Impact of Financial risks at Intermediaries on CSDs

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Risk & Recovery Management Task Force
(National Securities Depository Limited)

NSDL
Technology, Trust & Reach

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Topics

- Reasons for financial risks to an Intermediary

- Types of Risk

- Impact of Financial Risk at Intermediaries

- How are operationally these risks are addressed at CSD

- Indian Context

- Indian Context - Mitigation Measures

Reasons for Financial Risk

- Outsourcing of activities

- Competition due to rapid growth of Intermediaries

- Lack of expertise and human factor

- Conflict of interests between multiple activities undertaken

- Non-availability of sufficient and reliable risk data and information

- Little attention to risk culture, talent and capabilities

Type of Risks

- Insolvency or Bankruptcy of Participant

- Cyber-attacks

- Frauds or errors / delays by Participants employees

- Non-performance by third party service providers

Impact of Financial Risk at Intermediaries

- Increase in Investor Grievances

- Deterioration of services standard to investor

- Non servicing to Client

- Possibility of losses to Clients

- Not able to meet its legal / regulatory obligations

How are operationally these risks are addressed at CSD

- Omnibus Account Structure
  - Securities held in CSD are in the name of intermediaries
  - Owners name is known only to the Intermediaries and not the CSD
  - Investors ownership is at risk in case of delinquency of an intermediary as security owners name is available only with the intermediary
  - Inability of CSD to address investor grievances

- Beneficial Account Structure
  - Securities held in CSD are in the name of beneficial owner
  - Owners name is known to the Intermediaries and the CSD
  - Investors ownership is protected in case of delinquency of an intermediary
  - CSD is able to address investor grievances
  - Transparency

Indian Context

- Depositories Act
  - Depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner
  - Depository as a registered owner shall not have any voting rights or any other rights in respect of securities held by it
  - The beneficial owner shall be entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository
  - Depository shall maintain a register and an index of beneficial owners

Indian Context   ... Contd.

- **SEBI (D&P) Regulations**
  - Participant to open separate accounts in the name of each of the beneficial owners
  - Securities of each beneficial owner shall not be mixed up with the securities of other beneficial owners or with the participant's own securities
  - A participant shall register the transfer of securities to or from a beneficial owner's account only on receipt of instructions from the beneficial owner
  - Every entry in the beneficial owner's account shall be supported by an instruction received from the beneficial owner

- **NSDL Bye Laws**
  - The Participant shall not give a debit or credit to the account of a Client without a due authorisation from Client
  - Participant shall not commingle its own securities with the securities of its Client and shall maintain each Client's account separately

Indian Context - Mitigation Measures

- Consolidated Account Statement sent by NSDL directly to Clients

- SMS

- Audit Trail of each transaction is maintained at central system

- Mandatory Concurrent and Internal Audit for Participants

- Training of internal auditors & Participant staff and Certified personnel, who provide important services to the investors

- Uploading of client instructions to NSDL

- Inspection of Participants

- Capital Requirement for Participants

- Monitoring of the Aggregate Value of Securities of Stock Broker Participants

- Approval of NSDL for outsourcing any activity by Participants

Mitigation Measures   ... Contd.

- Risk Based Supervision of Participants

- Insurance coverage for NSDL & its Participants for possible risks related to their activities

- Policy for closure of Participant (withdrawal / termination)

- Transmission of data is carried out in encrypted form

- Cyber Security and Cyber Resilience framework for Participants

Thank you