

CSDs make fall guys of pension funds

By Bob Crew
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Bob Crew asks what can be done about the risks faced by pension funds having to deal with central securities depositories

With only 55% of the world's central securities depositories (CSDs) having insurance cover for loss or theft of securities - and not more than 56% of them being legally required to compensate for the loss of missing or deposited securities, investors are potentially at risk in many markets.

Research by custody consultants Thomas Murray finds that investors are particularly at risk when it is compulsory for them to use a CSD or clearing system (as it is in 58 of the world's operational CSDs). And, with custodian banks refusing to bear any liability for losses suffered by their clients as a result of securities or cash being put into or handled by a CSD or clearing system, clients are on their own !

So what can be done to make more of the world's CSDs accountable and to face up to their liabilities and eliminate risk ?

According to Simon Thomas, a director with Thomas Murray: A significant number of CSDs are not guaranteed by anyone and none of them fully eliminate market or liquidity risk. The problem for investors is that custodian banks regard CSDs as part of the local market infrastructure and, as such, hold all risks associated with their use to be market risks which should be borne by their clients. A lot of work remains to be done by CSDs to satisfy growing institutional and bank awareness of the issues surrounding their use. It no longer seems possible for custodians to leave their clients in the dark about the consequences of using CSDs, particularly where their use is optional."

So why are some custodians keeping their clients in the dark?

Tony Lewis, a network manager with Britain's HSBC Midland Bank, says: "There is a lot of concern and rightly so. Some CSDs are well below international standards and we visit them to do our due diligence and advise our clients accordingly.

"We look carefully at the procedures and controls of CSDs, because it does concern us, and we help our clients manage the risks associated with using a depository by making them aware of their exposure."

But what custodian banks don't do is share any of the liability for those risks ('in no circumstances' is what it says in legal contracts)

Mike Faulkner, a consultant with Towers Perrin, says: "The custodian should worry about this because it deals with CSDs on behalf of its clients But CSDs need to be better regulated and they should insure themselves in order to reimburse users.

"Users shouldn't have taken out insurance to cover the failings of CSDs."

In the meantime, investors had better keep their wits about them when using dodgy CSDs, either because it is compulsory for them to do so, or because their custodian has not advised them that it is optional"