AFFAKI
Société d'avocats

INSIGHT

November 2016

Arbitration in Banking and Financial Disputes Deconstructed

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FIRM IN NEWS

AFFAKI AVOCATS was ranked by Euromoney in the 2016 Guide to the World's Leading Experts in Commercial Arbitration, the international legal market's leading guide to the top legal practitioners in commercial arbitration.

28 October 2016 *click here to view*

Dubai Arbitration Week

Georges Affaki will present his remarks on arbitration in financial disputes at the ICC Event.

16 November 2016 *click here to view*

International Center for the Settlement of Investment Related Disputes (ICSID), Secretariat Conference

Georges Affaki will present his remarks on banking and financial instruments as qualifying investments in the recent investment arbitration experience.

10 January 2017 *click here to view*

Swiss Arbitration Association (ASA) Annual Conference 2017

Georges Affaki will present his remarks on Shaping Arbitral Proceedings to Best Examine Damages Claims.

3 February 2017 *click here to view*

PREVIOUSLY ON INSIGHT

The Greek Sovereign Debt Rescheduling, EU Bail-in and Investment Arbitration

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The New ICC DOCDEX Rules: Dispute Settlement Becoming a Friendly Act

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Arbitration in Bank Regulatory Matters

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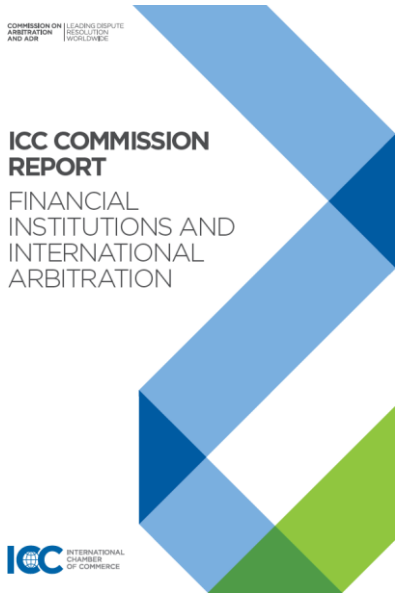
Arbitration in Banking and Financial Disputes Deconstructed

Deconstruction is not *destruction*. According to French philosopher Jacques Derrida who coined the term in its modern use, *deconstruction* consists in the analysis of the sedimented structures that form the discursive element. It is precisely in the conceptual contrast between the discursive and the intuitive reasoning methods that lie the distinctive features of the report released today by ICC on *Financial Institutions and International Arbitration*[1]. Two years of empirical research and countless interviews both of banking and of arbitration practitioners allow to affirm with certainty that the oft-cited financial institutions' averseness to arbitration, abstractly stated, is rebutted by evidence. The new report evidences this finding and offers deep insights into the specialized world of banking and financial arbitration.



And the matter is rapidly evolving in reflection of the fundamental changes in banking practices and regulation in the wake of the global financial crisis, the sovereign debt crisis, the digitalization of banking, and the new regulatory approach to bank resolution. With the new data disclosed in the report, arbitral institutions are in a strong position to engage with financial institutions and their regulators with a view to leading a mutual opening of arbitration to banking and of banking to arbitration. Both worlds will greatly benefit of the results.

Adopted unanimously by the ICC Commission on Arbitration and ADR on 17 September 2016 and endorsed by the ICC Banking Commission on 9 November 2016, the report crowns intense work of an unprecedented breadth. The background to the project, its methodology, and its main findings are summarized below.

The reasons for the project. Contrary to other economic sectors such as construction, mining and energy, banking and finance seem until recently to have been less perceptive of the advantages of international arbitration. Emboldened by years of uninterrupted growth in revenue and market share, a quasi-mandatory use of their financial intermediation services for any access to the markets or for financial advice, and adequately serviced by commercial courts in the main financial centers in the world where judges have developed an acute understanding of complex financial disputes, financial institutions felt that it was less urgent to explore the arbitration alternative.

This is profoundly changing. The avalanche of regulatory, liability and recovery litigation that accompanied the

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global financial crisis, the rebalancing of market equilibrium decisively in favour of emerging markets, and the quest for an expert, private and neutral jurisdiction that would be sufficiently flexible to adapt to the variable parameters of banking's core métiers have all contributed to presenting arbitration in a new light. Provided that the arbitration offer adapts to the realities of banking, an immense potential will ensue to the benefit both of financial institutions and their customers. Both the initiative of the Hong Kong banking and securities regulators jointly working with the Hong Kong International Arbitration Center to set up an optional mediation/arbitration mechanism dedicated to banking disputes[2] and the advent of an optional arbitration mechanism in ISDA's Master Agreement that is used worldwide in OTC derivatives[3] evidence the new reality.

The methodology. Building on previous works,[4] the international Task Force constituted under the aegis of the ICC Commission on Arbitration and ADR ascribed to itself a strict methodology where intuitive preferences had no place. First, the Task Force proceeded to taking stock of the reality of the use of arbitration in banking and financial disputes through a methodical review of statistics contributed both by 13 arbitral institutions and by financial institutions' own internal data, interviews with banking and arbitration practitioners in five continents, and an in-depth examination of relevant investment and commercial arbitration awards. To that end, ICC set up a database compiling the data received by the Task Force and referencing both the relevant publications in the field and the published arbitral awards dealing with the topic. Those archives will arguably be of significant interest to academics interested in pursuing related research.

In determining its scope of work, the Task Force ambitiously decided to cover all the fields of corporate and investment banking, as well as both investment and commercial arbitration. This choice of a broad scope and the reality that banking is not a one-size fits all have required of the Task Force to divide its work in 12 streams. Each stream was tasked with the examination of the reality of the use of arbitration, its challenges, and how best to foster a broader use of arbitration in the specific banking sector ascribed to it. Those streams are: derivatives, sovereign lending, investment arbitration and banking instruments, arbitration in bank regulatory matters, international financing (including syndicated loans and trade finance), Islamic finance, multilateral and development finance, advisory banking, asset management, and interbank arbitration. The specific dynamics in each stream were studied separately, discussed collectively, and upstreamed for a global compilation in the final report which offered both general and stream-specific recommendations for a better use of arbitration in banking and finance.

The report. The report itself comes in two volumes. The first volume synthetically

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presents the global findings of the Task Force and a summary of the findings of each stream. It is available both in paper and in soft copy on line on the ICC website. The second volume, available on line only, offers an analytical study into each stream's field of research. Both volumes are complementary.

The report starts by setting the record straight as concerns the use of arbitration in banking and finance. Financial institutions use arbitration. They do so in situations requiring the expert decision of a neutral jurisdiction which, in nonpublic proceedings, is open to accommodating the special procedural expectations of the parties, their shareholders and their regulators, including as to the selection of the arbitrators. Multiple examples were identified by the Task Force in project finance involving sovereign counterparties in emerging countries, in derivatives in certain regions of the world, notably in Asia, in sensitive capital restructuring and mergers/acquisitions, in certain multilateral loans benefiting of public support, in asset management, etc.[5] However, the report also notes that financial institutions neither use arbitration regularly nor as a default rule. During the interviews that it conducted, the Task Force noticed a lack of sufficient information at various levels of the risk control functions and business lines as to the multiple components of the arbitral offer as it stands today. That finding was particularly stark as concerns the immense potential for party autonomy that financial institutions and their counterparties enjoy when crafting the arbitral procedure to suit their particular needs.

An important contribution of the report is that it offers financial institutions and their

counsel the key to an expert decision as to when, where and how to choose arbitration in their dealings and how best to adapt their choice to the requirements of the transaction. It lists the many features that make arbitration today so efficient and attractive for businesses. These include the international recognition and enforcement of awards amongst the 160 New York Convention member countries, the selection of the arbitrator(s) who will adjudicate the case, a much broader reliance by tribunals on industry customs and practice, the adaptability of the arbitral procedure potentially offering an opt-in appeal if so chosen, the possibility to obtain from the tribunal provisional measures and early dismissal of claims, the support of arbitral institutions before, during and after a tribunal is empaneled, and the limitation of class action risks because of the contractual foundation of arbitration. In underscoring the flexibility of arbitration, the report emphasizes its potential accommodation both of the expectation of confidentiality in certain banking businesses, such as advisory banking, and of standard-setting precedent publication that other banking businesses, such as syndicated lending and derivatives, require to control risks in their field.

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The report also offers model clauses and cross references other ICC publications that deal with technical aspects of arbitration. Particular emphasis is put on reviewing and proposing techniques for controlling time and costs in arbitration, a leitmotif that was consistently raised in the interviews conducted with financial institutions for the purpose of establishing the report.

In particular, the report offers an unprecedented insight into the opening of investment arbitration to banking and financial instruments. In the past decade, investment arbitration awards have recognized in financings, the operation of bank networks and the issue of sovereign bonds, bank guarantees and derivatives the qualifying elements of protected investments. Barring a particular carve-out in the applicable investment treaty, a dispute between an investor (often a financial institution or its foreign shareholders) and the host State in relation to those instruments becomes potentially eligible to the protection of the treaty and to adjudication by an international arbitral tribunal even though the relevant banking contract may not include an arbitration clause.

Similarly, recent awards prompted a giant leap forward in the openness of arbitration to banking and finance when they allowed banks and their shareholders to seek vindication before international arbitral tribunals for expropriatory or discriminatory actions by national bank regulators which were either prompted by political motives or have denied their right to due process. With the recent introduction in Europe of bank resolution rules granting extraordinary bail-in powers to the resolution authorities, investment arbitration is very likely to be of interest to bailed-in creditors and shareholders of failing banks.

What's next? The end of the Task Force's assignment with the adoption and the publication of its report is in reality the beginning of its mission, namely, conducting the necessary educational action, in combination with arbitral institutions and federations of financial institutions, with a view to establishing the basis of a constructive dialogue fostered by the new findings published in the report. The advantages of arbitration need to be understood and compared with the advantages of court litigation. Giving financial institutions the tools for a knowledgeable choice is what the new report seeks to achieve, thus heralding in new era in banking and financial dispute resolution.

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[1] Georges Affaki co-chaired with Claudia Salomon the Task Force that drafted the report. A list of acknowledgments of the Task Force members features in the report, now freely available on the ICC website.

[2] http://www.fdrc.org.hk.

[3] 2013 ISDA Arbitration Guide, freely available on the web.

[4] See for instance the Report of the French Arbitration Committee on Arbitration in Banking and Financial Arbitration (2014), chaired by Georges Affaki, and freely available at http://www.cfa-arbitrage.com.

[5] The report also identifies two further situations where banks use arbitration. First, the situation where banks succeed, as a result of an assignment, a subrogation or a step-in, to other persons which were initially parties to contracts providing for arbitration. Secondly, the situation where banks act like any other going concern without any idiosyncratic banking aspect, such as in procurement contracts and in disputes with their shareholders. The latter case is illustrated by the well-known Bank of International Settlements award rendered under the aegis of the Permanent Court of Arbitration in 2003 (award available on the PCA website).

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