STATE OF COLORADO

Department of Regulatory Agencies

Richard F. O'Donnell Executive Director



DIVISION OF BANKING

Richard Fulkerson State Bank Commissioner

OPERATING MEMORANDUM

TO: President or Chief Executive Officer of all Money Transmitter

Companies Regulated by the Colorado Division of Banking

FROM: Richard Fulkerson

State Bank Commissioner

DATE: April 23, 2004

RE: Interest Rate Swap Contracts as Eligible Investments Under the Colorado Money Order Act

The Colorado State Banking Board recently considered the request from a money transmitter licensee that interest rate risk swap contracts be approved as permissible investments pursuant to Section 12-52-107 (3)(g), C.R.S.

An interest rate swap contract is an agreement between two or more parties to exchange fixed and variable interest rate payments on a notional principal amount over a predetermined period of time. The notional amount is not exchanged. The exchange of cash flows allows institutions to better manage interest-rate risk (IRR) by offsetting market value fluctuations in the underlying portfolio. However, swap contracts are derivative instruments that can be illiquid and highly volatile.

In its deliberations, the Banking Board considered the importance of swap contracts as IRR management tools, as well as the risk characteristics of these instruments, and determined that, subject to certain restrictions, interest rate swap contracts are acceptable investments for the purpose of covering outstanding payment obligations.

Money services business licensed by the Colorado State Banking Board under the Colorado Money Order Act may include interest rate swap contracts as permissible investments pursuant to Section 12-52-107(3)(g) C.R.S., subject to the following conditions:

- 1. The swaps must be held as non-trading investments for the express purpose of hedging the IRR of an identified investment portfolio accounted for in accordance with generally accepted accounting principals;
- 2. The swaps and hedged portfolio must be reported to the Division of Banking (Division) on a net basis as provided for in call report instructions; and
- 3. Licensees seeking to include swaps as permissible investments must be approved initially by the Division and reaffirmed at each license renewal period.

Requests for approval under item 3 above are to be submitted in writing to the Colorado Division of Banking, 1560 Broadway, Suite 1175, Denver, CO 80202. A brief description of the institution's investment practices, how the interest rate swaps will be utilized to manage IRR, the swap counterparties, and the amount, or contemplated range of amounts, of notional principal must be included. Direct specific questions to the licensee's caseload manager, the Director of Examinations, or the State Bank Commissioner.