Are banks making the most of arbitration?

The ICC publishes its report on the use of international arbitration in financial disputes.

Litigation has traditionally been the forum of choice for dispute resolution in international finance. This preference for litigation prompted the International Chamber of Commerce Commission on Arbitration and ADR (the ICC) to set up a Task Force to study financial institutions' perceptions and experience of international arbitration. The report, published on 9 November 2016, is the product of interviews with approximately 50 financial institutions and banking counsel.

Key Findings

The Task Force found that, while financial institutions do use arbitration, it is not used on a consistent or large-scale basis. The interviews revealed a general lack of awareness of the potential benefits of arbitration and misconceptions about the process and its suitability for certain aspects of the banking sector. The result has been that - in the Task Force's view - the full potential of arbitration as a means of resolving finance disputes has not been maximised.

There is of course variation across the range of banking and financial activities. The report notes that project finance often uses arbitration, because of the involvement of parties and assets located in jurisdictions that are perceived by lenders as being inadequate to handle the disputes that may arise in such transactions. The possibility of appointing arbitrators with financial expertise is cited as being beneficial for disputes arising from derivative transactions. Neutrality is an attraction particularly in sovereign finance. Confidentiality, enforceability and finality are identified as advantages of arbitration across the board. On the other hand, lack of precedent-setting, transparency and summary procedures are seen as negatives, and the cost of arbitration is also a concern in some jurisdictions.

Potential areas of development

Of particular interest is the work undertaken in relation to the perceptions and use of arbitration as between the different banking and financial activities. According to the Task Force, this has revealed the untapped potential of international arbitration.

Islamic finance: This was identified as an "*untapped area*" for international arbitration; attempts to promote arbitration in this area have gained "*very little traction*" among major Islamic banks. This is surprising given the importance of compliance with sharia (Islamic law) in Islamic finance transactions, and the advantages that arbitration offers in that context. Unlike in litigation (where many national courts are limited to applying national laws only), arbitrators are able to respect the parties' decision to subject a dispute to sharia principles. In addition, arbitration permits the appointment of specialists in Islamic finance and sharia law.

International financing: This is where the preference for litigation over arbitration appears to be strongest. This "*marked reticence*" to use arbitration is particularly noted in syndicated lending and asset finance, whereas arbitration is being used in international project finance in emerging markets. However, attitudes are slowly changing, particularly where financial institutions are dealing with assets located in jurisdictions where the courts are perceived as unreliable, the parties cannot agree on a choice of jurisdiction, or in multi-party disputes involving several jurisdictions.

Advisory matters and asset management: Arbitration is not commonly used despite the neutrality and confidentiality it offers, and the ability to appoint a decision maker with the relevant knowledge and experience to resolve the complex disputes that commonly arise.

Derivatives disputes: Arbitration is being used where counterparties are established in emerging markets or where counterparties suggest its use. However, arbitration was still not considered as the "*default*" dispute resolution option in a "European" context, despite its recent promotion by ISDA.

Will the report encourage greater use of arbitration?

The report attempts to dispel misconceptions about arbitration and makes recommendations as to how financial institutions can tailor arbitration procedures to suit their specific needs. For example, parties can expressly authorise tribunals to dispose of claims on a summary basis, and can encourage arbitral institutions to publish redacted awards in order to promote transparency and consistency.

The report is a useful addition to a growing body of work and initiatives to encourage the use of arbitration in the finance sector. It will help increase awareness of the possibility of using international arbitration in areas of banking and finance which have traditionally resolved disputes via national court litigation. And other recent developments, including the introduction of summary procedures by some arbitration institutions and the uncertainty created by Brexit on the issue of enforceability of English court judgments, may tip the balance in arbitration's favour in some situations.

However, whether a particular forum is appropriate for resolving disputes will depend on the particular circumstances of the transaction. This requires those negotiating the contracts to give careful thought to their dispute resolution procedures at the transaction stage. That will only happen if the institution has guidance in place to direct the negotiators to the most appropriate forum. Significantly, the report found that many of the financial institutions do not have an internal policy or precise guidelines on when to use arbitration (although several have adopted a regional approach). Without such guidance, it is unlikely that we will see a marked increase in the use of arbitration, at least for the foreseeable future.

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