

Risk Impact of Defaulting/Collapsing Economies on CSDs and Mitigating Measures and Practices adopted by CDSC, Nepal

Mr. Suraj Karki

Sr. IT Officer

CDS and Clearing Ltd, Kathmandu, Nepal

Introduction of CDSC

- 100% Subsidiary company of Nepal Stock Exchange (NEPSE)
- Established on December 22, 2010
- The main objective of the company is to act as a central depository for various instruments (Equity, Bonds) and provide the clearing and settlement service.

Liquidity Risk

- A collapsing economy can lead to a liquidity crunch.
- Challenging for CSDs and its stakeholders to fulfill their settlement obligations.

Mitigating measure:

- Maintaining sufficient reserves, diversifying their funding sources.

Practice in CDSC,Nepal:

- Provision of settlement guarantee fund to minimize the risk of fund shortage during clearing and settlement process.
- Provision of bank guarantee to the broker(clearing members) from the clearing banks

Default Risk

- When an economy defaults or collapses, there is a risk that issuers of securities may default on their obligations like paying different fees to the CSDs.
- Have an impact on the revenue of the CSDs.
- Have an impact on the returns(dividends) to the clients.

Mitigating measure:

- Monitoring credit ratings of the company, collateral management

Practice in CDSC,Nepal:

Credit rating of company is mandatory before any public issue and it is done by independent company.

Operational Risk

- In times of economic distress, operational risks can increase due to market volatility, increased trading volumes, and potential disruptions in communication networks and infrastructure.

Mitigating measure:

- Implementing robust IT systems, disaster recovery plans, and business continuity plans

Practice in CDSC,Nepal:

- **We have Data Center in Kathmandu and DR at Haetauda for Disaster and business continuity.**
- **Provision of dual site to site VPN from different ISPs to minimize the risk of disruptions in networks.**
- **HA(High availability) environment to minimize the risk of different device failure.**
- **Self Presence of the client to open the demat account.**
- **Transfer of securities from one beneficiary owner account to another beneficiary owner account can be done only with the approval of CDSC.**
- **Logs of every transaction module is recorded through non financial history inquiry module.**
- **Notifications of each debit and credit transaction to the client through mobile apps.**

Legal and Regulatory Risk

- Defaulting or collapsing economies often bring about legal and regulatory uncertainties.
- Changes in laws, regulations, or government policies can impact the legal framework within which CSDs operate, potentially affecting their ability to provide services and meet their obligations.

Mitigating measure:

- CSDs should closely monitor legal and regulatory developments.
- Maintain strong relationships with relevant authorities. Engaging in dialogue with regulators.
- CSDs should also have robust legal frameworks in place, to mitigate legal risks associated with defaulting or collapsing economies.

Counterparty Risk

- When an economy collapses, there is an increased risk of counterparties, such as brokers, Depository Participants, issuer company and other stakeholders defaulting on their obligations to CSDs.

Mitigating measure:

- Establishing strict eligibility criteria for participants
- Conducting regular assessments of counterparties' creditworthiness, setting exposure limits, and establishing collateral requirements.

Practice in CDSC, Nepal:

- Depository participants cannot hold securities of value more than 500 times of their net worth.
- Provision of checking balance at CDSC end before execution of trades in stock Exchange to reduce the risk of security shortage.

Reputational Risk

- If a CSD fails to effectively manage the risks associated with a defaulting or collapsing economy, its reputation can be significantly damaged.
- CDSC brings into parties which have fallen to provide support as per the standard procedure such that there is no such misinformation in the market which hampers CDSC's reputation.

Mitigating measures :

Control processes Standardization, technology, policies, and procedures reduce the likelihood and severity of events that could cause reputational damage. By focusing on consistently supplying quality products and services, it's much less likely that there will be a harmful mistake.

CDSC Updates

- Depository Participants:83
- Registered Companies:239
- Registered Mutual fund:40
- Registered Bonds and Debentures:70
- Registered Clearing Member:51
- Number of RTA:42
- Number of Clearing Banks:4
- Beneficial Owners demat account: 5697094(approx. 5.6 million)

