GLOSSARY

Balance-sheet liquidity
The ability of an institution to meet its obligations in a corresponding volume and term structure. The term funding liquidity is also used, meaning the ease with which economic agents can obtain external finance.

Capital adequacy ratio
The ratio of regulatory capital to total risk-weighted assets. Tier 1 capital adequacy is the ratio of Tier 1 capital to total risk-weighted assets (see also *Tier 1*).

CERTIS A payment system processing all domestic interbank transfers in Czech koruna in real time. Banks, credit unions and foreign bank branches are participants in this system. As of 31 December 2009, the CERTIS comprised 44 direct participants and 7 third parties – for example, card payment clearing houses and securities clearing and settlement institutions.

Collective investment funds
Mutual and investment funds whose sole business activity is collective investment, i.e. collecting funds from investors and investing them. CIFs are broken down by investor type into funds intended for the public (dominated by open-ended mutual funds) and funds for qualified investors, and by asset risk into money market, bond, equity, mixed and real estate funds and funds of funds. Sometimes the category of funds of funds is not listed separately, but is included in the other categories according to the type of funds in which they invest.

Connectivity An indicator of the degree of interconnectedness of a network element with the other elements (e.g. in a network of interbank exposures); for each bank, connectivity is calculated as the number of relationships with other banks divided by the maximum possible number of relationships and takes values from 0 to 100%. The average connectivity of the entire network is calculated as the average across all banks.

Credit default swap (CDS)
A credit derivative in which the buyer of the collateral undertakes to pay the seller periodical fixed payments ("swap premium") for the duration of the contract in exchange for a conditional payment of the counterparty in the case of default of the "reference entity" to which the agreement refers. If default does not occur, the contract terminates at a specified time and the seller only gains a premium for taking on the potential credit risk.

Credit premium The premium on the return on a portfolio for credit risk.

Custody Banks offer their clients the service of safekeeping and management of securities and settlement of securities transactions on both domestic and foreign markets. The bank opens and maintains a securities owner account for the customer, on which it performs settlement of the customer's capital market trades as instructed by the customer. As the custodian, the bank performs activities directed at preserving the rights attaching to the securities in its custody.

Debt deflation A situation where the real value of the debt of corporations and households rises as a result of falling prices and incomes. This happens primarily in a situation where the decrease in nominal interest rates is insufficient to offset the fall in the rate of growth of incomes.

Default Default is defined as a breach of the debtor's payment discipline. The debtor is in default at the moment when it is probable that he will not be able to repay his obligations in a proper and timely manner, without recourse by the creditor to settlement of the claim from the security, or when at least one repayment (the amount of which deemed by the creditor to be significant) is more than 90 days past due.

Default rate The 12-month default rate is the number of new defaulters over a 12-month reference period as a proportion of the total number of entities existing in that period. The default rate can also be defined analogously in terms of volume based on the obligations assumed by debtors.

Eligible collateral An asset accepted to ensure fulfilment of an obligation to the central bank.

Equalisation provision
The equalisation provision is set aside for individual areas of non-life insurance and is intended to equalise increased insurance claim costs arising due to fluctuations in loss ratios as a result of facts independent of the will of the insurance company.

Herfindahl index (HI)
The sum of the squares of the market shares of all entities operating on a given market. It expresses the level of concentration in the market. It takes values between 0 and 10,000. The lower the HI, the less concentrated the market.

Household insolvency
A situation where a household is unable to cover its current expenditures by its current income and the sale of its asset holdings. Insolvency is defined in legal terms in Act No. 182/2006 Coll., on Insolvency and Methods of Resolution Thereof.

Institutional investor
Either (a) a bank executing trades in investment instruments on its own account on the capital market, an investment company, an investment fund, a pension fund or an insurance company, or (b) a foreign entity authorised to carry on business in the same fields in the Czech Republic as the entities listed under (a).

Interest rate spread
Also interest rate differential; the spread between the interest rate on a contract (deposit, security) and a reference interest rate.

Interest rate transmission channel
One of the channels of the monetary policy transmission mechanism. It acts such that, for example, an increase/decrease in monetary policy interest rates leads first to an increase/decrease in interest rates on the interbank market. Consequently, there is an increase/decrease in the interest rates announced by banks for the provision of loans and the acceptance of deposits. The result is a downturn/upturn in investment activity as a part of aggregate demand and ultimately a decrease/increase in inflation pressures.

Jump-to-default risk
The risk of sudden default that arises before the market can reflect that risk in prices.

Liquidity Money in the broader sense (cash, short-term assets quickly exchangeable for cash, etc.).

Loan-to-value (LTV) ratio
The ratio of a loan to the value of pledged property.

Loss given default (LGD)
The ratio of the loss on an exposure in the event of counterparty default to the amount owed at the time of default (see also *Default*).

Market liquidity The ability of market participants to carry out financial transactions in assets of a given volume without causing a pronounced change in their prices.

Monte Carlo simulation
A numerical technique based on repeated random sampling. It employs a large number of simulations of a particular random variable to determine its approximate distribution and thus also the most likely value it can take.

Natural population increase
The difference between the number of live births and the number of deaths in the same period of time in a given area. See also *Total population increase*.

Non-performing loans
Substandard, doubtful and loss loans. Also called loans in default or default loans.

Overnight segment
The money market on which overnight funds are traded.

Price-to-income The ratio of the price of an apartment (68 m^2) to the sum of the annual wage in a given region over the last four quarters.

Price-to-rent The ratio of the price of an apartment to the annual rent. The price-to-rent ratio is the inverse of the rental return.

Property developers/developments
Companies/projects whose aim is to build a complex of residential and commercial property. Property developers' work includes choosing an appropriate site, setting up a project, obtaining the necessary permits, building the necessary infrastructure, constructing the buildings and selling the property. Developers also often organise purchase financing for clients and frequently lease or manage the property once it is built (especially in the case of commercial property). Given the combination of construction activity and speculative property purchases, developers' results are strongly dependent on movements in property prices.

Property supply prices
Property sale supply prices in estate agencies. Supply prices should be higher than transfer prices. Property supply prices in the Czech Republic are published, for example, by the CZSO and the Institute for Regional Information (which also publishes data on market rent supply prices). See also *Property transfer prices*.

Property transfer prices (aka "Property realisation prices")
Prices based on Ministry of Finance statistics from property transfer tax returns and published by the CZSO. These prices are the closest to actual market prices in terms of methodology, but are published with a time delay. See also *Property supply prices*.

Quantitative easing
A method for implementing monetary policy in a situation where the central bank is no longer able to lower its monetary policy rate because it has already reduced it almost to zero. Quantitative easing involves the central bank buying assets from commercial banks and thereby creating a sizeable stock of free reserves with those banks. The purpose of this type of policy is to strengthen the balance-sheet and market liquidity of the banking system and minimise the risk of growth in interest rates due to insufficient liquidity. Japan has applied quantitative easing in the past decade, and the US Fed, for example, is to some extent pursuing a similar policy at present.

Rent return The ratio of the annual supply rent to the supply price of the flat. It is the inverse of the price-to-rent indicator.

Risk premium The risk premium an investor demands on investments in riskier financial instruments.

Secondary market The market on which existing securities are traded.

SKD Short-Term Bond System. The system is used for issuing and registering all book-entry securities with maturities of up to one year and for settling trades in these securities. At present, T-bills and CNB bills are registered in SKD. The system enables sales of securities, repos and sell and buy operations, as well as pledges and exchanges of securities. As of 31 December 2009, a total of 155 owner accounts – belonging to 109 clients (securities owners) – were registered in SKD. In all, 18 agents and 5 custodians use the system.

Solvency Solvency in the insurance sector is the ability of an insurer to meet its insurance obligations, i.e. to settle eligible insurance claims arising from insured losses. Solvency II – a new regulatory framework prepared by the European Commission – is a set of rules for European insurance companies and reinsurers laying down quantitative requirements, qualitative requirements, prudential rules, compliance with market discipline and disclosure duties.

Systemic risk The risk of the entire financial system or market collapsing.

Technical provisions
Under the Act on Insurance, an insurer must set aside technical provisions to meet insurance obligations which are either likely to be incurred or certain to be incurred but uncertain as to amount or as to the date on which they will arise.

Tier 1 The highest quality and, for banks in the Czech Republic, also the most significant part of regulatory capital. The dominant components of Tier 1 are equity capital, retained earnings and mandatory reserve funds.

Value at risk The size of loss, with predefined probability, which a bank may suffer when holding a current portfolio for a certain period if market factors (e.g. interest rates, exchange rates) develop unfavourably.

Yield spread Also yield differential; the spread between the yield on a bond and the yield on a reference ("benchmark") bond.