



January 13, 2014

**Interpretive Letter #1140  
February 2014**

Subject: [ ] (Bank) Membership in  
Renminbi (RMB) Clearing House Automated Transfer System (CHATS)

Dear [ ]:

This responds to your request that the Office of the Comptroller of the Currency (OCC) confirm that it is permissible for the Bank, via its London Branch, to become a direct member of RMB<sup>1</sup> CHATS. The Bank proposes to join RMB CHATS to facilitate the provision of RMB account and payment services to its customers.<sup>2</sup> The Bank requests OCC confirmation that it may become an RMB CHATS direct member, even though such membership would subject it to potentially open-ended liability<sup>3</sup> for certain operational losses of the payment system.<sup>4</sup>

For the reasons discussed below, we conclude that the Bank may become a direct a member of RMB CHATS, provided the Bank, prior to becoming a member, submits a written no-objection request to its examiner-in-charge (EIC) describing its proposed activities and receives a written EIC supervisory no-objection. In support of its no-objection request, the Bank should document

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<sup>1</sup> “RMB” is the currency of the People’s Republic of China.

<sup>2</sup> RMB CHATS is a real time gross settlement system (or RTGS) for RMB per the Hong Kong Monetary Authority’s (HKMA’s) Clearing and Settlement System Ordinance (Cap. 584 of the Laws of Hong Kong) (Ordinance). The Bank of China (Hong Kong) Limited (BOCHK) and the Hong Kong Interbank Clearing Limited (HKICL) jointly operate RMB CHATS. HKICL is a private company owned by HKMA and the Hong Kong Association of Banks.

<sup>3</sup> “Open-ended liability” refers in this context to operational liability that is not capped under the rules of the payment system or otherwise (*e.g.*, by negotiated agreements or controlling law of the jurisdiction).

<sup>4</sup> “Operational loss” means loss resulting from sources other than defaults by other members; it includes: employee misconduct, misjudgment, or human error; management failure and fraud; information system failures; disruptions from external events that result in the degradation or failure of services provided by a payment system; and payment or settlement delays, constrained liquidity, contagious disruptions and resulting litigation.

to the satisfaction of the EIC that the payment system appropriately mitigates operational risk and that the Bank has an appropriate risk management program in place that can effectively monitor and manage its potential exposures as a member of the system.

## Background

RMB CHATS provides members with interbank payment services in RMB, which is the currency of the People's Republic of China, on a real time gross settlement basis.<sup>5</sup> Transactions settled through RMB CHATS are final and irrevocable.<sup>6</sup> RMB CHATS has 180 members, which include major banks around the world and local banks in Hong Kong.<sup>7</sup>

RMB CHATS is governed by Hong Kong law.<sup>8</sup> BOCHK is the clearing and settlement bank for RMB CHATS (Clearing Bank).<sup>9</sup> Non-local banks, such as the Bank, can become direct members of RMB CHATS on a case-by-case basis with approval from the Clearing Bank. Before becoming a direct member, the Bank must open a settlement account, and simultaneously enter into an agreement for clearing and settlement of RMB business (Settlement Agreement), with the Clearing Bank for purposes of settlement of payments effected through RMB CHATS.<sup>10</sup> By signing the settlement account opening form (Account Opening Form for RMB Settlement Account and Supplement) the Bank agrees to be subject to, and to comply with, the Terms and Conditions document that governs the account and with other governing documents (referred to in this letter as the "Relevant Rules"<sup>11</sup>), which subject members to potentially open-ended liability to the Clearing Bank, HKICL and the HKMA for the system's operational losses.

The Bank identifies a number of factors associated with its current and projected business needs that it asserts support its membership in RMB CHATS. The Bank believes that as a member of RMB CHATS it will be able to compete more effectively with other financial institutions that are already members and to meet its customers' demand for payment services. The Bank states that

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<sup>5</sup> RMB CHATS is also known as the RMB RTGS System. <http://www.hkma.gov.hk/eng/key-functions/international-financial-centre/infrastructure/payment-systems.shtml>. In an RTGS system, interbank payments settle on a continuous, deal-by-deal basis. *Id.*

<sup>6</sup> The finality of the payment is protected from insolvency laws and other laws by the Ordinance. *Id.*

<sup>7</sup> <http://www.hkicl.com.hk/clientbrowse.do?docID=7198&lang=en>

<sup>8</sup> See Terms and Conditions Governing RMB Settlement Account (Terms and Conditions), Section 21.

<sup>9</sup> *Id.* The People's Bank of China (PBOC) acts as the central bank of the People's Republic of China under the law of the People's Republic of China. PBOC authorized the Clearing Bank to provide clearing and settlement services for RMB banking business in Hong Kong. The Clearing Bank maintains a settlement account with PBOC and uses HKICL as its system operator to carry out RMB clearing services. <http://www.hkma.gov.hk/eng/key-functions/international-financial-centre/infrastructure/payment-systems.shtml>

<sup>10</sup> See Terms and Conditions, Section 2.2 and RMB Clearing House Rules, Section 3.1.1.

<sup>11</sup> "Relevant Rules" means the Terms and Conditions and Supplement thereto, all documents incorporated therein, the Settlement Agreement, the Operating Rules, the RMB Clearing House Rules, and any other rules and regulations promulgated by HKMA or the PBOC. See Terms and Conditions and Supplement thereto.

current active members of RMB CHATS include U.S. banks. The Bank represents that it is at a competitive disadvantage in terms of satisfying its customers' cross border payment needs if it is not an RMB CHATS member. The Bank asserts that a significant number of its customers need to make and receive payments to and from China, and wish to do so in RMB. The Bank anticipates that over the next eight years its customer transactions with China and surrounding countries will increase and migrate from USD to RMB. The Bank represents that its participation in RMB CHATS will afford the Bank the RMB payment and receipt capabilities valued by these customers. Moreover, because HKILC offers a fee waiver to overseas direct members, the Bank believes it would also be at a competitive disadvantage in terms of cost if it must pay a third-party servicer to provide RMB CHATS services.

## **Discussion**

National banking law permits national banks, their operating subsidiaries, and their foreign branches to engage in payments related activities, as activities within the business of banking, subject to safety and soundness limitations.<sup>12</sup> Memberships in systems that impose open-ended liability on members for operational losses of the system raise unique safety and soundness issues. For this reason, a bank seeking to join a payment system that exposes the bank to potentially open-ended liability should request and obtain a written EIC no-objection before becoming a member. An EIC may issue a no-objection in response to a bank request to join a payment system if the bank demonstrates to the satisfaction of the EIC that: (1) the payment system appropriately mitigates operational risk; and (2) the Bank can appropriately monitor and manage its potential risk exposures. Criteria that an EIC will consider in determining whether a membership meets these standards are described below.

### **A. Has the bank demonstrated that the payment system appropriately mitigates risk?**

A payment system that appropriately mitigates risk will have many of the operating characteristics outlined below. While not all encompassing, these characteristics are key components that the EIC expects to see in the bank's analysis of the payment system and its membership criteria:

- Processing occurs on a real-time gross settlement basis or provides reasonable assurance (*e.g.*, prefunding, etc.) that members will meet settlement obligations.
- The payment system's rules limit its liability to members.
- The payment system has insurance coverage and/or self-insurance arrangements to cover

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<sup>12</sup> See, *e.g.*, OCC Interpretive Letter No. 1014 (Jan. 10, 2005); OCC Interpretive Letter No. 929 (Feb. 11, 2002); and OCC Interpretive Letter No. 993 (May 16, 1997) ("IL No. 993"). Payment system activities (*e.g.*, electronic payments message transmission, electronic payments processing, and payments settlement among members) are clearly within the business of banking and are functionally consistent with the primary role of banks as financial intermediaries. See IL No. 993, *supra*. See also Conditional Approval Letter No. 220 (Dec. 2, 1996) ("Banks are the most important institutional participants in . . . payments systems. They deal with cash, issue, process, clear and settle checks and similar monetary instruments, administer credit card and debit card programs for consumers and merchants, and transfer funds electronically in a variety of situations and circumstances.").

operational losses.

- The payment system's rules provide an unambiguous pro-rata loss allocation methodology under its indemnity provisions and the methodology provides members the opportunity to reduce or eliminate liability exposure by decreasing or ceasing use of the payment system.
- The payment system's rules provide for unambiguous membership withdrawal procedures that do not require the prior approval of the system.
- The payment system has appropriate admission and continuing participation requirements for system participants. Such requirements should address, among other things:
  - the participants' access to sufficient financial resources to meet obligations arising from participation;
  - the adequacy of participants' operational capacities to meet obligations arising from participation; and
  - the adequacy of the participants' own risk management processes.
- The payment system has processes and controls in place to verify and monitor on an ongoing basis the compliance of each participant with admission and participation requirements.
- The payment system has written policies and procedures for addressing participant failures to meet ongoing participation requirements.
- Payment system rules relating to the system's emergency authorities are unambiguous and cannot be amended or otherwise altered without prior notification to all members and an opportunity to withdraw.
- The payment system is governed by uniform, comprehensive and clear legal standards in its operating jurisdiction that address payment and/or settlement activities.
- The payment system is subject to and in compliance (or observance) with the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions (CPSS-IOSCO) Principles for Financial Market Infrastructures.
- The payment system is designated as a systemically important financial market utility (SIFMU) by the Financial Stability Oversight Counsel (FSOC) or is the international or foreign equivalent.
- The payment system provides members with information relevant to governance, risk management practices, and operations in a timely manner and with sufficient

transparency and particularity for the bank to ascertain with reasonable certainty the bank's level of risk exposure to the system.

- The payment system is operated by or subject to oversight of a central bank or regulatory authority.
- The payment system is legally organized as a not-for-profit enterprise or is owned and operated by a government entity.
- The payment system has appropriate systems and controls for timely communicating to members material events that relate to or could result in potential operational losses, *e.g.* fraud, system failures, natural disasters, etc.
- The payment system has never exercised its authority under indemnification provisions.

**B. Has the bank demonstrated that it can appropriately monitor and manage its potential risk exposures?**

A bank's risk management program should ensure that management can effectively monitor and manage its risk with respect to payment system memberships both individually and in the aggregate. The program should be risk based, commensurate with the level and breadth of payment activities and the bank's risk tolerance levels. An effective risk management program will exhibit the following criteria:

- The bank has appropriate board supervision and managerial and staff expertise.
- The bank has comprehensive policies and operating procedures with respect to its risk identification, measurement and management information systems that are routinely reviewed.
- The bank has effective risk controls and processes to oversee and ensure the continuing effectiveness of the risk management process. The program should include a formal process for approval of payment system memberships as well as ongoing monitoring and measurement of activity against predetermined risk limits.
- The membership evaluation process includes assessments and analyses of: (1) the credit quality of the entity; (2) the entity's risk management practices; (3) settlement and default procedures of the entity; (4) any default or loss-sharing precedents and any other applicable limits or restrictions of the entity; (5) key risks associated with joining the entity; and (6) the incremental effect of additional memberships in aggregate exposure to payment system risk.
- The program includes policies and procedures that identify and estimate the level of potential operational risks, at both inception of membership and on an on-going basis.

- The bank has auditing procedures to ensure the integrity of risk measurement, control and reporting systems.
- The program includes mechanisms to monitor, estimate, and maintain control over the bank's potential liabilities for operational losses on an ongoing basis. This should include: (1) limits and other controls with respect to each identified risk factor; (2) reports generated throughout the processes that accurately present the nature and level(s) of risk taken and demonstrate compliance with approved policies and limits; and (3) identification of the business unit and/or individuals responsible for measuring and monitoring risk exposures, as well as those individuals responsible for monitoring compliance with policies and risk exposure limits.

A bank with memberships in multiple payment systems should have the ability to monitor and report aggregate risk exposures and measurement against risk limits both at the sponsoring business line level and the total exposure organizationally.

### **Conclusion**

We conclude that the Bank, via its London Branch, may become a member of RMB CHATS, provided the Bank, before becoming a member, submits a written no-objection request to its EIC describing its proposed activities and receives a written EIC supervisory no-objection. As part of the Bank's no-objection request, the Bank should document to the satisfaction of the EIC that: (1) the payment system appropriately mitigates operational risk; and (2) the Bank can appropriately monitor and manage its potential risk exposures as a member of the system.

I trust this is responsive to your inquiry. If you have additional questions, please contact Tena M. Alexander, Senior Counsel, Securities and Corporate Practices Division, at (202) 649-5510.

Sincerely,

*Amy S. Friend*

Amy S. Friend  
Senior Deputy Comptroller  
and Chief Counsel