

## **GLOSSARY OF TERMS**

**Capital adequacy ratio** is the ratio of capital to assets. Assets in this case are risk weighted based on their relative riskiness, thus the term is also referred to as the risk-based capital adequacy ratio. Capital refers to eligible regulatory capital which includes Tier 1 or core capital and Tier 2 or supplementary capital. Tier 2 capital includes unsecured subordinated debt instruments but may not exceed the amount of Tier 1 capital.

**Credit default swap** is a credit derivative wherein the protection buyer may exchange the reference asset for cash equal to a specified amount upon the occurrence of a defined credit event.

**Credit derivative** is a contract wherein one party called the protection buyer or credit risk seller transfers the credit risk of a reference asset to another party called the protection seller or credit risk buyer. In return, the protection buyer pays a premium or interest-related payments to the protection seller reflecting the underlying credit risk of the reference asset.

**Credit-linked note** is a pre-funded credit derivative wherein the note holder acts as a protection seller while the note issuer is the protection buyer. As such, the repayment of the principal to the note holder is contingent upon the non-occurrence of a defined credit event.

**Credit risk** is the current and prospective risk to earnings or capital arising from a counterparty's failure to meet the terms of any contract with the financial institution or otherwise perform as agreed.

**Derivative** is a financial instrument whose characteristics and value depend upon the characteristics and value of an underlying, typically a bond, equity, currency, or commodity.

**External credit risk rating** represents an assessment of the credit quality of a borrower made by a credit risk rating agency.

**Interest rate risk** is the current and prospective risk to earnings or capital arising from movements in interest rates.

**Market risk** is the current and prospective risk to earnings or capital arising from adverse changes in the value of traded portfolios of financial instruments.

**Operational risk** is the current and prospective risk to earnings or capital arising from fraud, error, and the inability to deliver products or services, maintain a competitive position, and manage information.

**Repo transaction** or repurchase agreement is a contract in which the seller of securities, such as Treasury Bills, agrees to buy them back at a specified time and price.

**Risk weight** is the weight given to an asset to reflect its relative riskiness. Thus, a 50% risk weight means the asset is not that risky and would get only half of the minimum required capital of 10% of asset value.

**Securitization** is the process of aggregating similar instruments, such as loans or mortgages, into a negotiable security.

**Structured product** refers to a financial instrument where the return is a function of one or more underlying market indices, such as interest rates, equities and exchange rates. There may also be embedded derivatives that reshape the risk-return pattern.

**Total return swap** is a credit derivative wherein the protection buyer exchanges the actual collections and variations in the prices of the reference asset with the protection seller in return for a fixed interest payment.

**Trading book** consists of positions in financial instruments which are taken on by the institution for its own account or the accounts of its clients with the intention of benefiting in the short-term from actual and/or expected difference between their buying and selling prices.