Swaption

A payer swaption is also called a right-to-pay swaption that allows its holder to exercise into a swap where the holder pays fixed rates and receives floating rates, while a receiver swaption is also called right-to-receive swaption that allows its holders to exercise into a swap where the holder receives fixed rates and pays floating rates.

An interest rate swaption or interest rate European swaption is an OTC option that grants its owner the right but not the obligation to enter an underlying interest rate swap. There are two types of swaptions: a payer swaption and a receiver swaption.

Swaptions provide clients with a guarantee that the fixed rate of interest they will pay at some of future time will not exceed certain level.

Market participants use swaptions to manage interest rate risk arising from their business. A firm might buy a payer swaption if it wants protection from rising interest rates. A corporation holding a mortgage portfolio might buy a receiver swaption to protect against decreasing interest rates that might lead to mortgage prepayment.

A company believing that interest rates will not increase much might sell a payer swaption and earns the premium. An institution believing that interest rates will not decrease much might sell a receiver swaption and earns the premium.

Reference:

https://finpricing.com/lib/EqBarrier.html