Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

2017 - 2018

Division/Agency: Australian Securities and Investment Commission
Question No: 91
Topic: Bank Bill Swap Rate
Reference: Hansard page 9 (31 May 2017)
Senator: Dastyari, Sam

Question:

Senator DASTYARI: Finally, I note that we are going to table this graph at some point. Perhaps Mr Medcraft and Ms Armour, you could take this on notice: I am sure the information exists of a layman's explanation of the bank bill swap rate. Of why it is important, how it interacts—perhaps the graph will answer a lot of this—with the market the consequences and significance of whether or not it has been manipulated and the winners and losers if such a thing happens.
Ms Armour: We will need to be a little bit circumspect. I am happy to give a layman's explanation, but this is a matter that is before the courts so we cannot go into some of the—
Senator DASTYARI: I understand that, but I want to take it to a different level. I see the significance of the bank bill swap rate but I feel that some of the debate around it, unfortunately, because of the technical nature of what we are dealing with, has become very easy to try and push aside. I have seen larger organisations treating the whole thing as: 'This is just a complicated internal bank matter. It does not mean anything to anybody.' I think there is a public interest in bringing that back to an explanation and an understanding of its relevance.

Answer:

The graph referred to above is Tabled Doc 10 - *Chart: BBSW Sectoral Impacts and Transmission Mechanisms*. At Hansard, page 22 (31 May 2017), Mr Medcraft, Chairman of Australian Securities and Investments Commission, provided an explanation of this document to the Senate Economics Legislation Committee.

The bank bill swap rate, also known as BBSW, is a benchmark interest rate used for the valuation and pricing of number of a financial products.

Methodology of Calculation

Prior to 27 September 2013, the BBSW was calculated using the submissions from a panel of 14 banks of their observations of the mid-point rate at which prime bank bills and negotiable certificates of deposit traded in the market. This panel included ANZ, Westpac, National Australia Bank and Commonwealth Bank of Australia, who were all designated as Prime Banks.

Post September 2013, an automated process was used to extract rates from regulated brokers, eliminating the need for a submissions panel.

BBSW now represents the midpoint of the nationally observed best bid and best offer for prime bank bills and negotiable certificates of deposit of all specified tenors, as calculated in accordance with the approved Calculation Mechanisms. These Calculation Mechanisms are set out in the BBSW Conventions published by the Australian Securities Exchange (ASX).

Since 1 January 2017, ASX has administered the BBSW. In late 2017, the ASX intends to introduce a volume weighted average price calculation as the primary BBSW calculation method.

The role of BBSW in Australia's Financial Markets

BBSW is the rate at which banks commonly lend to each other.

BBSW is also used to provide reference interest rates (i.e. BBSW + a margin) for the pricing and re-valuation of a number of financial products, including:

1. Interest Rate derivatives, such as interest rate swaps, which are often used as hedges by institutional investors, superannuation funds, fund managers, banks, companies and individuals to protect themselves against changes in market interest rates.
2. Floating Rate Notes and Bonds, which are mainly issued by governments and financial institutions and invested in by sophisticated investors and retail investors via self-managed superannuation funds.
3. Commercial loans, which are loans entered into by corporates, finance companies and small businesses. Where the floating rate on a commercial loan is the BBSW plus a margin, the interest payment obligation of the borrower, is directly referenced to the BBSW. BBSW may have an indirect effect on retail borrowers, in that it may affect the general costs of borrowing funds, which is one component of retail lending rates.