BBSW Starts New Rate Setting Regime

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The Australian Securities Exchange (ASX) has introduced a new method for the calculation of bank bill swap rate (BBSW) based on actual transactions of bank bills and negotiable certificates of deposit (NCD). Following revelations banks had been involved in manipulation of the process for setting BBSW, the Australian government introduced a regulatory framework which sets rules for benchmarks including BBSW.

The volume-weighted average price (VWAP) methodology introduced by the ASX reflects the recommendation of the Council of Financial Regulators and it is consistent with IOSCO Principles for financial benchmarks. It is a process already used pervasively in ASX securities markets and it uses a volume-weighted average yield of all eligible transactions observed within a rate-set window. Unlike the previous rate-set window which was open for very short periods, the new window operates from 8.30 am to 10.00 am on each business day.

Until this week, BBSW had been calculated using a nationally observed best bid and best offer (NBBO) methodology for prime bank securities. Quotes were sampled from three time periods around 9.45am and then an average mid-point was calculated.

With the successful completion of a parallel run, the ASX began calculation and publication of BBSW each day using the new VWAP methodology. The NBBO method of calculating BBSW has now ended and it has been replaced with the VWAP process as of 21 May.

BBSW is the primary short-term interest rate in Australian financial markets for the pricing and valuation of floating-rate debt securities. It is also a major reference rate for bank lending and many derivative structures.

The equivalent to BBSW globally is LIBOR. Past manipulation of LIBOR by financial firms tainted this benchmark and it is being progressively replaced by other benchmarks such as the Secured Overnight Financing Rate (SOFR) in the US and Sterling Overnight Index Average (SONIA) in the UK.