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## Standardization of Telbor quotes

### Background

In order to support the development of the short term interest rates market (the Telbor market), the Bank of Israel established in early 2007 an inter-organization committee, "The Telbor Interest Rate Committee". The main goal of the committee is to ensure that the commercial contributor banks operate reliably and transparently in the inter-bank market. To that end, the Committee determines the definitions, the contributors and the rules for calculating and publishing the fixing Telbor interest rates.

The Tel Aviv Inter-Bank Offered Rate (Telbor) is based on interest rate quotes by a number of commercial banks (hereinafter: the contributors) in the inter-bank market. It is published daily by Reuters. The algorithm for fixing the Telbor for each term to maturity averages the banks' quotes after excluding outliers. See section 3.

In recent years, the futures contracts on the Telbor market have greatly developed, within growing volume of Forward Rate Agreement (FRA) transactions and Interest Rate Swap (IRS) transactions, in which valuation at expiration is based on the Telbor. Since the middle of 2010, the obligation to conclude transactions include Overnight Index Swap (OIS) transactions in which valuation at expiration is based on the Over-Night Telbor. Committee members are of the opinion that there is tremendous potential in the market for products based on the Telbor, which has not been realized.

### 1. Definitions

- 1.1 Telbor—the benchmark daily interest rate on loans, deposits and other financial products. See Section 4 for further details.
- 1.2 Telbor Interest Rate Committee—a committee for standardizing and developing the Telbor. The committee shall consist of the following members:
  - 1.2.1 Head of the Capital Markets Unit of the Research Department at the Bank of Israel—chair of the committee.
  - 1.2.2 A representative of Forex Israel.
  - 1.2.3 The Maof Unit Manager at the Tel Aviv Stock Exchange.

- 1.2.4 A representative of the Market Operations Department at the Bank of Israel.
- 1.3 Publishing of information—Information shall be distributed by a number of entities defined as suppliers of information to the capital market in Israel. One supplier shall be defined as the central distributor responsible for accepting information from the contributors, publishing the list of the contributors, inspecting the quotes in accordance with the rules, calculating the Telbor based on the quotes, and presenting the quotes per contributor as well as the Telbor. The other suppliers shall be responsible for receiving the Telbor fixing (see section 1.5, below) and for its proper presentation for each term to maturity.
- 1.4 The contributors—Commercial banks that operate and carry out their transactions in a trading room in Israel, that are approved by the Telbor Interest Rate Committee, shall quote inter-bank rates via the central distributor for the purpose of fixing the Telbor. The list of contributors shall comprise at least five banks, each of which shall be obliged to quote interest rates on every business day, in accordance with the rules determined by the committee.
- 1.5 The fixing Telbor—the average of the interest rate quotes that the contributors shall present, calculated by means of an algorithm that the Committee has determined (see section 3) for each term to maturity defined by the Committee (see section 4.2.1), provided that at least five contributor banks provide quotes for each term. If there are fewer than five quotes, the fixing shall not be calculated automatically by the rules established and shall not be published in the ordinary manner by the central distributor. Rather, the Telbor Interest Rate Committee shall be fixed based on the existing interest rate quotes.
- 1.6 The days on which quotations must be provided by contributor banks and the Telbor rate is fixed and published are determined to be as follows: All business days in Israel, excluding Sundays, Passover eve, Rosh Hashanah eve, Purim (in Jerusalem), and four dates on which major holidays occur abroad—the last Monday in May, December 25–26, and January 1. Toward the end of each calendar year, it shall be the responsibility of the Committee members to send out a detailed list of the days for the next calendar year.

## **2. The work of the Telbor Interest Rate Committee**

- 2.1 The Committee shall convene at least three times a year and shall discuss current developments in the Telbor market. It shall distribute the minutes of the meeting to representatives of the contributor banks and shall publish them immediately afterward on the Bank of Israel website.
- 2.2 The Committee is entitled to change the rules in accordance with current developments in the market, and a notification of any such change shall be published 30 days in advance of its effective date.
- 2.3 The Committee shall establish which banks will be on the list of contributor banks, based on the commitment of the commercial bank to the guidelines set by the Committee regarding interest rate quotations in the inter-bank market for fixing the Telbor rate.
- 2.4 The Telbor Interest Rate Committee shall examine the extent to which the contributors conform to the criteria and rules which it has determined.
- 2.5 The Committee shall require a quotation to be amended and may even issue a warning to a contributor bank if a contributor does not adhere to the directives for the quotations. Under the authority vested in it, the Committee is also entitled to remove the contributor from the list. In such a case, the Committee shall publish an announcement of the matter on the same day.
- 2.6 Should a new candidate for contributor status undertake to comply with all of the Committee's criteria and rules, and the Committee decides at the new contributor's request to include it in the list of contributors, the Committee shall issue an announcement of this 30 days in advance.

3. The algorithm for calculating the Telbor for each term to maturity has been determined as follows: a simple average of all the contributor banks quotes, unless there is one quote that deviates from the average of the rest of the contributor banks by more than 8 basis points in absolute value. In such case of an outlier quote, the simple average shall be calculated excluding this quote. If there is more than one outlier quote on the same day for the same term, then the calculation will not be made automatically and the interest rate will be determined by the members of the Committee.

The Telbor Interest Rate Committee is entitled to change the calculation algorithm at any time, and a notification of this shall be issued 90 days before the change becomes effective.

4. Telbor interest rate quotes, on which the Telbor rate is fixed, these are based mostly on short term interest rates, expectations regarding their future path, and the liquidity premium in the market. Credit risks can be expressed into the interest rates quoted only due the obligation for concluding over-night loans. Thus, the Telbor interest rate can only serve as a benchmark for interest rates in the deposits and loans market for different maturities.

#### 4.1. The contributors' commitments:

4.1.1. Every contributor shall report on a continuous basis the Telbor interest rate for the different terms to maturity on Monday through Thursday from 10:00 until 17:00 and on Friday from 10:00 and until 13:00. However, only quotes published on Monday through Friday between 11:00 and 12:00 shall commit the contributor bank to conclude a transaction according to its quotes at the request of another contributing bank in accordance with the directives determined by the Committee (see paragraph 4.3).

4.1.2 Every contributor bank needs to confirm the proper working order of communications in the central distributor system by 10:30 and to report a malfunction not later than 11:00 am.

4.1.3. The Committee shall monitor abnormal Telbor interest rate quotes that are not included in the fixing. In the event of an abnormality in their quotes, which is not one-time in nature, the contributors shall justify this abnormal rate to the Committee.

#### 4.2. Directives for quotes:

4.2.1. Telbor interest rates shall be quoted for terms to maturity of one business day (Over-Night), one month, three months, six months, nine months and twelve months.

4.2.2. The Telbor interest rate quotes shall be a nominal interest rate and shall be expressed in annual terms.

4.2.3. The Telbor interest rate quotes shall be reported in percentage points, to an accuracy of three digits after the decimal point.

#### 4.3 Binding nature of the interest rates:

The Telbor interest rate quotes between 11:00 and 12:00 for all terms to maturity commit the contributor bank to concluding a transaction in accordance with the following directives:

- 4.3.1 For a term to maturity of Over-Night: a loan at the Telbor interest rate quote or a deposit at the Telbor interest rate quote minus 4 basis points in an amount of at least NIS 50 million.
- 4.3.2 For a term of one month: an OIS transactions at an obligatory spread of  $\pm 2$  basis points from the quoted Telbor interest rate, in the amount of NIS 100 million.
- 4.3.3 For a term of three months: an OIS transactions at an obligatory spread of  $\pm 2$  basis points from the quoted Telbor interest rate, in the amount of NIS 100 million.
- 4.3.4 For a term of three months to one year—FRA transactions for periods of 6 x 3, 9 x 6 and 12 x 9 (months), at an obligatory spread of  $\pm 2$  basis points from the forward rate which is derived from the quoted Telbor interest rate, in the amount of NIS 100 million.
- 4.3.5 For a term of one year—a one-year IRS transaction at an obligatory interest rate spread of  $\pm 2$  basis points from the quoted Telbor interest rate, in the amount of NIS 50 million.
- 4.3.6 The number of required transactions
- 4.3.6.1 The contributor bank's commitment is to extend a loan or accept a deposit for a term to maturity of Over-Night, once vis-à-vis each other contributor bank which requests to do so, on any day in which there is a requirement to provide quotes. This directive limits the number of possible loans or deposits per day to the number of contributor banks less one. When a contributor bank receives several requests at one time to conduct a transaction, it is committed to respond to all requests at that quote.
- 4.3.6.2 Every contributor bank is required to conclude up to 15 derivative transactions each day in which there is a requirement to provide quotes, in total for the entire curve, vis-à-vis other contributor banks which request to conclude a transaction with it, as long as it has been given an opportunity to change its quote between transactions. If the number of requests for transactions which a contributor bank receives from other banks on a given day reaches 15, the bank is not required to conclude additional requests; in such case, it must prove to the Committee that on that day it concluded 15 transactions within its commitment.

- 4.3.7 If a contributor bank is not prepared to conclude a transaction as requested, the initiating bank may send a letter of complaint to the Committee. The Committee shall examine the allegations arising from such letters and shall decide whether the contributor shall remain on the list of contributors, taking into account exceptional cases such as temporary crises in the financial markets.
- 4.3.8 Since the Banking Supervision Department defines the foreign contributor banks as customers, their Over-Night deposits in domestic banks are subject to a reserve requirement, which makes them more expensive to the domestic banks. This allows foreign banks to quote lower rates than those available in the market without concern that domestic banks will request credit from them. The Committee members therefore decided to restrict the Over-Night quotes of foreign banks based on the following general rule: The interest rate quote will not be less than the lowest quote among the domestic banks. In addition, it was established that when a foreign bank requests to deposit funds with a domestic bank at the interest rate quoted by the domestic bank minus 6 basis points, the cost of the reserve requirement will be deducted from the interest it receives, so that the foreign bank will pay the cost of the reserve requirement. In the reverse situation, when the domestic bank requests to take a loan from the foreign bank at the interest rate quoted by the foreign bank, the cost of the reserve requirement will not be deducted from the interest (so that it will be paid by the domestic bank). It is further noted that nothing prevents a foreign bank from requesting to take a loan from a domestic bank and a domestic bank requesting to deposit funds with the foreign bank, as established in section 4.3.1.
- 4.3.9 It should be emphasized that the goal of these commitments is to provide an incentive to the contributor banks to quote interest rates based only on proper considerations. With that, the commitments to carry out transactions are not intended to serve as a tool to create liquidity.

## **5. Calculation and circulation of the Telbor fixing**

- 5.1 The central distributor shall calculate the Telbor fixing in accordance with the existing interest rate quotes separately for each term to maturity, at a point in time that shall be selected at random between 11:45 and 11:55.
- 5.2 The central distributor shall assume responsibility for the sound forwarding of the quotes published in the information systems and shall send several alerts to representatives of the contributor banks and to the Committee's members: At 10:30, an alert of no change in the rates relative to the previous day; at 11:30, an alert in the event of an unusual spread (to be defined by the Committee) between the bank's quote and the provisional theoretical average. In addition, the central distributor shall send an alert if a foreign bank's quote is less than the lowest quote among the domestic contributor banks (see Section 4.3.8). In addition, whenever the Bank of Israel changes the monetary rate of interest (apart from changes that are not on the predetermined date), the Reuters system sends a warning concerning the change to the representatives of the contributor banks. The central distributor shall publish the Telbor rates to each term separately by 12:00 on the days listed in section 1.6. The central distributor shall also enable the other information suppliers to obtain and publish the information.
- 5.3 The central supplier shall publish the list of contributor banks.