INSIGHT

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Arbitration in Bank Regulatory Matters

Readers considering that the title subsumes an oxymoron are entitled to hold this view. True, the appetite for arbitration in banking and finance is increasing in the wake both of the global financial crisis and of recent investment arbitration forays in bank instruments. But there must be, it is argued, a no-go area, a part of bank practice that remains inherently inarbitrable. Regulatory matters must be one of them. After all, when interviewing a financial market regulator a year ago during public hearings that I held while chairing the CFA working group on arbitration in banking and financial matters, she replied: "Arbitrators repair by awarding damages; regulators sanction!"

Bank regulators use their statutory enforcement powers to exercise their regulatory prerogatives on regulated entities, just like law enforcement authorities use theirs in investigating wrongdoings and charging the accused parties. Because arbitration rests on contract and regulators are unlikely to agree to an arbitration clause in their dealing with regulated entities, it is difficult to conceive how redress could be sought before an arbitral tribunal in case of abuse. Or is it the case?

What if the target of the regulatory action is a foreign investor, including a foreign shareholder of a local bank entity, a national of a country linked with the State of the regulator by an investment protection treaty that allows recourse to arbitration in the case of an action by the host state that is akin to expropriation, an infringement of the fair and equitable treatment standard or a violation of the duty to accord full protection and security to investments? Then surely the wronged investor should consider arbitration as an option to seek reparation. The lack of arbitration agreement would bar recourse to international commercial arbitration, but the bilateral investment treaty is a valid consent by the host state to arbitration.

In the *Deutsche Bank* case (ARB/09/2), the ICSID tribunal considered that the various actions by the Sri Lankan Central Bank against Deutsche Bank (essentially investigating protractedly the bank and issuing an order prohibiting payments to the bank under the hedging agreement) amounted to an expropriation of the bank's claim to debt under the hedging agreement. In the *Renée Rose Levy de Levi* case (ARB/10/17), the ICSID tribunal considered likewise that a foreign investor's equity stake in a Peruvian bank is an investment within the scope of the relevant protection treaty, but declined to consider the action of the central bank in ordering the liquidation of the bank for numerous safety and soundness failures as an expropriation of the investment. Other claims are currently pending before other arbitral institutions in relation to monetary

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authorities' actions concerning the Cypriot bail-in or the debt conversion in the Greek sovereign debt rescheduling.

Contrary to commercial arbitration where an agreement is sufficient to crystallize the jurisdiction of the arbitral tribunal over the dispute, resorting to investment treaty arbitration also requires the characterization of an "investment" in accordance with the relevant protection treaty and, according to the "double-barreled" doctrine, to article 25 of the ICSID Convention as well. Claimants can nonetheless derive comfort from the current trend of hardy investment awards recognizing a broad array of financial instruments as "investments": bank loans, negotiable instruments, bonds, guarantees, derivatives, etc.

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