

The following is taken from <http://www.bbalibor.com/bbalibor-explained/the-basics>

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 - thus producing 150 rates each business day.

bbalibor is a benchmark giving an indication of the average rate at which a LIBOR contributor bank can obtain unsecured funding in the London interbank market for a given period, in a given currency. Individual bbalibor rates are the end-product of a calculation based upon submissions from LIBOR contributor banks, which are then averaged under a "trimmed mean" methodology.

Definition

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 at which a bank could go into the London interbank money market and obtain funding in reasonable market size, for a given maturity and currency.

bbalibor is not necessarily based on actual transactions, as not all banks will require funds in marketable size each day in each of the currencies/ maturities they quote and so it would not be feasible to create a full suite of LIBOR rates if this was a requirement. However, 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 broadly defined: it would have to be constantly monitored and in the current conditions would have to be changed very frequently. It would also vary between currencies and maturities, leading to a considerable amount of confusion.

The current definition was adopted as the standard after a review in 1998. Up until this point, 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 rates are quoted as an annualised interest rate. This is a market convention. For example, if an overnight Sterling rate from a contributor bank is given as 2.00000%, this does not indicate that a contributing bank would expect to pay 2% interest on the value of an overnight loan. 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 written into standard derivative and loan documentation such as the ISDA terms, and is used for an increasing range of retail products such as mortgages and college loans. It is used as a barometer to measure strain in money markets and as a gauge of market expectation for future central bank interest rates. It is also the basis for settlement of interest rate contracts on many of the world's major futures and options exchanges.

Selection of Contributors

Contributor banks have been selected for currency panels in line with three guiding principles:

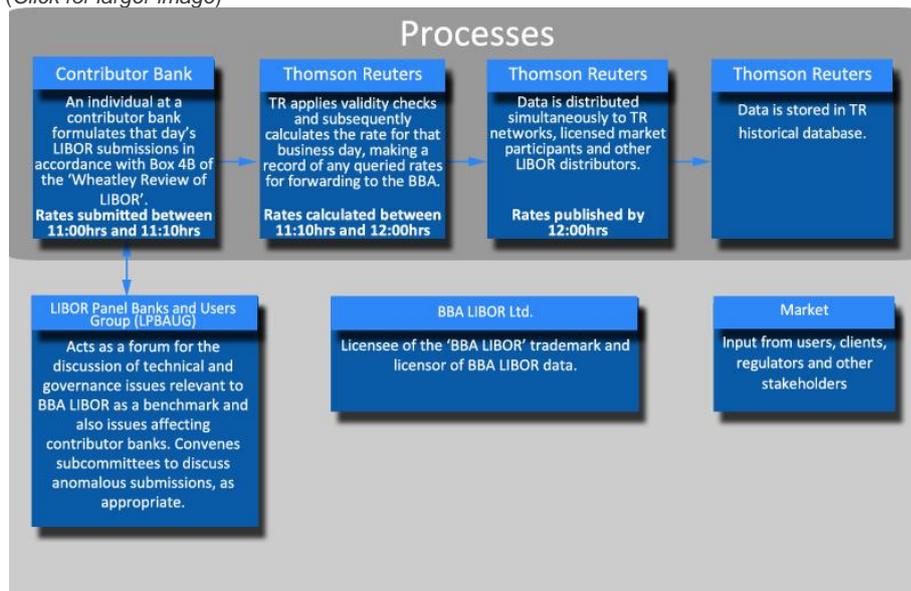
1. **Scale of market activity**
2. **Credit rating**
3. **Perceived expertise in the currency concerned**

Calculation of bbalibor

Thomson Reuters is the designated calculation agent for BBA LIBOR. Data submitted by panel banks into the bbalibor process is received and processed by Thomson Reuters and the data is calculated using guidelines provided by the "LIBOR Panel Banks and Users Group" ("LPBAUG").

Each LIBOR contributor bank has an application installed allowing that institution to confidentially submit rates. Each morning between 1100 and 1110 each panel bank formulates their own rates for the day and inputs them into this application, which links directly to a rate setting team at Thomson Reuters. A bank cannot see other contributor rates during the submission window - this is only possible after final publication of the BBA LIBOR data. Thomson Reuters run a collection of automated and manual tests on the submitted rates before they are sent to the calculation engine, and after calculation the data is released to the market via Thomson Reuters and other licensed data vendors.

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Every bbalibor rate produced by Thomson Reuters is calculated using a trimmed arithmetic mean. Once Thomson Reuters receive each submission they rank them in descending order and then exclude the highest and lowest 25% of submissions - this is the trimming process. Details of this are shown in the table below. The remaining contributions are then arithmetically averaged to create a bbalibor quote. This is repeated for every currency and maturity, producing 150 rates every business day.

No. of Contributors	Methodology	No. of Contributor rates averaged
18 Contributors	top 4 highest rates, tail 4 lowest rates	10
17 Contributors	top 4 highest rates, tail 4 lowest rates	9
16 Contributors	top 4 highest rates, tail 4 lowest rates	8
15 Contributors	top 4 highest rates, tail 4 lowest rates	7
14 Contributors	top 3 highest rates, tail 3 lowest rates	8
13 Contributors	top 3 highest rates, tail 3 lowest rates	7
12 Contributors	top 3 highest rates, tail 3 lowest rates	6
11 Contributors	top 3 highest rates, tail 3 lowest rates	5
10 Contributors	top 2 highest rates, tail 2 lowest rates	6
9 Contributors	top 2 highest rates, tail 2 lowest rates	5
8 Contributors	top 2 highest rates, tail 2 lowest rates	4
7 Contributors	top highest rate, tail lowest rate	5
6 Contributors	top highest rate, tail lowest rate	4

The trimming of the top and bottom quartiles allows the exclusion of outliers from the final calculation.

Inception of bbalibor

bbalibor was first developed in the 1980s as demand grew for an accurate measure of the real rate at which banks could borrow money from each other. This became increasingly important as London's status grew as an international financial centre.

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 these are now widely used in the City of London and worldwide.