

# Primary Dealers in Government Securities



Marco Arnone  
Piero Ugolini



**International  
Monetary  
Fund**

# **Primary Dealers in Government Securities**

Marco Arnone and Piero Ugolini

International Monetary Fund  
Washington, DC

©2005 International Monetary Fund

Production: IMF Multimedia Services Division

Cover Design: Massoud Etemadi

Typesetting: Alicia Etchebarne-Bourdin

Cover Photo: Getty Images

### **Cataloging-in-Publication Data**

Primary dealers in government securities / Marco Arnone and Piero Ugolini — Washington, D.C. : International Monetary Fund, [2004].

p. cm.

Includes bibliographical references.

ISBN 1-58906-379-1

1. Government securities. I. Arnone, Marco. II. Ugolini, Piero, 1946 –

HG4715.P75 2004

*Disclaimer:* The views expressed in this work are those of the authors and do not necessarily represent those of the IMF or IMF policy. The IMF has not edited this publication. Some documents cited in this work may be not available publicly.

Price: \$25.00

Please send orders to:

International Monetary Fund, Publication Services  
700 19th Street, NW, Washington, DC 20431, U.S.A.

Telephone: (202) 623-7430 Telefax: (202) 623-7201

Internet: <http://www.imf.org>

# Contents

<b>Preface</b>	<b>v</b>
<b>Chapter 1. Introduction</b>	<b>1</b>
<b>Chapter 2. Definition and Findings</b>	<b>2</b>
<b>Chapter 3. Rationale for a Preliminary Dealer System</b>	<b>4</b>
<b>Chapter 4. Implications of Establishing a Primary Dealer System</b>	<b>6</b>
<b>Chapter 5. Market Structure and Development</b>	<b>8</b>
A. Financial Development	8
B. Market Structure	9
C. System Design in the Course of Financial Development	10
<b>Chapter 6. Key Prerequisites for a Primary Dealer System</b>	<b>12</b>
<b>Chapter 7. Operational Issues in Establishing a Primary Dealer System</b>	<b>15</b>
A. Selection Criteria	16
B. Obligations	19
C. Privileges	27
D. Foreign Institutions as Primary Dealers	34
E. Supervision	37
F. Other Operational Considerations and Legal Aspects	41
<b>Chapter 8. Evidence from the Survey</b>	<b>45</b>
A. Reported Advantages and Disadvantages	46
B. Primary Dealers and Stages of Development	53
<b>Appendix 1. Summary of Primary Dealer System Characteristics</b>	<b>56</b>
<b>Appendix 2. Complete Survey Results by Country</b>	<b>58</b>
<b>Bibliography</b>	<b>91</b>

**Tables**

1. Selection Criteria for Primary Dealers	20
2. Selection Criteria for Primary Dealers—Selected Country Experiences	21
3. Survey of Obligations of Primary Dealers	28
4. Obligations of Primary Dealers—Selected Country Experiences	28
5. Survey of Privileges of Primary Dealers	34
6. Privileges of Primary Dealers—Selected Country Experiences	35
7. Institutions Responsible for Supervision and Enforcement	40
8. Survey of Advantages of a Primary Dealer System	48
9. Survey of Disadvantages of a Primary Dealer System	51

**Figures**

1. Year of Establishment of a Primary Dealer System	46
2. Debt-to-GDP Ratio of Countries With and Without a Primary Dealer System, 1999	47
3. Recommendation of a Primary Dealer System	54
4. Phases of Economic Development and the Establishment of a Primary Dealer System	54

## Preface

In the last 10 years there have been a growing number of countries that have established or are in the process of establishing a primary dealer system. This paper discusses theoretical and operational issues related to the establishment of a primary dealer system for countries that may be considering taking this step. Drawing on a survey of country practices conducted in 2001, the first part of the paper discusses the rationale, costs and benefits, and key prerequisites, while selection criteria, obligations, and privileges, among other issues, are discussed in the second part. The paper also tries to address whether a primary dealer system fits into the overall strategy for financial market development in the country. In this context, under appropriate circumstances, primary dealers can support the primary market for government securities by helping to provide a consistent, dependable source of demand. At the same time, they can foster development of the secondary market by providing two-way quotes for selected issues of government securities and by servicing the retail market. Under a primary dealer system, the debt manager and the group of primary dealers pursue a common strategy in support of the effective functioning and development of primary and secondary markets for government securities. Among the countries surveyed, there was broad agreement among authorities that a primary dealer system is to be highly recommended.

The authors would like to thank the Director of the Monetary and Financial Systems Department, Stefan Ingves; the Deputy Directors, Tomás Baliño, Charles Enoch, and Hervé Ferhani; and Peter Dattels, Jennifer Elliott, Mats Filipsson, George Iden, Robert Price, Christine Sampic, Andrea Schaechter, Mark Stone, V. Sundararajan, Mark Swinburne, and Mark Zelmer for their helpful comments. A special thanks goes to Patricia Mendoza-Ibarguen for her impeccable editorial assistance, to Sandra Marcelino for her excellent research assistance, and to Archana Kumar of the External Relations Department for coordinating the production of the publication. The authors would also like to express their gratitude to the national authorities that participated in the survey.

CHAPTER

**1**

**Introduction**

In the last 10 years there have been a growing number of countries establishing primary dealer (PD) systems. This paper discusses the role of primary dealers, as well as operational and technical issues related to the establishment of a PD system, in the overall management of public debt for countries that may be considering establishing such a system. One of the goals of the paper is to provide guidance on how to design a primary dealer system in an appropriate way to meet market development needs.

The paper tries also to determine under what conditions a PD system would make a positive contribution to the functioning and development of the government securities market. Even though it is difficult to give a precise analytical answer to this latter question for all countries, the paper will try to address this issue by drawing from practical experiences for individual countries. To provide empirical support and detailed information for the project, a survey on primary dealer practices and views was sent in 2001 to 47 countries, varying widely in terms of size and stage of economic development, and responses were received from 39 of these countries.

It is important to note that industrial countries already have PD systems, although many that do have established them only in the last few years. In addition, a number of emerging market and developing countries have either adopted, or are in the process of adopting, PD systems, but many others have not done so.