

Focus on

Why LIBOR is important

Since the onset of the global financial crisis in 2007, there has been increased interest in the calculation of the global benchmark for interbank lending – the London Interbank Offered Rate (“LIBOR”).

LIBOR has been widely adopted across the world’s financial markets and is recognised today as the primary benchmark for short-term interest rates. It is used as the basis for the settlement of interest rate contracts on many of the world’s futures and options exchanges and is increasingly employed as a key economic indicator for the health of the financial markets. Independent research suggests that about US\$350 trillion of swaps and US\$10 trillion of loans are now indexed to LIBOR. It represents the lowest actual cost of unsecured funding in the London market.

The individual LIBOR rates are the end product of a calculation based upon submissions from a panel composed of the largest and most active banks in each of the ten currencies in which LIBOR is calculated. The calculation is undertaken by Thomson Reuters (the designated calculation agent) on behalf of the British Bankers’ Association. Thomson Reuters audits the data submitted by the panel banks and creates the daily rates, usually within one hour of receiving the submission.

A LIBOR application is installed at cash desk of every LIBOR panel bank. Every business day just after 11am the currency dealer at each panel bank inputs the bank’s rates for the day into the application. This links directly to the team at Thomson Reuters. Each bank submits its rates independently of the other and the data is only made known to each of them after final publication by Thomson Reuters. Once received Thomson Reuters runs a barrage of automated and manual tests on the submitted rates before sending them to its calculation engines. Once this is complete and all of the benchmarks have been generated, the data is released to the market.

The simple calculation is known as a trimmed arithmetic mean. Thomson Reuters receives and reviews all submissions and discards the furthest outlying numbers, known as the trimming. This is repeated for every currency and maturity, giving 150 daily rates!

Trimming ensures that no single panel bank can influence the calculation and hence affect the benchmark because any submissions which are dramatically different from the mean are outliers and therefore discarded.

LIBOR has a number of strengths:

- **Simplicity:** the calculation methodology is straightforward and unambiguous;
- **Transparency:** all the information required to understand the calculation is published at www.bbalibor.com.
- **Market-led:** all decisions are taken by a panel of independent market experts in consultation with all the market participants
- **Feedback:** comments on any aspects of the data are welcome and may be submitted to libor@bba.org.uk

Contact

To find out more about how our award-winning corporate finance team can help you understand how LIBOR may affect your financing costs contact us now for a no-obligation, initial discussion on 0845 366 4793 or via email: mhcfinfo@mhllp.co.uk

To find out more please visit
www.macintyreHUDSON.co.uk

