

### Box 1 Risks in securities settlement systems

*Credit risk:* The risk that a counterparty will not settle an obligation for full value, either when due or at any time thereafter.

*Custody risk:* The risk of loss on securities in safekeeping (custody) as a result of the custodian's insolvency, negligence, misuse of assets or fraud.

*Legal risk:* The risk that a party will suffer a loss because laws or regulations do not support the rules of the securities settlement system, the performance of related settlement arrangements, or the property rights and other interests held through the settlement system. Legal risk also arises if the application of laws and regulations is unclear.

*Liquidity risk:* The risk that a counterparty will not settle an obligation for full value when due, but on some unspecified date thereafter.

*Operational risk:* The risk that deficiencies in information systems or internal controls, human errors or management failures will result in unexpected losses.

*Pre-settlement risk:* The risk that a counterparty to a transaction for completion at a future date will default before final settlement. The resulting exposure is the cost of replacing the original transaction at current market prices and is also known as replacement cost risk.

*Principal risk:* The risk that the seller of a security delivers a security but does not receive payment or that the buyer of a security makes payment but does not receive delivery. In such an event, the full principal value of the securities or funds transferred is at risk.

*Settlement risk:* A general term used to designate the risk that settlement in a transfer system will not take place as expected. The risk may comprise both credit and liquidity risk.

*Systemic risk:* The risk that the inability of one institution to meet its obligations when due will cause other institutions to be unable to meet their obligations when due. Such a failure may cause significant liquidity or credit problems and, as a result, might threaten the stability of or confidence in markets.

*Source: CPSS/IOSCO Recommendations, pp 46-49.*