



## CHANGES TO HOW BBSW IS CALCULATED

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Early this year the Australian Financial Markets Association announced that the ASX had been appointed as the new **bank bill swap** (BBSW) benchmark rate administrator. Following a transition period, the ASX has now taken over full responsibility for calculating the BBSW which is a key interest rate benchmark.

The BBSW is the primary short-term rate used in the financial markets for the pricing and valuation of derivatives and debt securities such as floating rate bonds, and as a lending reference rate in Australia.

As part of the transition, a new calculation methodology is being finalised and will be introduced. This new methodology is aimed to align with international best practice and the International Organisation of Securities' Commission (IOSCO) Principles for financial benchmarks.

Commenting on the proposed methodology, Terry Toohey from Atchison Consultants is pleased with the outcome of the review and the proposed methodology, “We believe that this new methodology meets the local market requirements and introduces best principles for benchmark construction of the BBSW. Previously, the BBSW was calculated by aggregating bids from AFMA members (including the big four banks) with high and low extremes discarded to find an average rate. The previous methodology presented some challenges and concerns, in particular the robustness and integrity of the bid prices being collected.”

The proposed changes to the methodology followed revelations of a conspiracy among a group of Wall Street financial firms (mostly based in Japan and London) to manipulate the price of London interbank offered rates (LIBOR). These activities generated big trading gains for the firms, big bonuses for staff and alleged associated corrupt activities. LIBOR is the interest rate that big banks charge one another to borrow money. Refer to our previous article on the manipulation of the BBSW [here](#).

Similar to the BBSW, LIBOR is the benchmark base short-term interest rate used to set the price of loans around the world, including corporate loans, car loans, credit card loans and mortgages. Lenders add a margin above LIBOR to reflect credit risk. The manipulation of LIBOR meant that borrowers incurred higher borrowing costs.

The new methodology will be based on a volume weighted average price (VWAP) calculation as the primary calculation method.

The calculation will be performed from transactions in eligible Bank Bill and NCD securities. Where the BBSW rate cannot be calculated under the VWAP method, then the existing National Best Bids and Offers (NBBO) method will be used to determine the rate. Where the BBSW cannot be determined under the NBBO method the ASX will use an algorithm to calculate the BBSW.

Toohey fully supports the changes proposed which provides and added level of integrity to the process. “The interest rate market is one of the key foundations of the financial system as a whole. Improving the quality and accuracy of the interest rate market’s position can only assist market participants in making better and more informed investment decisions. We fully support the proposed changes which reflect the evolution of market practice. What this means in practical terms is that the BBSW will be determined by actual trades executed in the market, rather than bids and offers that may or may not have been traded”.

Interestingly, Toohey believes that there is the scope and ability for the ASX to provide further assistance and transparency to the opaque world which is the fixed interest market through its Austraclear service which has over 830 participants and holding over \$1.9 trillion of securities.

“Given the ASX also has visibility over a large number of fixed interest transactions processed through Austraclear, there is definitely scope for it to increase transparency in this part of the market, and in particular prices at which trades have occurred. Further transparency would greatly assist buyers and sellers in establishing prices. However, banks and the like may not be too keen given their role as market makers”, commented Toohey.

The ASX has sought public comment on the proposed BBSW volume weighted average price (VWAP) calculation methodology, with submissions closing on 7 August.

Should all go according to plan, the ASX will look to later this year replace the current BBSW methodology with the proposed new methodology.

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