CAP, FLOOR AND COLLOR

Common points for all three:

- These are Over the Counter type of Option derivatives.
- These are useful for those who borrow or lend on Floating rate of Interest.

I. Cap:

- Useful for those who borrow money.

Cap Seller ← Pay Commision/ Premium ← Cap Buyer

Cap Seller → Undertaking that he will compensate his loss on account of increase in Interest Rate → Cap Buyer

In Simple word, Cap Buyer fixes a maximum rate for himself i.e. he limits his loss not gains. Gains are not shared with cap seller.

II. Floor:

- Useful for those who lend money.

Floor Seller ← Pay Commision/ Premium ← Floor Buyer

Floor Seller → Undertaking that he will compensate his loss on account of decrease in Interest Rate → Floor Buyer

In Simple word, Floor Buyer fixes a minimum rate for himself i.e. he limits his loss not gains. Gains are not shared with floor seller.

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III. <u>Collor:</u>

- It is a combination of Cap and Floor.
- In this, no commission is paid to anybody.
- Profit/ Loss of Collor buyer is limited i.e. he will not be gaining or loosing excessively on account of change in Interest Rate.

Collor Seller	← Share of Profit, if he gains Compensate the loss, if he looses →	Collor Buyer

- Collor can be taken by anybody whether borrower or lender.

i. <u>If Taken by borrower (Collor Buyer):</u>

- If interest rates goes up then his loss will be compensated by color seller.
- If Interest rates goes down then collor buyer will share the profit.

ii. <u>If Taken by lender (Collor Buyer):</u>

- If interest rates goes up then collor buyer will share amount of profit with collor seller.
- If interest rates goes down then the loss to collor buyer will be compensated by collor seller.

Thank You

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