Preface

The International Financial Products and Services Committee ("IFPSC") publishes a newsletter on a quarterly focusing on new international and comparative legal, regulatory, and supervisory issues related to financial institutions worldwide.

The next Issue of the IFPSC’s newsletter will be issued in June 2017.

If you have any comments or are interested in taking a part of the next newsletter or any other IFPSC’s publications, please do not hesitate to contact the Publications and Year-In-Review Vice-Chair at IFPSC who is currently:

Mohamed Hashish
Partner
Soliman, Hashish & Partners, Egypt
m.hashish@shandpartners.com

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I. Introduction

A condo hotel is an operating mode of economic activity. In practice it is a hotel where the property is shared by a condominium of investors that jointly finance the project and are remunerated in proportion to their respective participation by the operating results of the project, which is administered by a hotel operator.

From the perspective of the entrepreneurs, who plan and will manage the hotel, a condo hotel is a mode of financing the project. Those who build and manage the hotel aim to be remunerated for their services, but first someone must finance it. In this sense, the condo hotel appears as an alternative to implement the project.

For those who finance the project, the condo hotel is a form of investment. The ownership of the condo hotel is in general restricted to economic purposes. Therefore, the person that decides to invest funds in this type of real estate project has the main goal to monetize money. This article will examine the investment side of the condo hotel.

II. Market participants

In all its stages, from planning, marketing, fundraising, incorporating and operating the hotel, the market for condo hotels involves different stakeholders, each with their interests, roles and responsibilities. The market participants are the following:

(a) the Developer (development company): the company responsible for planning, designing and launching the hotel project as well as for the promotion and construction of the hotel, even if it hires a construction company. In this process, the Developer takes care of the documentation, the contracts and the works and also the marketing, although usually it retains third parties, which may be a real estate brokerage house or a group of brokers (Realtors), to intermediate the sales. The Developer has an active role throughout the period of the distribution offer of the project to the investors, until the delivery of the works and the beginning of the management of the hotel. It is liable for complying with the applicable laws such as the Condominium and Units Development Law (Lei de Condomínio e Incorporações), the Brazilian Civil Code (Código Civil) and the Brazilian Consumer Protection Code (Lei de Defesa do Consumidor).
Consumidor), and the regulations issued by the Brazilian Securities and Exchange Commission (Comissão de Valores Mobiliários - CVM) related to the offer of the condo hotel as a financial investment.

(b) the Realtors: the company and/or the professionals engaged in the intermediation, presentation and sale of condo hotel units to the investors. They receive a percentage of the sales as remuneration and have an important role, because they are the link of contact with the investors.

(c) the Hotel Operator: the company responsible for managing the hotel after the project is concluded and that will operate the business on a daily basis and be accountable, distributing the economic results to the investors/co-owners. Usually the management agreement has a fixed term, which may be renewed or not, and the remuneration is a percentage on the hotel revenues. The Hotel Operator takes a more active role after the delivery of the works and the beginning of the operations, but it participates and has responsibilities as offeror of the investment.

(d) the Investor (co-owner): the person or legal entity that adheres to the collective investment contracts (CICs) of a condo hotel and provides the funding of the project with his/her/its financial resources, by acquiring a stake in the business and, with it, the right to participate in the results obtained with the commercial operation of the project.

(e) the Asset Manager: although not mandatory, it is also possible to have the presence of a professional who acts as a sort of representative of the investors/co-owners (sindico) and has the primary responsibility of inspecting the business on behalf of the investors/co-owners.

III. The operation of condo hotels

The CICs can take on different characteristics. The most common is the model of autonomous real estate units, in the traditional manner of a mixed-property condominium (Condomínio Edilício), whereby the investors buy autonomous real estate units, with individual registration and enrollment in the General Registry of Immovable Property (Registro Geral de Imóveis - RGI).

However, the agreement of purchase and sale of autonomous units is linked to a set of contracts that form the CICs, to which the investor must explicitly join by purchasing the unit. Through CICs, units acquired are transferred to the Hotel Operator, which will commercially exploit the project for a period determined in the agreement.

One of the contracts usually used is the Constitution of Silent Partnership (Sociedade em Conta de Participação -

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2 To participate in a condo hotel, the investors sign a set of contracts which, together, define the investment model. In the financial market, this set of contracts receives the name of collective investment contracts (contratos de investimento coletivo - CICs) in condo hotels.

3 The acquisition is very similar to any property such as a house, an apartment or a store, governed by Law No. 4,591, of December 16, 1964, as amended (the Condominium and Units Development Law).

4 During this period, the investor cannot exercise the right of usufruct on the unit. In practice this means that the investor does not have the freedom to live, lend or rent the unit separately, as in general it is possible in a traditional investment in real estate. In the case of the CICs in condo hotels, the acquired unit enters the "pool" of units administered by the Hotel Operator. In some cases, the investor has the right to use the unit for a few days each year.
International Financial Products and Services Committee

SCP), in which the Hotel Operator figures as the ostensible partner (sócio ostensivo) and the investors of the units are the silent partners (sócios participantes). Each investor will receive a share in the results of the hotel according to his/her/its participation, which usually is fixed and proportional to the optimal unit fraction relative to the project.

Under Brazilian law the definition of “securities” comprises, whenever offered publicly, any collective investment agreements or instruments that create the right of participation on profits or remuneration, including as a result of the provision of services, and whose profits derive from the efforts of the entrepreneur or third parties.

The CICs offer to the investors an alternative to invest their financial resources in the expectation to participate in the results obtained in the operation of the project, which is administered by a third party, the Hotel Operator. Therefore, public offerings of CICs of condo hotels are subject to the CVM rules.

IV. The CVM regulation

Currently, public offerings distributions of securities are regulated by CVM Instruction No. 400, of December 29, 2003 (ICVM 400/2003). Therefore, as a general rule, any public offering of CICs of condo hotels has to be registered with CVM. However, article 4 of ICVM 400/2003 provides for the possibility of CVM, at its discretion and always considering the public interest, the adequate information and investor protection, to exempt the registration or some registry requirements.

In this regard, the offerors of CICs in condo hotels, taking into consideration the conditions established in CVM Deliberation No. 734, of March 17, 2015 (Del. 734/2015), as amended, can apply to CVM for exemption of the following: (i) public offering registry; (ii) registration of the issuer of securities; (iii) the hiring of the intermediary institution and member of the securities distribution system; and (iv) compliance with the deadlines for the duration of the offer. Among the conditions laid down in the decision are the characterization of the type of investor who can participate in the offer, the set of information that should be available to the public and the advertising material.

For the purposes of Del. 734, 2015, the offerors are the Hotel Operator jointly with the Developer or, in the absence of a Developer, the company responsible for the offer of the ideal parts of the condominium.

Considering the features of CICs in condo hotels, including the risks arising therefrom, and as a form of protection to retail investors, CVM restricts public offerings of this investment to a particular profile of investor. If the operating model of condo hotel is for autonomous real estate units, the public offering will be exclusively restricted to investors who have an equity of at least R$1 million or alternatively to investors who invest at least R$ 300 thousand in the offer. If the model is for ideal fractions, the public offering will be made exclusively

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5 The SCP is governed by articles 991 to 996 of the Brazilian Civil Code. The SCP is formed by at least two partners by means of a private instrument executed by the parties interested in carrying out a specific activity. Although it is not vested with legal capacity, the partnership is treated as a legal entity for income tax purposes. Only the ostensible partner, in its own name and account, can perform the activities of the partnership. The silent partners are liable only for their obligations with the ostensible partner, but share in the results of the partnership.

6 Article 2, item IX of Law No. 6,385, of December 7, 1976 (the Brazilian Securities Law), as amended by Law No. 10,303, of October 31, 2001.
to qualified investors (as defined by CVM) and cumulatively with at least an equity of R$ 1.5 million or an investment of at least R$ 1 million in the offer.

As to information to investors, one of the foundations of CVM regulation is that true and complete information must be periodically available to all investors indistinctly. Even when registration exemption is granted by CVM, the offerors of CICs in condo hotels have a series of obligations in relation to disclosure of information. During the period of the offer, the offerors must make available to the public, among others, the summary prospectus, the economic feasibility study of the project and all the contracts template of the CICs.

The summary prospectus is the document that contains all the information related to the project and to the offer. It identifies the Construction Company, the Developer, the Hotel Operator and other participants, if any. In the prospectus, investors also will be presented to the risk factors related to the business and a summary of the contractual provisions regulating relations between investors and the offerors and among investors and other counterparties involved in the transaction.

The economic feasibility study of the project must contain: (i) trends and macroeconomic perspectives; (ii) the hotel market analysis by segment and prospects of its evolution; (iii) revenue, expenditure and results projection for a period of at least five years of the hotel operation; (iv) calculation of the internal rate of return of the project for the period of ten years; and (v) other relevant information that enable the investors to evaluate the offer. This economic feasibility study will have to be prepared by an independent professional or company.

These documents, including the contract templates, will be made available by the offerors on their webpage. In addition, the Realtors that participate in the offer intermediation must possess a copy of the summary prospectus.

During the existence of the hotel enterprise, the offerors will prepare and make available to the public, on the internet: (i) annual financial statements audited by independent auditors registered with CVM, within 60 days from the date of close of the financial year; and (ii) quarterly financial statements regarding the three first quarters of each year, accompanied by a special review report issued by independent auditors registered with...
CVM, within 45 days from the closing date of each quarter.

V. The condo hotel as an alternative of investment

In order to invest consciously in condo hotels, it is paramount to know their profitability and liquidity characteristics.

A condo hotel is a variable income investment. The return on investment in condo hotels depends on the operating results of the project. In the course of a given period, such as a calendar, for example, the hotel will operate managed by the Hotel Operator. During this period, the hotel will have revenues, fruit of the leases, or as it is said in the market, the occupancy rate of the hotel, and will also have costs. The result available to the investor is, in short, the difference between revenue and expenditure in proportion to their participation. But revenues from a hotel are not fixed, not guaranteed. These revenues can range enough over the course of a period for a variety of reasons. Around the vacation, holidays and regional events, when demand increases, the revenues tend to improve, and they can be reduced in other periods of the year, with low demand. Other factors, such as location, competition (including new technologies, such as apartment rental applications), quality, etc. may also affect the revenues.

Even if the intent is to get return from the sale of the investment, the yield is variable. This is the case, for example, of the investor who buys his/her participation in the offer of the condo hotel, for a given price, expecting to resell it for a higher price in the future. However, there is no way to know exactly if the future price will be higher, equal or even less than the paid at purchase. So, whatever the form of profitability, the condo hotel is characterized as a variable income investment, and therefore brings with it risks that are only suitable for investors who have the ability and propensity to support them.

The liquidity of a condo hotel is low and is related to the ability to resell the investment, turning it into money for a fair value or with a minimum loss in relation to the fair value. A deposited amount in a savings account, for example, can be withdrawn at any time. The Bank has the obligation to return to the investor all money applied, including the income to which he/she is entitled. Therefore, it is said that the savings account is an investment of high liquidity.

To better understand the liquidity of a condo hotel, one must remember of its nature. First, the investors of a condo hotel have a property, generally an autonomous real estate unit with individual record. By nature, buildings are low liquidity assets. In fact, it may not be as easy to sell a property for its fair price. Although the scenery changes in accordance with the market conditions, in general those who wish to sell fast need to offer a discount in relation to the price considered fair. In the case of condo hotels the situation is a little more challenging because the autonomous real estate unit acquired in a condo hotel is linked to a set of contracts (CICs) that limit the right of property. To dispose of a condo hotel, the investor will have to find someone willing to accept all the conditions of the contracts to which the unit is bound, including the willingness to accept restrictions on the property. So the investment in condo

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8 Even the fixed expenses can be difficult to predict with accuracy as a result of any increase in the costs of hiring, employment contracts, rates, tariffs, taxes and others. Thus, it is not possible to know in advance what will be the operating income of the hotel, and, therefore, what will be the return on investment.
hotels is seen as of low liquidity. Therefore, it is more suitable for investing the equity portion of resources that may be unavailable for a long period, without undermining the financial security of the family.

Regarding the resale of real estate units linked to collective investment contracts in condo hotels, it is worth remembering that the efforts for sale, if public as the advertisement in a newspaper of great movement, are considered public distribution of securities and, therefore, are subject to the provisions of ICVM 400/2003. However, pursuant to item II of article 5 of ICVM 400/2003 the public offering of a single and indivisible lot of securities is exempt from registration with CVM.

VI. Main risks for investors

Considering its operational characteristics, profitability and liquidity, the condo hotel investment is considered risky. There are several factors that contribute to it. Without the pretension of exhausting the analysis, the main risks that the investors of condo hotels may be exposed are indicated below:

(a) pre-operational investment-related risks: in general, public offerings of CICs in condo hotels occur even before the works begin. It is important to consider, therefore, the possibility that trouble in the works would happen, including that the hotel be delivered with delay. This can impact the expected results and, therefore, the remuneration of the investor. In addition, the financial analysis presented in economic feasibility studies based on estimates of revenue and expenditure may not be achieved. There are estimates that depend on unknown variables. For example, the demand designed for future would come true? Other hotels would settle in the region? Operating costs would remain in the projected levels? The response to all these questions can negatively impact on future profitability of the investor.

(b) risks related to the market: even with the hotel in operation, there are risks that need to be evaluated. The conditions of supply and demand, for example, can change at any time, and may cause decrease in the hotel occupancy rate or amount charged by the day, adversely affecting the results of the project. Increased operating costs, difficulties in obtaining credit, rising interest rates and other changes in the economic conditions can also occur.

(c) risks related to the capital contribution: in the event of losses, especially if recurring, additional capital contributions to the hotel operation will be required to cover the cost of the activity. In this situation, if other alternatives are not possible, it is important to be aware that the investors/co-owners may be called upon to contribute capital to the project.

(d) liquidity-related risks: the low liquidity of the CICs in condo hotels can make investors who need to dispose of the business to have to sell it at a price below the fair value, which can represent a loss in relation to the amount paid for the purchase. Still, even at a low price, there is no guarantee that the investor can sell it within the required time.

(e) risks related to leverage: in some cases, investors acquire a condo hotel using Bank financing. There

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9 It should be noted that some risks such as the liquidity risk, the risk related to the market price, among others, may be more significant in the model of ideal fractions of condominiums in condo hotels.
is no guarantee that the future profitability of the investment will exceed the rate of the contracted financing.

(f) risks related to the market price of the purchased units: regardless of the liquidity, the value of the real estate units of the condo hotel are subject to variations. What determine the price are the conditions of supply and demand, which are intrinsically related to the economic conditions. This represents a potential risk to the investor, to the extent that there is no way to predict if the purchase price will be recovered or not. There is also the risk that the business model of condo hotels loses attractiveness over time, reducing the demand and consequently the prices.

(g) risks related to Hotel Operator: condo hotels are managed by Hotel Operators, by means of long-term contracts. There is no way to ensure that the hotel services will be rendered exactly with the quality expected by the investors. Problems in the management or execution of the contract may negatively affect the results of the investment. In addition, the contracts with the Hotel Operator have a fixed term, at the end of which the may be renewed or not.

VII. Final Considerations

In order to determine the cost of the investment, one should realize that investors in condo hotels tend to pay, for example, fees related to decoration and the furniture of the hotels, as well as their remodeling. So, it is paramount to check the value of any taxes and when they must be paid.

Furthermore, it is highly recommended to become aware of the real estate market and the hotel industry before purchasing CICs in condo hotels, as well as to visit the area of the hotel enterprise and to know, among other relevant information, the potential competitors, the average daily rate charged in the region, the average cost of the square meter of real estate in the region, the guest profile to be drawn to the hotel, the attractions of the region and its economic potential.
Public financing to Brazilian companies with foreign control

By:

Walter Stuber
Walter Stuber Consultoria Jurídica
São Paulo, Brazil
walter.stuber@stuberlaw.com.br

The Brazilian Foreign Capital Law (Law No. 4,131, of September 3, 1962), that governs foreign direct investments in Brazil, prohibits the granting of loans, credits or financing by the Brazilian Treasury (Tesouro Nacional) and public credit official entities of the Union and the States, including joint stock companies (sociedades de economia mista) controlled by any of these entities, to Brazilian companies whose majority of the voting capital belongs to non-resident individuals or legal entities (persons resident, domiciled or headquartered outside Brazil). This restriction is contained in article 39 of Law 4,131/1962.

Public funding is only allowed in the case of companies that invest their funds in sectors of activities and economic regions of "high national interest" (alto interesse nacional), as defined and listed in a Decree of the Executive Branch. Currently, the list of sectors deemed of "high national interest" is provided for in Decree No. 2,233, of 23 May 1997. Among the loans impacted by this legal restriction is the BNDES FINAME, of the Special for Industrial Financing (Agência Especial de Financiamento Industrial – FINAME) of the Brazilian Development Bank (Banco Nacional de Desenvolvimento Econômico e Social – BNDES). Regulatory standards of the BNDES FINAME Product (SUP/Circular AOI No. 12/2015-BNDES, of May 8, 2015) provide that any operations carried out with companies under control of foreign capital for investment of any kind in any economic activity not covered by Decree 2,233/1997 must adopt as financial cost a differentiated rate of the one typically applied to BNDES FINAME. The standard rate is the Long Term Interest Rate (Taxa de Juros de Longo Prazo - TJLP). This differential cost is either (a) the variation of the currency of BNDES (Unidade Monetária do BNDES - UMBNDES), plus the cost of a basket of currencies (Basket) – UMBNDES/Basket; or (b) the exchange rate of the United States Dollar (US$), plus the same basket of currencies – US$/Basket.

At the beginning of this year, the Brazilian Executive Branch issued Decree No. 8,957, dated January 16, 2017, expanding the list of economic sectors considered to be of "high national interest" for the purposes of public funding.

In the infrastructure sector, Decree 8,957/2017 included telecommunications activities of any nature, logistics, distribution of goods, sanitation, solid waste management, oil. In the industrial sector, it included the chemical activities from renewable sources, mining and mineral processing, agro-forestry and paper products and related bio-products from biomass, oil and gas, healthcare, textile, graphic and audiovisual complex infrastructure, as well as greater detail on the activities covered by the segment of information technology and communications. In the service sector, it included education activities and energy efficiency. Finally, the trade sector was also included in the list originally provided for in Decree 2,233/1997.

The easing of the above-mentioned legal restriction extends the financing sources to various sectors of the economy, favoring the expansion of their businesses from loans, credit or financing granted by the public sector (especially BNDES).
Latest amendments to the financial sector in Egypt

By:

Mohamed Hashish
Partner
Soliman, Hashish & Partners, Egypt
m.hashish@shandpartners.com

I. International Public Finance Agreements

During the past quarter of 2017 and upon obtaining the approval of the Egyptian House of Representatives (the "Parliament"), the Egyptian Official Gazette published a number of international finance agreements made with the Government of Egypt and each of the following:

- The World Bank for the USD 1,000,000,000 (one billion United States Dollars) Loan Agreement for the purpose of the Second Fiscal Consolidation, Sustainable Energy, and Competitiveness Programmatic Development Policy Financing, which agreement was executed on December 19, 2015 and approved by virtue of the Presidential Decree No. 505 of 2015;

- The Agence Française de Développement for the EUR 68,000,000 (sixty eight million Euros) Grant Agreement, as a part of the European Union’s contribution, for the purpose of financing the cost of installing gas connection to 2,400,000 underprivileged households, which agreement was executed on April 17, 2016 and approved by virtue of the Presidential Decree No. 308 of 2016;

- The Government of Germany for the EUR 65,000,000 (sixty five million Euros) Financial Cooperation Agreement for the purpose of supporting (i) micro, small, medium-sized enterprises, (ii) development of irrigation and drainage systems; and (iii) solid waste national management system, which agreement was executed on May 29, 2016 and approved by virtue of the Presidential Decree No. 385 of 2016;

- The Government of China for the CNY 200,000,000 (two hundred million Chinese Yuan) Grant Agreement for the purpose of financing, inter alia, the national drainage system and the Egyptian satellite Nilesat 2, which agreement was executed on January 21, 2016 and approved by virtue of the Presidential Decree No. 228 of 2016;

- The Government of South Korea for the KRW 114,978,000 (one hundred fourteen million, nine hundred seventy eight thousand South Korean Won) Loan Agreement for the purpose of financing the Railway Traffic Signals from Nagaa Hamady to Luxor, which agreement was executed on March 3, 2016 and approved by virtue of the Presidential Decree No. 387 of 2016;

- The Government of Japan for the JPY 2,000,000,000 (two billion Japanese Yen) Grant...
Agreement for the purpose of supplying educational and research equipment for the Japanese Egyptian University for Science and Technology, which agreement was executed on July 26, 2016 and approved by virtue of the Presidential Decree No. 529 of 2016; and

- Kuwait Fund for Arab Economic Development for the KWD 30,000,000 (thirty million Kuwaiti Dinar) Loan Agreement for the purpose of financing the electricity interconnection between Egypt and Saudi Arabia, which agreement was executed on November 22, 2015 and approved by virtue of the Presidential Decree No. 38 of 2016.

II. New banking regulations

During the past quarter of 2017, the Central Bank of Egypt (“CBE”) issued a number of decrees including, inter alia, the following:

- As of March 5, 2017, the banks that are registered with CBE are required to notify CBE with any arrangement for making foreign currencies available to any governmental entity in Egypt including public economic entities, public business companies and public companies as well as any their suppliers and contractors.

- As a part of CBE’s initiative encouraging banks in Egypt to provide finance to Small and Medium-sized Enterprises (“SMEs”), CBE decided to change the definition of SMEs to be as follows:

<table>
<thead>
<tr>
<th>Size</th>
<th>Paid capital</th>
<th>Personnel</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>less than EGP 50,000</td>
<td>less than 10 employee</td>
</tr>
<tr>
<td>Small</td>
<td>From EGP 50,000 to EGP 5,000,000 for industrial companies and less than EGP 3,000,000 for non-industrial companies</td>
<td>less than 200 employee</td>
</tr>
<tr>
<td>Medium</td>
<td>From EGP 5,000,000 to EGP 15,000,000 for industrial companies and from EGP 3,000,000 to EGP 5,000,000 for non-industrial companies</td>
<td></td>
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</tbody>
</table>

CBE also relaxed the compliance requirements and conditions for providing finance to SMEs.
This article briefly summarizes an initial checklist of legal topics that should be considered and addressed by U.S. FinTech companies expanding in the Americas. The goal of answering the questions from the checklist is to learn how financial institutions and mobile financial services are regulated in different jurisdictions within the Americas, benefits and risks. The legal counsel helping a FinTech company to enter a new market should find the answers to the most of the questions below:

I. Lending License:

- Whether unsecured lending and mobile financial services are regulated in the country? Whether a lending license is required for lending? Is the license on a national or provinces/ state level?
- Whether a money transmitter or similar license is needed?
- Who are the governmental and other regulators to oversee the lending activities in the country?
- Whether the regulations are applicable to your company? Whether there is a “grey area” to operate being unregulated? Can the product be structured in a manner to avoid licensing (closed-end term loan versus a revolving line of credit)? Can a partner’s license be used to pursue a “piggy-back” structure (using a local partner’s license) at least for initial market testing?

II. Lending requirements and best market practices:

- Incorporation and post-incorporation steps:
- Is setting up a local entity mandatory? What are the alternative structures, for example, whether using a local partner (rails) would be sufficient?
- What type of legal entity to choose? What the least regulated type of legal entity could be set up?
- Whether there is a required paid-up capital? Can this capital be used to fund the loans and/ or operations?
- Whether there are local ownership and local director requirements?
- Price & Time for Incorporation and Post-incorporation phases, meaning a total price and timeline for setting up an entity, obtaining a tax ID, opening a bank account, having a nominal director and a local address if needed for the incorporation?
- What are the IP protection measures can be made in the country? Specifically, whether there is a trademark and/ or patent protection? How enforceable are those protections?
Is there an interest rate cap or other restriction on how to charge interest or fees? Are these restrictions on a national level or do they vary in different provinces/ states? Whether there is a difference in legal regulation of interest and technology fees?

Know-Your-Customer (KYC) and Anti-Money Laundering (AML) provisions. Specifically, what customer information should be verified and what documents, if ever, can be used for this purpose? Whether are online sources and database for online KYC? Whether there are third parties which provide KYC services? How other similar companies and/ or competitors do their KYC?

Data privacy, consumer protection law, fair lending restrictions, etc. Specifically, what disclosers should be provided to the customers before disbursing a loan, what data can be used to underwrite a customer?

Whether reporting the borrower repayment information to a local credit bureau is mandatory?

What are the consequences of noncompliance with any of the applicable laws (legal and reputational)? Whether other market participants are not in compliance? Whether there are pending cases against those companies?

The country specific corporate legal requirements:

Labor law. Specifically, how to structure the hiring of local employees in the country? For example, whether the profit sharing with employees is mandatory?

What are the taxes should be paid, e.g., VAT, GST, income tax withholding, stamp tax?

The risks:

Is moving money in and out of the country regulated or restricted, so it would be difficult to fund the local entity and repatriate the capital and profit?

Whether there is a risk of currency devaluation?

Whether a local government is planning to change the “game rules,” especially with regard to licensing requirements and KYC/AML?

International Tax Planning (optional, depending on a company’s profitability):

Are there applicable international tax treaties with the country?

How to capitalize the local subsidiary (capital contribution in return for equity versus a loan)?

In the longer term, whether the profits should be returned to the United States or can be kept in overseas subsidiaries?
International Arbitration by Financial Institutions: Current Practices and Opportunities

By:

Timothy J. McCarthy
Partner
Thompson Hine LLP
New York
Timothy.McCarthy@ThompsonHine.com

Richard A. De Palma
Partner
Thompson Hine LLP
New York
Richard.DePalma@ThompsonHine.com

Shaun D. McElhenny
Associate
Thompson Hine LLP
New York
Shaun.McElhenny@ThompsonHine.com

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”). 12 The Report finds that financial institutions’ overall assessment of arbitration is more positive than previously thought, and is rapidly changing. Financial

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 (FDRC) in Hong Kong, and DIRIBAN, an interbank dispute settlement mechanism created by the Spanish Banking Association with the support of Spain’s central bank.13

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

13 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.\(^\text{14}\)

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.\(^\text{15}\)

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

\(^{14}\) See ICC Rules of Arbitration, Article 28: “Conservatory and Interim Measures.”

\(^{15}\) 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.¹⁶

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.¹⁷

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

arbitrators in newly-filed claims, unless there is an objection from the parties.  

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 falling into disuse due to legal challenges to their enforceability.

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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19 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.20

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.21

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.22

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

21 Id., pp. 21-22.
22 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.23

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 or 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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23 Id., pp. 7, 14-15.