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The Basics

bbalibor™

bbalibor stands for London InterBank Offered Rate. It is produced for ten currencies with 15 maturities quoted for each, ranging from overnight to 12 Months producing 150 rates each business day.

bbalibor is a benchmark; giving an indication of the average rate a leading bank, for a given currency, can obtain unsecured funding for a given period in a given currency. It therefore represents the lowest real-world cost of unsecured funding in the London market.

Individual bbalibor rates are the end product of a calculation based upon submissions from a panel, made up of the largest, most active banks in each currency bbalibor is quoted for.

Definition

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Every contributor bank is asked to base their bbalibor submissions on the following question; *"At what rate could you borrow funds, were you to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 11 am?"* Therefore, submissions are based upon the lowest perceived rate that a bank on a certain currency panel could go into the inter -bank money market and obtain sizable funding, for a given maturity.

The rates are not necessarily based on actual transaction, indeed it would not be possible to create the suite of bbalibor rates if this was a requirement, as not all banks will require funds in marketable size each day in each of the currencies and maturities they quote. However, this does not mean the rates do not reflect the true cost of interbank funding. A bank will know what its credit and liquidity risk profile is from rates at which it has dealt, and can construct a curve to predict accurately the correct rate for currencies or maturities in which it has not been active.

"*Reasonable market size*" is intentionally left loosely defined: it would have to be constantly monitored and in the current conditions would have to be changed almost daily, certainly every week, and would vary between currencies, maturities and contributors. This would lead to a great deal of confusion.

The current definition became the standard after a review in 1998 where previous submissions from panel members were based upon the following: *"At what rate do you think interbank term deposits will be offered by one prime bank to another prime bank for a reasonable market size today at 11am?"* The new definition enables accountability for the rates.

All bbalibor fixes are quoted as an annualised interest rate. This is a market convention. So, as an example, if an overnight sterling rate from a contributor bank is given as 2.00000%, that does not mean that a contributing bank would expect to pay 2% of the value of an overnight loan in interest. Instead, it means that it would expect to pay 2% divided by 365.

What is bbalibor used for?

bbalibor is the primary benchmark for short term interest rates globally. It is used as a barometer to measure strain in money markets and often as a gauge of the market's expectation of future central bank interest rates. Independent research indicates that around $350 trillion of swaps and $10 trillion of loans are indexed to bbalibor. It is the basis for settlement of interest rate contracts on many of the world's major futures and options exchanges. It is written into standard derivative and loan documentation such as the ISDA terms. It is also used for an increasing range of retail products, such as mortgages and college loans.

Selection of Contributors

Contributor banks are selected for currency panels with the aim of reflecting the balance of the market for a given currency based upon three guiding principles:

1. scale of market activity
2. credit rating
3. perceived expertise in the currency concerned.

Each panel for the 10 currencies, ranging from 8 to 20 contributors, is chosen by the independent Foreign Exchange and Money Markets Committee (FX&MM Committee) to give the best representation of activity within the London money market for a particular currency. Therefore, with all due to consideration to current economic situations, bbalibor submissions from panel members will be on average the lowest interbank unsecured loan offers within the money market that are on offer.

Twice yearly the FX&MM Committee undertakes an assessment of each libor panel, based upon a review by the BBA of the contributors. The review re-evaluates each bank by ranking them according to their total money market and swaps activity over the relevant period and selecting the banks with the largest scale of activity with due concern given to the other 2 criteria. The review is not limited to current contributors as any Banks can submit themselves to the evaluation process for any currency.

Calculation

Thomson Reuters are our designated calculation agent. They audit data submitted by panel banks and create the rates using the definitions provided by the FX & MM Committee, and they do so under the supervision of BBA.

Each cash desk in a contributor bank has a Thomson Reuters application installed. Each morning between 1100 and 1110 an individual at each bank, typically the member of staff with responsibility for management of the bank's cash, takes their own rates for the day and inputs them into this, which links directly to the fixings team at Thomson Reuters. Banks cannot see each others' rates as they submit, only after final publication. Thomson Reuters run a barrage of automated and manual tests on the submitted rates before they are sent to the calculation engine. After calculation the data is released to the market, via Thomson Reuters and nine other data vendors.

Every bbalibor rate produced by Thomson Reuters is calculated by the same method, using a trimmed arithmetic mean. Once Thomson Reuters receive each contributor submissions they rank them in descending order and then drop the top and bottom quartiles – this is the trimming. The middle two quartiles reflecting 50% of the quotes are then averaged to create a bbalibor quote. This is repeated for every currency and maturity resulting in 150 rates produced every business day.

Please see the below example for a US dollar quote for one maturity.

~~*Barclays Bank plc*~~	~~*2.15*~~
~~*Bank of Tokyo-Mitsubishi UFJ Ltd*~~	~~*2.15*~~
~~*HSBC*~~	~~*2.12*~~
~~*Royal Bank of Scotland Group*~~	~~*2.11*~~
UBS AG	*2.105*
Abbey National	*2.1*
Bank of America	*2.1*
Citibank NA	*2.1*
Mizuho Corporate Bank	*2.1*
Rabobank	*2.1*
Royal Bank of Canada	*2.1*
WestLB AG	*2.1*
~~*BNP Paribas*~~	~~*2.05*~~
~~*LLoyds Banking Group*~~	~~*2*~~
~~*Deutsche Bank AG*~~	~~*1.95*~~
~~*JP Morgan Chase*~~	~~*1.95*~~

bbalibor Rate =

2.10063

The decision to drop the bottom and top quartiles in the calculation was taking to increase the accuracy of bbalibor quotes. As previously described, bbalibor is a benchmark and including outliers for any given reason will not reflect a market rate. By dropping outliers it is out of the control of any individual panel contributor to influence the calculation and affect the bbalibor quote.

Inception of bbalibor

bbalibor was first developed in the 1980s as demand grew for an accurate measure of the real rate at which banks would lend money to each other. This became increasingly important as London's status grew as an international financial centre. More than 20 per cent of all international bank lending and more than 30 per cent of all foreign exchange transactions now take place in London.

In 1984 UK banks asked the BBA to develop a calculation that could be used as an impartial basis for calculating interest on syndicated loans. This led to the creation of “BBAIRS” – the BBA Interest Rate Settlement in 1985, which in 1986 became bbalibor. The objectivity and accuracy of the rates allowed derivatives to be created based on the data as a reference, and this has flourished to become an enormously successful cornerstone of business transacted in the City and worldwide.