

Date: August 20<sup>th</sup>, 2019

## **Nibor: New methodology – Public consultation**

*Norske Finansielle Referanser AS (NoRe) has today launched a public consultation on a proposed new methodology for Nibor, based on the requirements in the EU Benchmarks Regulation (BMR) and the existing definition of Nibor. The consultation report is available from NoRe's website. This newsletter gives an English summary of the proposals under consideration.*

BMR is in the process of being included in the European Economic Area (EEA) Agreement and Norwegian legislation. The regulation brings more detailed requirements on administrators of interest rate benchmarks and the contributing panel banks. According to Norwegian benchmarks legislation, before an administrator changes the definition or method of determining an interest rate benchmark, any proposed change shall be made publicly available, with a deadline for commenting on the proposal. The deadline for commenting upon the new methodology is October 2<sup>nd</sup>, 2019.

### *The definition of what Nibor is to reflect*

Nibor is intended to reflect the interest rate lenders require for unsecured money market lending to a leading bank. "Leading bank" is in the Nibor rules defined as a "bank with a high credit rating for short-term debt which is active in the Norwegian money and foreign exchange market on competitive terms". Considering the widespread use of Nibor in contracts and for analysis, no new definition is proposed.

### *Requirement on panel banks' market activity and what market Nibor is to be based on*

According to current Nibor Rules, point 5, Nibor panel banks must be active market makers in the market in which the redistribution of NOK liquidity takes place – in the relevant maturities and throughout the market's trading hours – and has been such for a period of at least three months. With the exception of the very shortest maturities (less than a week), the volume of unsecured loans in the Norwegian interbank market is small. Most liquidity distribution, in volume terms, takes place in the forward exchange market.

The reference to the forward exchange market is today supplemented with requirements on providing committed quotes. These requirements are now proposed to be replaced with a requirement to provide committed quotes on certificates of deposits (CDs) denominated in Norwegian kroner for all Nibor tenors except the 1-week maturity.

### *How input data shall be determined*

Nibor submissions are today based upon panel banks' judgement of own borrowing costs in foreign currencies. The NOK interest rates are determined as the sum of the relevant foreign interest rate and the return derived from the difference between the relevant spot and forward currency rate. A spread is added to the swapped borrowing rate, so that the bank's Nibor submissions reflects the interest rates that the bank would charge for unsecured lending in NOK to a leading bank, ref. above.

The proposed new methodology is based on a waterfall approach, where information from transactions shall be used if available. The first level (A) in the waterfall is interest rates from interbank lending to leading banks as defined in the current Nibor rules. The second level (B) is prices from sales of CDs. The rates from such sales must be adjusted to make sure that the submitted rates are aligned with the definition of Nibor. Most importantly, the rates must be adjusted for the difference between lending and borrowing rates. Common for level A and level B are rules for the use of transactions with maturity that deviates somewhat from the Nibor tenor and use of interpolation. The third level (C) is contributions based on expert judgements. Such judgements shall take into consideration relevant market information about the bank's borrowing costs abroad, preferable actual transactions or committed quotes, and the bank's committed quotes on CDs.

The proposed methodology has been tested in June 2019 by the Nibor panel banks, which included both a day with publication of a change in the Central Bank's signalling rate and value date after the half year end. The test confirmed the lack of unsecured transactions denominated in local currency, a challenge mutual for most ibors. As such, the differences observed between the test fixing and the official fixing are explained by the broadening of the basis for the expert judgements and that test-submissions may have been calculated some minutes before the official submissions. However, the test fixings deviated not more than 1 basis point from the official fixing. 75 of 95 test-fixings equalled the official fixings for the same period.

*Rules om how Nibor is to be calculated based on the input data*

Nibor is calculated as a simple average of the interest rates submitted by the panel banks for each maturity. The calculation shall omit high and low rates depending on how many banks that have submitted rates, as specified in point 3 in the Nibor rules. Nibor shall not be calculated if fewer than two banks have submitted rates. In the event of errors being detected, regardless of reason, Nibor may be adjusted up to one hour after the fix time. As specified in "Principles for the correction of Nibor" Nibor shall be re-fixed if the size of the error in the input data is two or more basis points.

The proposed new methodology continues the rules for calculating Nibor on normal days. However, it is suggested that Nibor on days without sufficient input data is to be fixed as a republication of the fixing of the tenor in question the previous day. If the situation prevails, the Nibor administrator will have to consider if market developments allows for yet another republication. The rule for correction is proposed to be based on the consequence of the error for the fixing, not the individual submission. It is suggested a materiality threshold for a re-fix of 2 basis points of the published Nibor rate.

*Other changes being considered*

The consultation also includes some other changes not considered parts of the "methodology". For users the most important is to end the arrangement with earlier fixing on New Year's Eve and the Wednesday before Maundy Thursday.

We invite all interested parties to submit comments on the changes considered. Please use the following e-mail address: [post@referanserenter.no](mailto:post@referanserenter.no).

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