain reluctant to send disputes to arbitration, many of its perceived defects are in fact illusory. Financial institutions stand to benefit substantially from increased use of arbitration, and from proceedings that are properly tailored to suit their needs.

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<sup>12</sup> Id., pp. 7, 14-15.