Banking and Finance - Demystifying the Jargon

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Introduction

The title of this paper is somewhat misleading. The jargon of banking and finance law is too vast a subject to "demystify". The plethora of terms, ancient and modern, indigenous and exotic, elegant and ugly, are both the source of the subject's development and a measure of its vitality.

To illustrate this variety, I have chosen, at random, three examples of finance law argot

First, an ancient case dealing with the duties of a mortgagee:

> "But it was said by the counsel for the defendant, that no order was ever yet made to compel a mortgagee to take out execution, whether he would or not; and to order the defendant to take out execution, might involve him in a suit with Goodchild: and it was to make him, nolens volens, the Duke's bailiff: and a mortgagee, who desires to act discreetly, would not enter before he had foreclosed the equity of redemption."[1]

Next, a late Victorian statute regulating security over goods:

> "Every attornment whereby a power of distress is given or agreed to be given by any person by way of security for any debt or advance shall be deemed to be a bill of sale, within the meaning of the Act, of any personal chattels which may be seized or taken under such power of distress."[2]

Last, a description of a modern form of finance lease:

> "The pickle-leasehold is a fully defeased three-tiered transaction A head lease is established between a foreign (head) lessor and a US owner trustee. Head lease rents are paid upfront by the owner trustee to the head lessor, with cash from US equity investors and bank debt. In some cases, debt is provided by the head lessor. The head lessor then puts the funds on deposit with a defeasance bank."[3]

So, whatever the changes in fashion in prose and the substance of the law in the past three centuries, judges, legislators and practitioners have talked about banking and finance (and other areas of law too[4]) in a language very much their own

1 *Duke of Buckingham v Gayer (1684) 1 Vern 258.*

2 *Section 6 of Bills of Sale Act 1878 (Eng)*

3 *Asset Finance & Leasing Digest 1996.*

4 *Taxation law is remarkable for the deployment of mundane words in baffling arrangements. Section 82KTJ(4)(b) of the Income Tax Assessment Act 1936 (Cth) offers an egregious example.*

In this paper I want to set out what I think are the causes of that variety, to give some explanatory examples and finally to look at solutions to the problems of classifying information and making it accessible.

Causes

There are at least five causes of the variety of banking and finance terms

The first is the embarrassing wealth of the English language The river of English legal expression rises from many sources: there are solid Anglo-Saxon terms, quaint Law French terms, portentous Latinisms. Their number sometimes outstrips the basic concepts which they express. Sometimes a word becomes associated with more than one discrete concept. Practitioners draw on whatever is to hand or convenient to their immediate concerns Usage is always in the van, analysis lags well to the rear.

The second is novelty. Financial markets, in the English speaking countries, thrive on innovation. At times there is a genuine discovery of a new, cheap way to raise money: lease financing, euromarket raisings or "securitisation" programmes are modern examples. Often it is little more than salesmanship - a catching name is needed to differentiate a new investment from its competitors.

The third is the effect of regulation. Legislators proscribe or inhibit or tax transactions. Players in the market and their advisers invent new forms, or cloak old forms in new names, to escape from these unwelcome consequences.

The fourth is borrowing from one market or jurisdiction to another Foreign commerce imports foreign terms, in recent times mostly from the most vigorous English speaking market, the United States Thence come not only the latest neologisms of the market place but also old words from the English common law which took root in America before the Revolution and flourish there to this day, long after their obsolescence or extinction in the British Commonwealth

The fifth is specialisation. While the core legal concepts of banking and finance are relatively few, the detail of commercial practice in employing those concepts is forever increasing. New markets breed new sets of customary terms, which in time have their own labels - "project finance", "structured finance", "infrastructure finance" and so on.

Examples

The interplay of these causes can be illustrated in five examples of simple, well known commercial transactions.

Finance, Debt and Equity

"Finance" is the raising of capital. For a commercial company, there are two basic means by which this can be done: one is to issue shares, the other is to borrow money. The former offers investors a share of the profit of the company but no right to be repaid the capital subscribed. The latter consists of a promise to repay the amount borrowed, with interest from time to time.

In both commercial and legal parlance, the latter is referred to as "debt finance", "debt capital" or simply "debt", the former as "share capital". But commercial parlance introduced at the turn of the century[5] a new term for the former It is 'equity capital', or simply 'equity'. This is perplexing for lawyers and laymen alike, for whom the term may have a number of other significances. For a lawyer 'equity', in a technical sense, is a system of jurisprudence developed in Court of Chancery before its dissolution in 1873. In a large office, on the other hand, it is not unusual for solicitor's practices to be described in the commercial parlance, those engaged in share raising transactions "working in equity", while the oppressed souls in the banking department "work in debt".

Guarantees

A common commercial transaction is for A to lend money to B and C to promise A to answer for B if B defaults. This goes by a variety of names.

The first is "guarantee". The word dates from the seventeenth century[6] but is still in common use for example in Professor Donovan's *The Modern Contract of Guarantee.*

The person who gives a 'guarantee' is a 'guarantor'. An older word for 'guarantor' is 'surety'. This comes from the dead dialect, Law French, a barbarous amalgam of Old French and bits of English and Latin, used by the medieval common lawyers. A notable old text, '*Rowlatt on Principal and Surety*', preserves the usage, but it is rare nowadays.

The contract of guarantee might also be described as a 'security'. This is a newer form of 'surety' derived from the original Latin ("securitas" = "security"). Doubtless the extra syllable was thought to make it more reassuring to all the parties It is used in statutes (for example *Supreme Court Act 1986 (Vic)*[7]), and may include a guarantee; but it has also a vast range of other usages, including 'asset securities' and especially in relation to investments issued by companies

Lastly, I would mention 'indemnity'. Strictly, this is a promise to hold a person harmless against loss (Latin "damnum") suffered through that person's entry into a transaction. It can produce the same commercial result as a guarantee - C promises to hold A harmless for loss he suffers if B defaults in repayment of A's loan to B. The courts have given the indemnity slightly different legal incidents from the guarantee Lenders usually ask for an "indemnity" in addition to a guarantee when they want to avoid the consequences at common law and under statute which affect "guarantees" in the strict sense

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5 *O E D q v. 'equity*

6 *O E.D q v. 'guarantee'*

7 *Section 52*

Asset Securities

Another very simple commercial transaction is where A lends money to B, and B promises to A that, if he defaults, A may take possession of an asset belonging to B and sell it, so that then A has the proceeds to apply against the debt in priority to the claims of other creditors. I shall call this arrangement an "asset security" An American lawyer would often refer to the holder of the security having a "security interest" in the relevant asset. There are a vast number of forms and names for asset security. The terms are not exact synonyms and there are slightly different legal incidents of each, which parties are free to choose or attempt to exploit, e.g to avoid registration requirements under the Corporations Law

Oldest is the "mortgage". The word is a synthesis of Law French and Anglo Saxon "Gage" is an Anglo Saxon term for an asset security; "mort" a French word meaning "dead". (The reason for this quaint amalgamation is outside the scope of this paper[8]) Applied to land, it came to mean an arrangement whereby a debtor transferred land to the creditor on the proviso that the land would be revested in him if he duly made repayment.

A different species of asset security in English law is a "charge". The idea here is that the asset is charged, i.e burdened, with an obligation. In the United States, the usual legal term for the same arrangements is "lien". "Lien" is derived from the Latin "ligamen", a bond, i.e. the asset is "bound" by the obligation[9]. In that sense, it is similar in concept to the charge. Both words were in use in eighteenth century England, with lien perhaps the older term. The Americans took it up. In England and Australia it survives today only for a peculiar species of asset security.

Nineteenth century mercantile practice spawned another word for an asset security given by a company, the term "debenture" Literally a debenture is an instrument signifying indebtedness It is probably derived from the Latin "debentur", "there are owed"[10] Strictly, therefore, it has nothing to do with asset securities. But investment practice in the nineteenth century was such that no-one lent to a company without taking security over the company's assets. So "debenture" came to signify such a security. In fact, in Australia, a company now cannot generally borrow money and issue what is termed a "debenture" unless its obligations are secured on its assets[11]

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8 I have dealt with this in (1993) 6 JIBL 252, 253.

9 O.E.D. q.v. 'lien'.

10 O.E.D. q.v. 'debenture'.

11 Section 1045 Corporations Law.

Debt Capital Markets

It also happens frequently that A borrows from B and B, rather than wait for payment, wishes to sell his right to receive payment from A for ready cash or to finance another investment. A legal form and term is required for A's promise to create such a transferable asset. There is a vast array of terms used to effect this arrangement.

One is "bond". Properly a bond is a promise to pay a sum of money under seal. There is a vast amount of learning on bonds, most of which, if you look in, say, the English and Empire Digest, seems to terminate in about 1800. This was because in the eighteenth century, lawyers wrote contracts as bonds in the form, "I promise to pay you £100, unless before a certain date I have done..." and what follows set out the terms of the real bargain between the parties. This sort of "conditional" or "defeasant" bond has nothing to do with a negotiable or transferable security. That is the creation of the bond market, the place where interest bearing securities are sold.

In this market there are many types of so-called "bonds" with all manner of colourful epithets to distinguish them. Examples are:

- government bonds;
- eurobond (a form of capital market raising developed in London in the 1960s);
- "dragon" bond (an Asian market instrument);
- "matilda" bond (an A$ foreign sovereign issue sold in Australia and overseas); and
- junk bonds (a high yielding, speculative investment).

Many of these are not constituted as "bonds" in the legal sense at all.

The "debenture", which we met above, is usually made transferable. Its cousin is the "note", a term used because it suggests the lack of an asset security to secure the promise to repay the amount subscribed.

Another term is "certificate of deposit". In Australia, this is frequently used for transferable debt issued by banks. The term is used because banks traditionally take deposits and because, in Australia, liabilities on deposits rank ahead of other obligations[12]. The Bank can accordingly get a lower rate of interest on a 'deposit' than on a 'note'.

"Commercial paper" is an American term for short term (i.e. 30 to 365 days) promissory note. It is the usual term for issues of this kind in the Australian capital markets. However, with new technology, the cost of issuing and trading in physical paper is encouraging efforts to create the equivalent in electronic form. The market will see soon "paperless commercial paper".

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12 Section 16, Banking Act 1959 (Cth)

Specialist Financings

In many fast developing areas the terminology reflects not traditional legal forms, but the commercial species of debt financings.

Examples are:

- "project finance" - this is finance for the construction of a project "Infrastructure finance" uses similar techniques;
- "asset finance" - this is financing, often by means of a lease, for the acquisition or operation of an asset, with the debt being repaid out of the income earned from the asset; and
- "structured finance" - this is a particularly amorphous term for a complicated transaction, usually structured to deliver cheap funding by taking advantage of a tax concession

Solutions for Classification

English and Australian law has never been strong on classification The Digest, Halsbury's and other familiar research tools are all organised after the most elementary of systems - the alphabet When this is combined with wide vocabulary, chaos is liable to descend. This is not something which can be dispelled by computers They save time, but do not create order

I have, however, two suggestions The first is to develop broad conceptual categories for banking and finance practice Materials can be organised by recognising the conceptual wood that rises above the thicket of words I have tried to suggest one or two such categories above, e g "asset security", "debt capital markets". Of course, not everybody agrees with what the labels for these core categories should be, but I do not think it impossible to develop conventions, as the basic concepts are relatively few

The second suggestion is for work to be done to develop glossaries to help relate particular usages to those categories This is a larger and necessarily an ongoing task, but there are already a number of useful publications on the market, e g *IFR Financial Glossary*, as well as conventional law dictionaries

Neither suggestion will rid us of jargon, but they would go some way to keeping it under control