



Ministry of Finance

Debt and Financial Assets
Management Department

Performance Evaluation of Primary Dealers in Czech Government Securities

December 2013



31 January 2014

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Letenská 15, 118 10 Prague 1
Tel.: +420 257 041 111
E-mail: pd@mfcz.cz

Electronic archive:
www.mfcz.cz/statedebt

Introduction

The Ministry of Finance (hereinafter the Ministry) hereby presents its regular Performance Evaluation of Primary Dealers in Czech Government Securities (hereinafter the Performance Evaluation). As from 1 October 2011, the evaluation methodology has changed significantly. This change is related to the implementation of the MTS Czech Republic electronic platform for trading on the domestic secondary bond market from 1 July 2011 and to signature of the *Primary Dealer Agreement for Czech Government Securities* (hereinafter the Agreement) by the Ministry and the Primary Dealers in Czech Government Securities (hereinafter the Primary Dealers) on 1 October 2011. Conclusion of the Agreement established a new and more efficient trading structure, as is common in other advanced countries of the European Union and which brought standardisation and professionalism to the cooperation in financing and managing the state debt as well as its complete transparency. The modernisation of this framework was rounded off by publication of the new *Rules for the Primary Sale of Government Securities organized by the Czech National Bank*, which came into effect on 1 January 2012. Under this newly formalised framework, and on the basis of the consensually agreed rules, the Ministry became active on the secondary market after an almost two-year break, in particular by directly buying back government bonds before their maturities and by tap sales of government bonds from the Ministry's own portfolio.

A new version of the Agreement which entered into force on 1 January 2013 does neither bring about any change into Primary Dealers status nor does it alter any of their rights and obligations. However, it strictly defines the procedure in case of non-compliance with their obligations on both

primary and secondary market. A new version of the Agreement also brings a new name of the Agreement in Czech language. The new version of the Agreement preserves the weight ratio between the criterion of primary and secondary market, further reinforcing the importance of the secondary market, which enables the evaluation of active market-makers in relation to their performance at primary auctions of government bonds. The new version of the Agreement preserves the criterion of the primary market unchanged, modifies the system of weights in qualitative criterion and in the evaluation of the secondary market establishes a new sub-criterion evaluating pricing strategy of tap sales and buy backs, which consequently modifies the system of weights of the secondary market criterion.

According to the new version of the Agreement, the Primary Dealers are evaluated for the period from Q1 2013 to Q4 2013. In Q4 2013, the number of the Primary Dealers has decreased to 12, when The Royal Bank of Scotland plc terminated its activities as a Primary Dealer as of 1 November 2013. Since 2014, Morgan Stanley & Co International PLC has become the new Primary Dealer.

Starting with the Performance Evaluation for 2011, the Ministry has been publishing the point scores obtained by individual Primary Dealers in the published evaluation groups. The Ministry expects to achieve greater transparency by this step. In accordance with the Amendment Agreement signed on 30 June 2012 also the first seven Primary Dealers are published (only five Primary Dealers were published in accordance with the old Agreement). Other Primary Dealers receive a notification with the outcome of their performance evaluation.

Evaluation for 2013

The performance evaluation of Primary Dealers for Q1 2013 to Q4 2013 was performed according to the evaluation methodology **valid from 1 January 2013**. The methodology is part of the new version of the Agreement. In order to attain an overall and objective evaluation of Primary Dealers' activities, the performance evaluation is based on three criteria: criterion for the evaluation of Primary Dealers' activities on the primary market (Criterion A), criterion for the evaluation of Primary Dealers' activities on the secondary market (Criterion B), and criterion for the evaluation of the effectiveness of derivative operations, marketing and sovereign advisory (Criterion C).

The performance evaluation of each Primary Dealer can reach a maximum of 100 points, and this score is calculated on a relative basis. Primary Dealers' activities are thus evaluated quarterly on the basis of the APEI (Aggregate Performance Evaluation Index defined in Attachment I of the new version of the Agreement), and always for four consecutive evaluated periods. According to Article I of the new version of the Agreement, each calendar quarter is an evaluated period, starting from 1 October 2011.

Within evaluated activities on the primary market, a given Primary Dealer's primary auctions share (i.e. the share of total nominal value of bids submitted by the

Primary Dealer on total nominal value of government bonds sold in all government bond auctions during the evaluated period) is monitored under the sub-criterion A.1. Using the ratio of accepted bids of the Primary Dealer to the total nominal value of bids submitted by the Primary Dealer (sub-criterion A.2.) the Ministry monitors investors' willingness to hold Czech government bonds. Another important aspect of evaluation of participation on the primary market is the auction pricing strategy under the sub-criterion A.3., through which the Ministry evaluates Primary Dealers' willingness to offer higher price. Under the sub-criterion A.4., the Primary Dealer is rated better if it is a regular auction participant. The maximum number of points under the sub-criterion A.5. is given to the Primary Dealer that subscribes the largest share of government treasury bills sold by the Ministry in the given period.

The quantitative criterion B is based particularly on statistical and monitoring instruments available on the MTS Czech Republic platform and focuses on quotation activities, their quality, traded nominal values of benchmark issues and trades with the Ministry. The most important indicator is the sub-criterion B.1., the Compliance Ratio, which evaluates the quotation activities of the Primary Dealer based on the quotation duration of bonds subjected to quoting obligations, where maximum allowed spread between bid and offer price condition and minimum nominal value of quotation condition (both defined in MTS Czech Republic Market Rules) must be fulfilled. If a Primary Dealer does not fulfil this sub-criterion by at least 90.0% (i.e. the value unanimously approved at the first MTS Czech Republic Committee meeting on 20 September 2011) on a monthly basis, it obtains 0.0 points for the given month. Sub-criterion B.2. evaluates the

quality of the quotation activities of the Primary Dealer regarding bonds both subjected and not subjected to quoting obligations on DETS based on bonds' duration, bid/offer spread, nominal value of quotation and duration of quotation. Under the sub-criterion B.3., the Primary Dealer is evaluated based on bonds' total nominal value traded on MTS Czech Republic platform taking bonds' duration and number of executed transactions into account, where transactions on the side of provider of quotation have greater weight. Under the sub-criterion B.4., the Primary Dealer is evaluated based on its weighted share on total nominal value of secondary market operations executed by the Ministry during the evaluated period according to particular types of operation (repo operation, buy/sell back operations, depo, tap sales and buy-backs of government bonds on the secondary market). The newly introduced sub-criterion B.5 evaluates pricing strategy of the Primary Dealers in form of willingness to pay the highest nominal amount and duration weighted price under tap sales of government bonds on the secondary market or get the lowest highest nominal amount and duration weighted price under buy-backs of government bonds on the secondary market.

The qualitative criterion C focuses on derivative operations, marketing and sovereign advisory. Primary Dealers are evaluated in ascending order according to the prices of various derivative instruments they provided and their long-term contribution to the effectiveness of the state debt management. The Ministry also evaluates the quality of advisory services, ability to cooperate and share information, technical and human resources in relation to risk management, and optimization of the debt portfolio.

Criteria for evaluation of Primary Dealers valid as of 1 January 2013

A. Primary market	45.0	B. Secondary market	40.0	C. Qualitative criterion	15.0
A.1. Government bond primary auctions share	25.0	B.1. Quoting obligations on DETS	9.0	C.1. Derivative operations	8.0
A.2. Dependability	5.0	B.2. Qualitative performance on DETS	9.0	C.2. Marketing & sovereign advisory	7.0
A.3. Auction pricing strategy	5.0	B.3. Traded volume on DETS	9.0		
A.4. Auction participation	2.5	B.4. Treasury operations on secondary market	9.0		
A.5. Primary auctions share – Treasury bills	7.5	B.5. Tap sales and buy-backs pricing strategy	4.0		

Source: Ministry of Finance

13 Primary Dealers were evaluated, the termination of The Royal Bank of Scotland plc as the Primary Dealer

as of 1 November 2013 was taken into account in the calculation.

Overall evaluation for Q1 2013 to Q4 2013

Ranking	Primary Dealer	Points*
1 st	Citibank Europe plc	81.3
2 nd	PPF banka a.s.	68.5
3 rd	Erste Group Bank AG / Česká spořitelna, a.s.	67.6
4 th	KBC Bank NV / Československá obchodní banka, a.s.	67.0
5 th	Société Générale / Komerční banka, a.s.	64.4
6 th	UniCredit Bank Czech Republic and Slovakia, a.s.	38.0
7 th	Goldman Sachs International	36.9

* max 100 points
Source: Ministry of Finance

Primary market for Q1 2013 to Q4 2013

Ranking	Primary Dealer	Points*
1 st	Citibank Europe plc.	35.4
2 nd	Société Générale / Komerční banka, a.s.	34.9
3 rd	PPF banka a.s.	34.1
4 th	Erste Group Bank AG / Česká spořitelna, a.s.	33.4
5 th	KBC Bank NV / Československá obchodní banka, a.s.	25.9
6 th	UniCredit Bank Czech Republic and Slovakia, a.s.	18.5
7 th	ING Bank N.V.	13.6

* max 45 points
Source: Ministry of Finance

Secondary market for Q1 2013 to Q4 2013

Ranking	Primary Dealer	Points*
1 st	Citibank Europe plc.	33.3
2 nd	KBC Bank NV / Československá obchodní banka, a.s.	30.1
3 rd	PPF banka a.s.	27.4
4 th	Société Générale / Komerční banka, a.s.	20.1
5 th	Erste Group Bank AG / Česká spořitelna, a.s.	19.5
6 th	Goldman Sachs International	12.0
7 th	Deutsche Bank AG	11.9

* max 40 points
Source: Ministry of Finance

This publication is available on the internet at:

www.mfcr.cz/statedebt

The next Performance Evaluation of Primary Dealers in Czech Government Securities
will be published on 30 April 2014 at 14:00.

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Letenská 15, 118 10 Prague 1 - Malá Strana

E-mail: pd@mfcr.cz, Reuters <MFCR>