



All Content

Images

Search journals, books, images, and



Search

Browse

About Support

Tools

JOURNAL ARTICLE

# Alternative Explanations of Interest Rate Swaps: A Theoretical and Empirical Analysis

Larry D. Wall and John J. Pringle

Financial Management

Vol. 18, No. 2 (Summer, 1989), pp. 59-73 (15 pages)

Published By: Wiley



<https://doi.org/10.2307/3665893>

<https://www.jstor.org/stable/3665893>

[Cite](#)

This is a preview. [Log in through your library.](#)

[Cookies Settings](#)

ITHAKA websites, which ITHAKA manages from its location in the United States, use cookies for different purposes, such as to ensure web site function, display non-targeted ads, provide social media features, and track usage, engaging with third party service providers such as Google Analytics. Some cookies are essential and always active and you may allow others, such as the Google Analytics cookies, as may be needed to use certain functions on the website, by accepting all or managing "Cookie Settings". For more information, please see our [Cookie Policy](#).

Accept Cookies

# Alternative Explanations of Interest Rate Swaps: A Theoretical and Empirical Analysis

Larry D. Wall and John J. Pringle

*Larry D. Wall is an Assistant Vice President at the Federal Reserve Bank of Atlanta, GA. John J. Pringle is a Professor of Finance at the University of North Carolina at Chapel Hill.*

■ An interest rate swap is a transaction in which two parties contract to swap interest payments for a pre-determined period of time.<sup>1</sup> The credit risk of a swap is less than that of a comparable debt contract because no principal changes hands and the payments under the swap are typically made on a net basis.<sup>2</sup> Interest rate swaps first appeared in 1981, and since then the market

has grown rapidly. One measure of the size of the market is the “notional principal” of the swap, that is the dollar amount on which the interest calculations are based. A survey of 49 leading participants in the swap market found that the outstanding notional principal of their swaps totaled \$889.5 billion in 1987.<sup>3</sup> The rapid growth of the market makes clear that interest

---

The opinions expressed in this paper are those of the authors and do not necessarily represent the views of the Federal Reserve Bank of Atlanta or the Federal Reserve System. The authors are grateful to Eugene Comiskey, Deborah Turner, three anonymous reviewers, and the editor for helpful suggestions; to Kevin Johnson for data analysis; and to Hal Clark for conducting the NAARS search.

<sup>1</sup>See Smith, Smithson, and Wakeman [16] for a review of swap mechanics and Smithson [18] for a discussion of the relationship of interest

---

<sup>2</sup>The terms “interest rate swaps” and “swaps” will be used as synonyms in this paper. Swaps involving more than one currency, called currency swaps, are not considered here. Early in the development of interest rate swaps, the transaction typically took place between two parties, often a domestic non-financial firm and a foreign bank, usually with a swap dealer acting as agent and/or guarantor. Dealers, typically commercial banks and investment banks, “matched” the swapping parties, pairing up parties wishing to swap floating for fixed with those wishing the opposite. As the market has developed, “match-

ITHAKA websites, which ITHAKA manages from its location in the United States, use cookies for different purposes, such as to ensure web site function, display non-targeted ads, provide social media features, and track usage, engaging with third party service providers such as Google Analytics. Some cookies are essential and always active and you may allow others, such as the Google Analytics cookies, as may be needed to use certain functions on the website, by accepting all or managing “Cookie Settings”. For more information, please see our [Cookie Policy](#).

[Cookies Settings](#)

Accept Cookies

## Abstract

The principal focus of the analysis is on the quality spread differential (QSD). Several explanations of QSDs are explored, consistent with arguments in the literature that swaps are a zero-sum game. An additional explanation, based on agency costs, also is advanced. Explanations of swaps that are not based on...

## Journal Information

Financial Management (FM) serves the profession by publishing significant new scholarly research in finance that is of the highest quality. The principal criteria for publishability are originality, rigor, timeliness, practical relevance and clarity. FM enjoys a broad circulation among academics and practitioners, and as...

## Publisher Information

Wiley is a global provider of content and content-enabled workflow solutions in areas of scientific, technical, medical, and scholarly research; professional development; and education. Our core businesses produce scientific, technical, medical, and scholarly journals, reference works, books, database services,...

## Rights & Usage

**This item is part of a JSTOR Collection.**

For terms and use, please refer to our [Terms and Conditions](#)

Financial Management © 1989 [Financial Management Association International](#)

[Request Permissions](#)

# Explore JSTOR

By Subject

Get Access

ITHAKA websites, which ITHAKA manages from its location in the United States, use cookies for different purposes, such as to ensure web site function, display non-targeted ads, provide social media features, and track usage, engaging with third party service providers such as Google Analytics. Some cookies are essential and always active and you may allow others, such as the Google Analytics cookies, as may be needed to use certain functions on the website, by accepting all or managing "Cookie Settings". For more information, please see our [Cookie Policy](#).

[Cookies Settings](#)

Accept Cookies

[About JSTOR](#)[JSTOR Labs](#)[Mission and History](#)[JSTOR Daily](#)[What's in JSTOR](#)[Careers](#)[Get JSTOR](#)[Contact Us](#)[News](#)[Webinars](#)[For Librarians](#)[For Publishers](#)

JSTOR is part of [ITHAKA](#), a not-for-profit organization helping the academic community use digital technologies to preserve the scholarly record and to advance research and teaching in sustainable ways.

©2000–2023 ITHAKA. All Rights Reserved. JSTOR®, the JSTOR logo, JPASS®, Artstor®, Reveal Digital™ and ITHAKA® are registered trademarks of ITHAKA.

[Terms & Conditions of Use](#)[Privacy Policy](#)   [Accessibility](#)[Cookie Policy](#)   [Cookie Settings](#)[Cookies Settings](#)

ITHAKA websites, which ITHAKA manages from its location in the United States, use cookies for different purposes, such as to ensure web site function, display non-targeted ads, provide social media features, and track usage, engaging with third party service providers such as Google Analytics. Some cookies are essential and always active and you may allow others, such as the Google Analytics cookies, as may be needed to use certain functions on the website, by accepting all or managing “Cookie Settings”. For more information, please see our [Cookie Policy](#).

[Accept Cookies](#)