

City Speak

Taking the mystery out of money

Understanding BBA LIBOR

The British Bankers' Association London Interbank Offered Rate (BBA LIBOR) closely reflects the real rates of interest being used by the world's big financial institutions. Central banks (such as the Bank of England, the US Federal Reserve and the European Central Bank) may fix official base rates monthly, but BBA LIBOR reflects the actual rate at which banks borrow money from each other. BBA LIBOR figures are issued daily on more than 300,000 screens around the world. Rates are quoted for a range of borrowing periods, ranging from overnight loans to 12 months, and a range of world currencies.

Why is it in the news?

Because BBA LIBOR rates are calculated daily from the rates at which banks agree to lend each other money, it is accepted as an accurate barometer of how global markets are reacting to market conditions.

How is it calculated?

The BBA uses Reuters to fix and publish the data daily, usually before 12 noon UK time. It assembles the interbank borrowing rates from 16 contributor panel banks at 11am, looks at the middle eight of these rates (discarding the top and bottom four) and uses these to calculate an average, which then becomes that day's BBA LIBOR rate. This process is followed 150 times to create rates for all 15 maturities (ranging from overnight to 12 months) and all 10 currencies for which a BBA LIBOR rate is quoted.

How did it become so important?

BBA LIBOR 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.

BBA LIBOR is now used to calculate the interest rates for a range of financial instruments and derivatives based on the BBA LIBOR rates are now traded on exchanges such as LIFFE, the Chicago Mercantile Exchange (CME) and SIMEX. Independent research shows that financial products worth a total of around \$150 trillion are indexed to BBA LIBOR.

How often is this process reviewed?

The BBA LIBOR setting process is reviewed annually by the Foreign Exchange and Money Markets Committee, a group of 13 active market practitioners who determine the membership of each panel (one for each of the 10 currencies covered) and review whether changes might be required in the setting process.

The last review was in May 2008

10 October 2008