

Swaps

Swaps are derivatives in which two parties exchange financial instruments. Swaps can be a swap of interest rates, cash flows, commodities, derivatives, or securities such as stocks or bonds. The most common is interest rates. Usually, when swapping interest rates, one party possesses a variable rate while the other has a fixed rate. Let's say that company A and company B borrows 500,000 dollars as the nominal principal amount. Company A has a variable rate but Company B has a fixed rate of 5%. Later Company A finds out that the rate is 6%, and decides to swap with company B for their fixed 5%. They would then head to a swap bank and swap the interest rates, thus company A will have a fixed rate of 5% and Company B has a variable rate (it could be higher or lower than 6%).

<http://www.investopedia.com/terms/s/swap.asp>