

Primary Dealers: An Essence of Indian Money Market

Abstract

Primary Dealers can also be referred to as Merchant Bankers to Government of India as only they are allowed to underwrite primary issues of government securities other than RBI who have since shed this role. Primary dealer is a formal designation of a firm as a market maker of government securities. The primary dealers have been playing a very significant role in strengthening the market infrastructure of Government Securities and helping the RBI in its monetary policy decisions. The present paper tries to study the role of primary dealers in strengthening the Indian Money market.

Keywords: Money Market, Primary Dealers, RBI.

Introduction

A primary dealer is a firm that buys government securities directly from a government, with the intention of reselling them to others, thus acts as a market maker of government securities. The government may regulate the behaviour and number of its primary dealers and impose conditions of entry. Some governments sell their securities only to primary dealers; some sell them to others as well. Governments that use primary dealers include Belgium, Canada, China, France, Hong Kong, India, Italy, Japan, Singapore, Spain, the United Kingdom, and the United States.

The objectives of the Primary Dealer system are:

1. To strengthen the infrastructure in the government securities market in order to make it vibrant, liquid and broad based.
2. To ensure development of underwriting and market making capabilities for government securities outside the RBI so that the latter will gradually shed these functions.
3. To improve secondary market trading system, which would contribute to price discovery, enhance liquidity and turnover and encourage voluntary holding of government securities amongst a wider investor base.
4. To make PDs an effective conduit for conducting open market operations (OMO).

Primary dealers are registered entities with the RBI who have the license to purchase and sell government securities. They are entities who buys government securities directly from the RBI (the RBI issues government securities on behalf of the government), aiming to resell them to other buyers. In this way, the Primary Dealers create a market for government securities.

The Primary Dealers system in the government securities market was introduced by the RBI in 1995.

Eligibility Conditions for PDs

1. Subsidiary of scheduled commercial bank/s and All India Financial Institutions
2. Subsidiaries/ joint ventures set up in India by entities incorporated abroad.
3. Company incorporated under the Companies Act, 1956 and does not fall under (a) or (b).

The applicant for PD should register as an NBFC for at least one year prior to the submission of application. Other conditions like net owned fund etc are mentioned by the RBI.

The decision to authorize PDs will be taken by RBI based on its perception of market needs, suitability of the applicant and the likely value addition to the system. Some other functions besides trading in government securities are also assigned to them.

Review of Literature

This area of study is not overdone. Only few studies are found in this regard. That is why review of literature is limited to the year 2012.

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Syal (2011) in her research paper examined the performance of Primary Dealers for the period 2006 – 2010. The study was based secondary data of Primary Dealers (PDs). The study revealed that the financial position of PDs fell in the year 2007 as compared to the year 2006. Net assets, income, capital of PDs decreased by huge margins due to sharp fall in the number of PDs functioning during 2006-07. The year 2008 was the greatest decline in all.

Sharma (2012) in his research paper made an attempt to study the performance of Primary Dealers (PDs) after the liberalisation era. The study was based on secondary data covering the period from 2006-07 to 2010-11. It was found that that net profits of all the PDs were falling during the period of study except in the year 2008-09. The study further concluded that primary dealers helped in strengthening the the Government securities market and put into action the efficient secondary market trading system.

Objectives of the study

The objective of the paper is to study the eminent role played by the primary dealers in strengthening the Indian money market.

Research Methodology

The study is based on secondary data. The secondary data has been collected from various sources like journals, articles, RBI and various research papers.

Primary Dealers' (PDs) role

PDs are expected to play an active role in the government securities market, both in its primary and secondary market segments. A Primary Dealer will be required to have a standing arrangement with RBI based on the execution of an undertaking and the authorization letter issued by RBI each year. The major roles and obligations of PDs are as below:

Support to Primary Market

PDs are required to support auctions for issue of Government dated securities and Treasury Bills as per the minimum norms for underwriting commitment, bidding commitment and success ratio as prescribed by RBI from time to time.

Market Making in Government Securities

PDs should offer two-way prices in Government securities, through the Negotiated Dealing System-Order Matching (NDS-OM), over-the-counter market and recognised Stock Exchanges in India and take principal positions in the secondary market for Government securities.

Obligations of PDs

1. PDs should maintain adequate physical infrastructure and skilled manpower for efficient participation in primary issues, trading in the secondary market, and to advise and educate investors.
2. A Primary Dealer shall have an efficient internal control system for fair conduct of business, settlement of trades and maintenance of accounts.
3. A Primary Dealer will provide access to RBI to all records, books, information and documents as and when required.

4. A PD should submit periodic returns as prescribed by the RBI from time to time.
5. PDs' operations are subject to prudential and regulatory guidelines issued by RBI from time to time.

Number of Primary Dealers in India

DFHI and STCI were accredited as primary dealers on March 1, 1996. On June 1, 1996, four more PDs- SBI gilts PNB gilts, Gilts Securities Trading Corporation Limited, and ICICI Securities became operational. As on March 31, 2009, there were 19 approved PDs in the gilts market. Of these, eight were non-bank entities (stand alone PDs) and the remaining 11 were banks undertaking PD business departmentally (Bank PSs) registered as NBFCs under section 45 IA of the RBI Act, 1934. The stand alone PDs are Securities Trading Corporation of India Ltd., SBI DFHI Ltd., ICICI Securities Ltd., PNB Gilts Ltd., ABN AMRO Securities (India) Pvt. Ltd., DSP Merrill Lynch Ltd., Deutsche Securities (India) Pvt Ltd., and IDBI Capital Market Services Ltd. At present there are 5 standalone primary dealers in India and 15 bank primary dealers. The list is shown below:

List of Primary Dealers in Government Securities Market (As on July 13, 2017)

(Source: RBI)

Standalone Primary Dealers

1. ICICI Securities Primary Dealership Limited
2. Morgan Stanley India Primary Dealer Pvt. Ltd.
3. SBI DFHI Ltd.
4. STCI Primary Dealer Limited
5. Goldman Sachs (India) Capital Markets Pvt. Ltd.

Bank Primary Dealers

1. Bank of America
2. Bank Of Baroda
3. HDFC Bank Ltd.
4. Canara Bank
5. CITIBank N.A
6. Corporation Bank
7. HDFC Bank Ltd.
8. Hongkong and Shanghai Banking Corpn. Ltd.(HSBC)
9. J P Morgan Chase Bank N.A, Mumbai Branch
10. Kotak Mahindra Bank Ltd.
11. Standard Chartered Bank
12. Axis Bank Ltd.
13. IDBI Bank Limited
14. Deutsche Bank AG
15. Yes Bank Limited

Conclusion

Primary dealers (PDs) continue to be highly over-leveraged, in their role as active market makers in the secondary market. PDs are performing an exceptional role in giving marketability to government securities. Also, RBI has expanded the role of PDs through various obligations like participating in primary auction, market making in G-securities, maintaining efficient internal control system for fair conduct of business etc.

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