3. GLOSSARY

	Asset	An asset is anything of value that is owned by a person or business
	Available for Sale	The securities available for sale are those securities where the intention of the bank is neither to trade nor to hold till maturity. These securities are valued at the fair value which is determined by reference to the best available source of current market quotations or other data relative to current value.
	Balance Sheet	A balance sheet is a financial statement of the assets and liabilities of a trading concern, recorded at a particular point in time.
	Banking Book	The banking book comprises assets and liabilities, which are contracted basically on account of relationship or for steady income and statutory obligations and are generally held till maturity.
	Basel Capital Accord	The Basel Capital Accord is an Agreement concluded among country representatives in 1988 to develop standardised risk-based capital requirements for banks across countries. The Accord was replaced with a new capital adequacy framework (Basel II), published in June 2004. Basel II is based on three mutually reinforcing pillars that allow banks and supervisors to evaluate properly the various risks that banks face. These three pillars are: ▪ minimum capital requirements, which seek to refine the present measurement

		framework ▪ supervisory review of an institution's capital adequacy and internal assessment process; ▪ market discipline through effective disclosure to encourage safe and sound banking practices
	Basel Committee on Banking Supervision	The Basel Committee is a committee of bank supervisors consisting of members from each of the G10 countries. The Committee is a forum for discussion on the handling of specific supervisory problems. It coordinates the sharing of supervisory responsibilities among national authorities in respect of banks' foreign establishments with the aim of ensuring effective supervision of banks' activities worldwide.
	Basic Indicator Approach	An operational risk measurement technique permitted under Basel II. The approach sets a charge for operational risk as a fixed percentage ("alpha factor") of a single indicator. The indicator serves as a proxy for the bank's risk exposure.
	Basis Risk	The risk that the interest rate of different assets, liabilities and off-balance sheet items may change in different magnitude is termed as basis risk.
	Capital	Capital refers to the funds (e.g., money, loans, equity) which are available to carry on a business, make an investment, and generate future revenue. Capital also refers to physical assets which can be used to generate future returns.

	Capital adequacy	A measure of the adequacy of an entity's capital resources in relation to its current liabilities and also in relation to the risks associated with its assets. An appropriate level of capital adequacy ensures that the entity has sufficient capital to support its activities and that its net worth is sufficient to absorb adverse changes in the value of its assets without becoming insolvent. For example, under BIS (Bank for International Settlements) rules, banks are required to maintain a certain level of capital against their risk-adjusted assets.
	Capital reserves	That portion of a company's profits not paid out as dividends to shareholders. They are also known as undistributable reserves.
	Convertible Bond	A bond giving the investor the option to convert the bond into equity at a fixed conversion price or as per a pre-determined pricing formula.
	Core Capital	Tier 1 capital is generally referred to as Core Capital
	Credit risk	Risk that a party to a contractual agreement or transaction will be unable to meet their obligations or will default on commitments. Credit risk can be associated with almost any transaction or instrument such as swaps, repos, CDs, foreign exchange transactions, etc. Specific types of credit risk include sovereign risk, country risk, legal or force majeure risk, marginal risk and settlement risk.
	Debentures	Bonds issued by a company bearing a fixed

		rate of interest usually payable half yearly on specific dates and principal amount repayable on a particular date on redemption of the debentures.
	Deferred Tax Assets	Unabsorbed depreciation and carry forward of losses which can be set-off against future taxable income which is considered as timing differences result in deferred tax assets. The deferred Tax Assets are accounted as per the Accounting Standard 22. Deferred Tax Assets have an effect of decreasing future income tax payments, which indicates that they are prepaid income taxes and meet definition of assets. Whereas deferred tax liabilities have an effect of increasing future year's income tax payments, which indicates that they are accrued income taxes and meet definition of liabilities
	Derivative	A derivative instrument derives much of its value from an underlying product. Examples of derivatives include futures, options, forwards and swaps. For example, a forward contract can be derived from the spot currency market and the spot markets for borrowing and lending. In the past, derivative instruments tended to be restricted only to those products which could be derived from spot markets. However, today the term seems to be used for any product that can be derived from any other.

	Duration	Duration (Macaulay duration) measures the price volatility of fixed income securities. It is often used in the comparison of the interest rate risk between securities with different coupons and different maturities. It is the weighted average of the present value of all the cash flows associated with a fixed income security. It is expressed in years. The duration of a fixed income security is always shorter than its term to maturity, except in the case of zero coupon securities where they are the same.
	Foreign Institutional Investor	An institution established or incorporated outside India which proposes to make investment in India insecurities; provided that a domestic asset management company or domestic portfolio manager who manages funds raised or collected or brought from outside India for investment in India on behalf of a sub-account, shall be deemed to be a Foreign Institutional Investor.
	Forward Contract	A forward contract is an agreement between two parties to buy or sell an agreed amount of a commodity or financial instrument at an agreed price, for delivery on an agreed future date. In contrast to a futures contract, a forward contract is not transferable or exchange tradable, its terms are not standardized and no margin is exchanged. The buyer of the forward contract is said to be long the contract and the seller is said to be short the contract.
	General provisions and loss reserves	Such reserves, if they are not attributable to the actual diminution in value or identifiable

		potential loss in any specific asset and are available to meet unexpected losses, can be included in Tier II capital
	General risk	Risk that relates to overall market conditions while specific risk is risk that relates to the issuer of a particular security
	Hedging	Taking action to eliminate or reduce exposure to risk
	Held for Trading	Securities where the intention is to trade by taking advantage of short-term price / interest rate movements.
	Horizontal Disallowance	A disallowance of offsets to required capital used the BIS Method for assessing market risk for regulatory capital. In order to calculate the capital required for interest rate risk of a trading portfolio, the BIS Method allows offsets of long and short positions. Yet interest rate risk of instruments at different horizontal points of the yield curve are not perfectly correlated. Hence, the BIS Method requires that a portion of these offsets be disallowed.
	Hybrid debt capital instruments	In this category, fall a number of capital instruments, which combine certain characteristics of equity and certain characteristics of debt. Each has a particular feature, which can be considered to affect its quality as capital. Where these instruments have close similarities to equity, in particular when they are able to support losses on an ongoing basis without triggering liquidation, they may be included in Tier II capital.
	Interest rate risk	Risk that the financial value of assets or liabilities (or inflows/outflows) will be altered

		because of fluctuations in interest rates. For example, the risk that future investment may have to be made at lower rates and future borrowings at higher rates.
	Long Position	A long position refers to a position where gains arise from a rise in the value of the underlying.
	Market risk	Risk of loss arising from movements in market prices or rates away from the rates or prices set out in a transaction or agreement.
	Modified Duration	The modified duration or volatility of an interest bearing security is its Macaulay duration divided by one plus the coupon rate of the security. It represents the percentage change in a securities' price for a 100 basis points change in yield. It is generally accurate for only small changes in the yield. $\boxed{MD = -\frac{dP}{dY}.\frac{1}{P}}$ where: MD = Modified duration. P = Gross price (i.e. clean price plus accrued interest). dP = Corresponding small change in price. dY = Small change in yield compounded with the frequency of the coupon payment.
	Mortgage-backed security	A bond-type security in which the collateral is provided by a pool of mortgages. Income from the underlying mortgages is used to meet interest and principal repayments.
	Mutual Fund	Mutual Fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objectives as disclosed in offer document.

		A fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments.
	Net Interest Margin	Net interest margin is the net interest income divided by average interest earning assets
	Net NPA	Net NPA = Gross NPA – (Balance in Interest Suspense account + DICGC/ECGC claims received and held pending adjustment + Part payment received and kept in suspense account + Total provisions held)‘
	Nostro accounts	Foreign currency settlement accounts that a bank maintains with its overseas correspondent banks. These accounts are assets of the domestic bank.
	Off-Balance Sheet exposures	Off-Balance Sheet exposures refer to the business activities of a bank that generally do not involve booking assets (loans) and taking deposits. Off-balance sheet activities normally generate fees, but produce liabilities or assets that are deferred or contingent and thus, do not appear on the institution's balance sheet until or unless they become actual assets or liabilities.
	Open position	It is the net difference between the amounts payable and amounts receivable in a particular instrument or commodity. It results from the existence of a net long or net short position in the particular instrument or commodity.
	Option	An option is a contract which grants the buyer the right, but not the obligation, to buy (call option) or sell (put option) an asset,

		commodity, currency or financial instrument at an agreed rate (exercise price) on or before an agreed date (expiry or settlement date). The buyer pays the seller an amount called the premium in exchange for this right. This premium is the price of the option.
	Risk	The possibility of an outcome not occurring as expected. It can be measured and is not the same as uncertainty, which is not measurable. In financial terms, risk refers to the possibility of financial loss. It can be classified as credit risk, market risk and operational risk.
	Risk Asset Ratio	A bank's risk asset ratio is the ratio of a bank's risk assets to its capital funds. Risk assets include assets other than highly rated government and government agency obligations and cash, for example, corporate bonds and loans. The capital funds include capital and undistributed reserves. The lower the risk asset ratio the better the bank's 'capital cushion'
	Risk Weights	Basel II sets out a risk-weighting schedule for measuring the credit risk of obligors. The risk weights are linked to ratings given to sovereigns, financial institutions and corporations by external credit rating agencies.
	Securitisation	The process whereby similar debt instruments/assets are pooled together and repackaged into marketable securities which can be sold to investors. The process of loan securitisation is used by banks to move their assets off the balance sheet in order to improve their capital asset ratios.

	Short position	A short position refers to a position where gains arise from a decline in the value of the underlying. It also refers to the sale of a security in which the seller does not have a long position.
	Specific risk	Within the framework of the BIS proposals on market risk, specific risk refers to the risk associated with a specific security, issuer or company, as opposed to the risk associated with a market or market sector (general risk).
	Subordinated debt	Refers to the status of the debt. In the event of the bankruptcy or liquidation of the debtor, subordinated debt only has a secondary claim on repayments, after other debt has been repaid.
	Tier one (or Tier I) capital	A term used to refer to one of the components of regulatory capital. It consists mainly of share capital and disclosed reserves (minus goodwill, if any). Tier I items are deemed to be of the highest quality because they are fully available to cover losses. The other categories of capital defined in Basel II are Tier II (or supplementary) capital and Tier III (or additional supplementary) capital.
	Tier two (or Tier II) capital	Refers to one of components of regulatory capital. Also known as supplementary capital, it consists of certain reserves and certain types of subordinated debt. Tier II items qualify as regulatory capital to the extent that they can be used to absorb losses arising from a bank's activities. Tier II's capital loss absorption capacity is lower than that of Tier I capital.
	Trading Book	A trading book or portfolio refers to the book of

		financial instruments held for the purpose of short-term trading, as opposed to securities that would be held as a long-term investment. The trading book refers to the assets that are held primarily for generating profit on short-term differences in prices/yields. The price risk is the prime concern of banks in trading book.
	Underwrite	Generally, to underwrite means to assume a risk for a fee. Its two most common contexts are: a) Securities: a dealer or investment bank agrees to purchase a new issue of securities from the issuer and distribute these securities to investors. The underwriter may be one person or part of an underwriting syndicate. Thus the issuer faces no risk of being left with unsold securities. b) Insurance: a person or company agrees to provide financial compensation against the risk of fire, theft, death, disability, etc., for a fee called a premium.
	Undisclosed Reserves	These reserves often serve as a cushion against unexpected losses, but they are less permanent in nature and cannot be considered as ‘Core Capital’. Revaluation reserves arise from revaluation of assets that are undervalued on the bank’s books, typically bank premises and marketable securities. The extent to which the revaluation reserves can be relied upon as a cushion for unexpected losses depends mainly upon the level of certainty that can be placed on estimates of the market values of the relevant assets, the subsequent deterioration in values under

		difficult market conditions or in a forced sale, potential for actual liquidation at those values, tax consequences of revaluation, etc
	Value at risk (VAR)	It is a method for calculating and controlling exposure to market risk. VAR is a single number (currency amount) which estimates the maximum expected loss of a portfolio over a given time horizon (the holding period) and at a given confidence level.
	Venture capital Fund	A fund with the purpose of investing in start-up businesses that is perceived to have excellent growth prospects but does not have access to capital markets.
	Vertical Disallowance	In the BIS Method for determining regulatory capital necessary to cushion market risk, a reversal of the offsets of a general risk charge of a long position by a short position in two or more securities in the same time band in the yield curve where the securities have differing credit risks.