

Floating Rate Notes

A floating rate note has variable coupons, depending on a money market reference rate, such as LIBOR, plus a floating spread. When interest rate raises, the coupons of a floating rate note increase in line with the increase of the forward rates, which means its price remains relatively constant.

Therefore, floating rate notes bear small interest rate risk. On the other hand, floating rate notes carry lower yields than fixed rate bonds of the same maturity. They also have unpredictable coupon payments.

The price of a floating rate note has very low sensitivity to changes in interest rates because the floating coupon increases but the discounting also increases as interest rate rises.

An investor who wants conservative investments may choose floating rate bonds. floating rate notes become more popular when interest rates are expected to increase. A floating rate note carry lower yield than fixed rate bonds of the same maturity and has unpredictable coupon payments.

A floating rate note is a bond in which the investor will receive coupons paid by the issuer at a floating coupon equivalent to a money market reference rate plus a spread at specified dates before bond maturity.

The bond principal will be returned at maturity date. Almost all floating rate notes have quarterly coupons. floating rate notes are usually issued by corporations, federal agencies, municipalities and states/provinces to finance a variety of projects and activities.

A floating rate note carries little interest rate risk as its duration is close to zero due to periodic reset. The price of a floating rate note has very low sensitivity to changes in interest rates because the floating coupon increases but the discounting also increases as interest rate rises.

Reference:

<https://finpricing.com/lib/EqVariance.html>