Financial Institutions and International Arbitration – Asset Management

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General Considerations

In the context of the series of posts dedicated to the Final Report of the ICC Task Force on Financial Institutions and International Arbitration, this post aims at providing a broad picture of the scope, survey and conclusions related to the use of arbitration in disputes involving asset management matters.

As a matter of consideration of the general background, in the banking and finance industry the asset management represents a non-negligible sector. For illustrative purposes only, the website of one single asset manager advertises the existence of assets under its supervision (this includes assets under management and other client assets for which that institution does not have full discretion) worth 999 billion USD, with investment solutions including fixed income, money markets, public equity, commodities, hedge funds, private equity and real estate. Hence, the dimension and complexity of issues potentially arising therefrom are of considerable importance for the banking and finance activities at large.

In the first article dedicated to arbitration in asset management that has come to our attention, Laurent Levy defined asset management as consisting of "…

custody, administration and management of assets which the client entrusts to the bank [or the other financial institution] which shall receive a compensation" [fn]Laurent Levy, *Arbitration of Asset Management Disputes*, in ARBITRATION IN BANKING AND FINANCIAL MATTERS, 89 (G. Kaufmann-Kohler and V. Frossard, eds., 2003).[/fn], involving several components and being conducted in the following areas: a) custody; b) administration; c) acquisition and disposal of assets; and d) management.[fn]See also Francisco G. Prol, "El Arbitraje Financiero: Una Aproximación desde España," in "Revista de Arbitraje Comercial y de Inversiones," edition of "Centro Internacional de Arbitraje, Mediación y Conciliación" (CIAMEN) de Madrid, Vol. VI, 2013 (3).[/fn] Notwithstanding this description, one might resort also to the standards of the ISO (the International Organization for Standardization), as revised in its "ISO 55000" for asset management.

Although seemingly focused on "physical" assets, a closer reading of the first definitions may lead us to consider that an asset is an item, thing or entity that has potential or actual value to an organization. Therefore, the definition encompasses all kinds of assets, including financial assets. Thus, the "ISO 55000" definition of "asset management" may be applicable in this context: asset management is the "coordinated activity of an organization to realize value from assets." Furthermore, it may be said that "asset management" is a systematically performed process of the long-term maintenance of assets, with the objective of using the assets to produce the best results.

In the finance and banking industry, "asset management" is a process which aims to substantially expand the client's financial portfolio. In order to do so, this process combines research, interviews, and statistical analyses of companies, markets, and trends, including evaluating asset financing options, asset accounting methods, productions operation management, and maintenance discipline in order to maximize a client's financial portfolio value.

The survey on the use of arbitration in asset management

As a result of the research and enquiries done over the course of the works of the Task Force, it was not possible to conclude for a single approach that the players in asset management have towards the use of arbitration. We provide below a summary of the results of the survey conducted under the auspices of the Task Force.

Indeed, when the interviewees were asked whether the special character and

nature of Asset Management and Private Banking have a significant bearing on the determination to use a certain type of dispute resolution system (i.e., state court litigation or arbitration), the answers ranged from “not necessarily,” or a simple “no,” to a clear positive recommendation of “arbitration as an adequate dispute resolution system in disputes between investment firms” although one interviewee was “more reluctant in relation to disputes between an investment firm and a retail client” to recommend arbitration.

When asked whether advisory and discretionary services in asset management raise any special concerns, and whether they play a role when making the determination to use arbitration to resolve disputes as opposed to traditional litigation, the answers ranged from a simple “unsure” or “no”, to a statement on the opposite end of the spectrum which suggested that instead of resorting to an institutionalized system of dispute resolution, the “nature of the services would be better protected in an arbitration procedure”. For some interviewees, the regulatory framework which applies to advisory and discretionary services in asset management may present an advantage, and may further support the use of arbitration.

Considering the question whether it would be advisable to use arbitration as a means of dispute solution in the context of asset management, generally speaking, the interviewees did not recommend the use of arbitration unless it is absolutely necessary due to the complexities inherent in the dispute. Concerns were raised because “one might anticipate problems in selecting an arbitral mechanism that is perceived as fair and impartial by the client, besides doubts about the arbitrability of such disputes (retail client as a consumer?).

As the question whether it would be advisable to use arbitration as a means of resolving asset management disputes between investment firms, with a professional client or an eligible counterparty, some interviewees expressed the view that disputes virtually never escalate, particularly up to the point of court proceedings. It is the modus operandi / “market practice” that even parties who are competitors in this field do not litigate against each other. Therefore, arbitration was not seen as having a major role in this field. On the other hand, this view was not shared by others, who recommend the use of arbitration among investment firms, and with eligible counter-parties. This lack of unanimity was also shown in cases where a dispute might arise between an investment firm and a retail client.

Finally, one interesting feature available in the international arbitration setting is the unilateral or asymmetrical arbitration clause, the use of which the interviewees were not much inclined to resort to, mostly because it may be considered invalid and unenforceable in some jurisdictions, or otherwise viewed as being biased in favor of the financial institution drafting the clause, or even bringing more complexity to the matter and possibly require additional advice.

Typical disputes in asset management

In order to properly ascertaining the use of arbitration in asset management matters, one must look at the issues that commonly arise in this context. The typical disputes are of course of a primarily contractual nature, giving rise to contractual liability.[fn]Laurent Levy, Arbitration of Asset Management Disputes, in ARBITRATION IN BANKING AND FINANCIAL MATTERS, 106 (G. Kaufmann-Kohler and V. Frossard, eds., 2003).[/fn]

However, when analyzing the cases where a dispute typically arises in the context of asset management, one should keep in mind the common features of this activity, which involve the setting of goals, the allocation of funds, the setting of a strategy and the monitoring of that strategy. Typically, asset management involves investments or specific advice regarding whether to invest, which are consequently subject to processes of decision-making. These processes are, in turn, subject to several factors associated with the prediction of the financial portfolio's performance. This performance may suffer due to changes in those factors but may also be impacted by wrong assessments and decisions (or advice provided in this context) along the way. Consequently, it is fair to assume that typical disputes in asset management involve issues related to misrepresentation, lack of consideration, and mistake. In addition, misappropriation, possible force majeure/fait du prince, an unexpected change in circumstances, and a change in regulation(s) may also appear as the subject matter of an asset management dispute.

Issues of the scope of the management agreement contract between the bank and the client may be at stake. According to the plain meaning of the agreement, considered together with trade usage and the special instructions of the client, one may ask whether the bank's actions were within the scope of the agreement. Going even further, what if the mandate is restricted to "common bank investment instruments"? And furthermore, what are "common bank investment

instruments”? Are they comprised of security lending? Over-the-counter instruments? Financial futures? One may also ask: was the bank authorized to enter into any of these transactions?

Key benefits of arbitration in asset management

The issues mentioned above reinforce the idea that resolving disputes in asset management requires a decision-maker with a sufficient level of skill(s) and expertise, which may not be available in courts in many jurisdictions around the globe.

Arbitration has the potential to provide a decision-maker who has the expertise the parties determine is desirable for a particular transaction or dispute. Arbitration also seeks to ensure that the decision-maker is neutral, which is particularly important for asset management disputes connected to two or more jurisdictions.

Arbitration is ideally suited to safeguarding the confidentiality of the proceedings and of the
dispute itself, which is particularly important for asset management providers who do not wish to have their identities revealed, especially in the case of a breach or fault, and for clients
who do not want to have their financial positions exposed.

As discussed in the introductory post, confidentiality can be protected and preserved through a careful analysis of the legal and institutional regulatory framework applicable to the arbitration proceedings, as well as through the drafting of arbitration clauses and other agreements to ensure that all stages of the proceedings and all participants comply with confidentiality duties and requirements.