Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #993
June 2004
12 CFR 24

May 16, 1997

Dear [ ]:

You have submitted a letter on behalf of the [ ] (the "Clearing House") in connection with the proposed reorganization of the Clearing House into a holding company with subsidiaries. Your letter seeks confirmation that national banks may lawfully acquire and hold minority interests both in the new holding company and in certain of its subsidiaries. The new holding company will itself conduct the current trade association activities of the Clearing House. Subsidiaries of the holding company will conduct the current payment system activities of the Clearing House, including: (1) the Clearing House Interbank Payments System ("CHIPS"), (2) the [ ]Clearing House ("[ ]CH"), (3) the Clearing House Electronic Check Clearing System ("CHECCS ") and (4) paper check exchange and settlement. For the reasons discussed below, I conclude that the activities of the Clearing House are part of or incidental to the business of banking and that the acquisition and ownership of interests in both the holding company and its subsidiaries are permissible for national banks.

A. Background

1. The Clearing House

The Clearing House is a not-for-profit, unincorporated association of [ ] commercial banks. Its members are [*Bank 1*], [*Bank 2*], [*Bank 3*], [*Bank 4*], [*Bank 5*], [*Bank 6*], [*Bank 7*], [*Bank 8*], [*Bank 9*] and [*Bank 10*]. The Clearing House operates a variety of payments related services, including CHIPS, [ ]CH and CHECCS, offered only to its member banks and to other financial institutions.

2. The Proposed Structure and Activities

The proposed structure consists of a holding company (the "Holding Company") and several subsidiaries. The Holding Company will be the successor to the Clearing House and will also be a not-for-profit organization. The Holding Company and its subsidiaries (collectively, the "Clearing House LLC's") will each be organized as a Delaware limited liability company ("LLC").

The Holding Company will have at least two subsidiaries that will conduct the payments related activities currently conducted through the Clearing House. One such subsidiary ("**[*XXX*]**") will operate CHIPS. One or more other subsidiaries (collectively, the "SVPCo's") will operate the small value payment systems currently operated by the Clearing House ([ ]CH, CHECCS, and paper check clearing).[1] The Holding Company also will have a subsidiary ("ServiceCo") that will own and operate the computer facilities and related licenses used by the Holding Company's subsidiaries in the conduct of their activities.

It is currently anticipated that each of ServiceCo, **[*XXX*]** and the SVPCo's will be organized as for-profit organizations, although the practicality of establishing one or more as a not-for-profit organization is still being considered. In either case, it is expected that revenues from fees will be priced on a basis that will approximate expenses.

The specific activities of these various entities are described below:

a. Payments Related Activities

As noted, **[*XXX*]** and other SVPCos will collectively conduct the current payments related activities of the Clearing House and provide a variety of payments related services to members and other financial institutions.

CHIPS: [*XXX*] will operate CHIPS. CHIPS is a large-dollar electronic funds transfer system in the United States that is the primary wholesale electronic payment system supporting the international transfer of U.S. dollars between domestic and foreign banks. CHIPS links over 100 large banking institutions and currently transfers and settles approximately $1.3 trillion in payments on an average day. CHIPS provides clearing house functions for these payments among members. Through CHIPS, participating institutions (generally, national and

[1] There may be a period while the restructuring is being completed, however, during which the Holding Company will conduct certain of the activities currently conducted by the Clearing House (other than CHIPS). The Clearing House anticipates that the Holding Company initially will establish one SVPCo subsidiary that will operate all of the current small value payment systems of the Clearing House. Over time, however, the Holding Company may divide these activities among additional SVPCo subsidiaries and may establish new SVPCo subsidiaries to operate additional small value payment systems.

state banks, private banks licensed under [*State*] banking law, branches and agencies of foreign banks, and qualified Edge Act subsidiaries) can send *inter se* electronic messages on payment instructions and additional transaction data related to payment instructions. CHIPS also provides processing of those payments and arranges for settlement between its members on a multilateral net basis at the end of each business day.[2]

The other SVPCo will operate the small value retail payment systems currently conducted by the Clearing House: [ ]CH, CHECCS and paper check clearing services.

[ ]**CH:** Automated clearing houses ("ACH"), like the [ ]CH, are electronic funds transfer systems designed predominantly to handle repetitive small dollar payments. Essentially, an ACH operates as an electronic alternative to the traditional paper-based check collection system. Usually, the ACH receives from member originating institutions batch payment instructions for the crediting and debiting of deposit accounts. These instructions are called entries. The ACH processes the entries by editing, balancing and sorting the payment data in the entries and then transmits the entries directly or indirectly (though other ACHs) to the appropriate receiving institution for further action. The ACH also arranges settlement between the originating and receiving institutions through credits and debits of accounts maintained by those institutions with Federal Reserve Banks.

[ ]CH, which operates essentially as described above, is a part of a national network of automated clearing houses linked by the Federal Reserve System and has also formed a network with the two other private ACH operators to process ACH items directly. The [ ]CH currently has more than 800 participants.

CHECCS: CHECCS is a payments processing system that enhances the efficiency of paper check processing by using electronic check presentment. In CHECCS, a banking organization presenting a check encodes the information on the check's magnetic ink character recognition line and transmits it to an electronic switch operated by CHECCS. These data are sorted and stored in the CHECCS system until retrieved by the paying bank. The use of CHECCS permits a bank to identify potential return items before the delivery of physical checks and therefore reduces the bank's exposure to such items. Other components of CHECCS include data processing and transmittal systems that permit (1) immediate identification of certain return items by comparing stored information with master files of closed account and stop

[2] The proposed reorganization will not affect the operational methodology of CHIPS or the current measures that have been implemented to control and reduce operational, fraud, credit and systemic risk. In order to reduce credit and systemic risk, CHIPS currently employs admission standards, same-day settlement, bilateral credit limits, net debit caps, loss sharing rules (additional settlement obligations) and collateral requirements. CHIPS will continue to meet all of the standards set forth in the Policy Statement on Privately Operated Large-Dollar Multilateral Netting Systems issued by the Board of Governors of the Federal Reserve System, 59 Fed. Reg. 67,534 (Dec. 29, 1994).

payment information, and (2) permits paying banks electronically to transmit return item notices.

Paper-based Systems: The SVPCo will also provide conventional paper check clearing services through which members of the Holding Company will exchange checks, coupons and other certificates of value among themselves on the premises of the SVPCo. The SVPCo will record the transactions and calculate net settlement amounts and arrange to have the resulting amounts settled through the Federal Reserve Bank of [*State*].

b. Facilitating Activities and Supporting Services

Holding Company: When the reorganization is completed, it is anticipated that the Holding Company itself will not conduct any payment systems activities. Instead, the activities of the Holding Company will consist of holding interests in its subsidiaries and providing "trade association services." Trade association services will consist primarily of submitting comments in respect of regulatory and legislative proposals, filing briefs as *amicus curiae* in judicial actions and submitting requests for regulatory interpretations, in each case where the proposal, action or matter affects the banking industry. The Holding Company is also expected to own the real property currently owned on behalf of the Clearing House (although such property may also be held through ServiceCo).

ServiceCo: ServiceCo will engage solely in the provision of services to the Holding Company's subsidiaries. Such services will consist primarily of data processing and data transmission services, databases and facilities. Specifically, ServiceCo will own and operate the computer facilities and related licenses used by the Holding Company's subsidiaries in their activities. ServiceCo will provide data processing services and access to its facilities to each of the Holding Company's subsidiaries.

3. Ownership

Each of the ten current members of the Clearing House will become a member of, and acquire an equal limited liability company interest in, the Holding Company. The affairs and activities of each Clearing House LLC are governed by a limited liability company agreement ("LLC Agreement").

[XXX] will be owned in part by the Holding Company and in part by the participants in CHIPS. [XXX] will have two classes of members, Class A members and Class B members. Each banking organization that is a participant in CHIPS (or becomes a participant after the date of the reorganization) will become a Class A member, and Class A membership will be limited to CHIPS participants. The Holding Company will be the only Class B member.

Ninety-nine percent of the common limited liability company interests in [XXX] will be held by the Class A members and will be allocated per capita among them. The Holding Company

(as the Class B member) will have only a 1 % common limited liability company interest, but it will elect a majority of the [XXX] Board.

ServiceCo and (initially) the SVPCo's will be wholly owned by the Holding Company. The ownership structure of the SVPCo's, however, is expected to change over time. It is anticipated that one or more of the SVPCo's will in the future become partly owned by the participants in the payment systems operated by it. In that case, the ownership structure of the SVPCo would be modeled after that of [XXX].

4. Governance

Each of the Clearing House LLCs will be managed by a Board of Directors (except ServiceCo). With respect to the Holding Company, each member of the Holding Company will be entitled to appoint one Director, and each Director will have one vote on all matters coming before the Board. Each member of the Holding Company will have one vote on all matters presented to the members, as such.

[XXX] will be managed by a ten-member Board of Directors. The Holding Company (as the Class B member) will be entitled to elect six of the Directors, and the Class A members will be entitled to elect the remaining four Directors. Every Director must be an executive officer of a Class A member of [XXX] and no two Directors may be officers of the same Class A member (or of affiliated Class A members). Each Director will be entitled to one vote on all matters coming before the Board.

The Class A members and the Class B member of [XXX] will vote as separate classes on all matters presented to the members, and all actions by the members will require the affirmative vote of both the Class A members and the Class B member. Although each Class A Member will have an equal common limited liability company interest in [XXX], each Class A member's vote will be weighted based on the member's usage of CHIPS over a specified period.

As the sole member, the Holding Company will initially be entitled to appoint all Directors of any SVPCo. If any SVPCo becomes partially owned by participants, the participants will become entitled to elect a minority of its Directors in a voting arrangement expected to be similar to that of [XXX]. ServiceCo will be managed directly by the Holding Company, as sole member, and will not have a Board of Directors.

5. Other Material Terms of the LLC Agreements

The LLC Agreement of each Clearing House LLC provides that the LLC shall not directly or indirectly carry on any activity that would prohibit a national bank or a member bank of the

Federal Reserve System from being a member of the LLC.[3] In addition, the LLC Agreements provide that a member may withdraw for any reason and without the consent of any other member (subject, in the case of [XXX] and any SVPCo, to thirty days written notice).

Membership in the Clearing House LLC's will be limited to banking organizations. In the case of the Holding Company, the LLC Agreement limits membership to commercial banks and trust companies. In the case of [XXX], the LLC Agreement limits membership to the Holding Company and to banking organizations that are participants in CHIPS (or in another electronic funds transfer system that may from time to time be operated by [XXX]). Membership in a SVPCo will be limited to the Holding Company and institutions that are participants in the payment system(s) operated by the SVPCo. Under their respective LLC Agreements, membership in the Clearing House LLC's (except ServiceCo) will be subject to restrictions on transferability. With certain exceptions, a member may not transfer any part of its interest without the consent of the Board of Directors.

None of the LLC Agreements of the Clearing House LLC's will require any member to make any capital contribution other than upon admission. From time to time, however, a Clearing House LLC may request additional contributions from members (including for expenses). In the case of the Holding Company, the failure of a member to make a requested contribution may be grounds for expulsion.

B. Discussion

Your letter raises the issue of the authority of a national bank to make a non-controlling investment in a limited liability company. In a variety of circumstances, the OCC has permitted national banks to own, either directly, or indirectly through an operating subsidiary, a minority interest in an enterprise. The OCC has said that national banks are legally permitted to make a minority investment in an LLC provided four criteria or standards are met. *See* Interpretive Letter No. 732, reprinted in, [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-049 (May 10, 1996); Interpretive Letter No. 692, reprinted in [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (Nov. 1, 1995), and OCC Interpretive Letter No. 694, reprinted in [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,009 (Dec. 13, 1995).[4] These standards, which have been distilled from our previous decisions on permissible minority investments for national banks and their subsidiaries, are:

[3] We interpret this language to mean that the LLCs will engage only in activities that are part of or are incidental to the business of banking. If this interpretation is incorrect, the language in the LLC Agreements should be changed to conform to this interpretation.

[4] See also 12 C.F.R. § 5.36(b). National banks are permitted to make various types of equity investments pursuant to 12 C.F.R. § 24(Seventh) and other statutes.

(1) The activities of the enterprise in which the investment is made must be limited to activities that are part of or incidental to the business of banking.

(2) The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment.

(3) The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.

(4) The investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

I conclude, as discussed below, that the proposed investments by national banks in the Clearing House LLCs satisfy these four criteria.

1. The activities of the enterprise in which the investment is made must be limited to activities that are part of or incidental to the business of banking

The National Bank Act, in relevant part, provides that national banks shall have the power:

> [t]o exercise … all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes ...

12 U.S.C. § 24(Seventh).

The Supreme Court has held that the powers clause of 12 U.S. C. § 24(Seventh) is a broad grant of power to engage in the business of banking, including but not limited to the enumerated powers and the business of banking as a whole. See NationsBank of North Carolina N.A. v. Variable Life Annuity Co., 115 S. Ct. 810 (1995) ("VALIC"). Judicial cases reflect three general principles used to determine whether an activity is within the scope of the "business of banking": (1) is the activity functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) would the activity respond to customer needs or otherwise benefit the bank or its customers; and (3) does the activity involve risks similar in nature to those already assumed by banks. See, e.g., Merchants' Bank v. State Bank, 77 U.S. 604, 648 (1871) (certification of checks has grown out of the business needs of the country and involves no greater risk than a bank giving a certificate of deposit); M&M Leasing Corp. v. Seattle First Nat'l Bank, 563 F.2d 1377, 1382-83 (9th Cir. 1977), cert .denied, 436 U.S. 987 (1978) (personal property lease financing is "functionally interchangeable" with the express power to loan money on personal property); American Ins. Assoc. v. Clarke, 865 F.2d 278,

282 (D.C. Cir. 1988) (standby credits to insure municipal bonds is "functionally equivalent" to the issuance of a standby letter of credit). Further, as established by the Supreme Court in VALIC, national banks are authorized to engage in an activity if it is incidental to the performance of the five enumerated powers in section 24(Seventh) or if it is incidental to the performance of an activity that is part of the business of banking.

a. Payments related activities

Modern electronic clearing house activities, such as those of the proposed LLCs, involve three distinct services: electronic payments message transmission, electronic payments processing, and payments settlement among members. All three services relate to different aspects of the payments systems that, as OCC recently noted, are central to banking.[5] Each of these three services is clearly within the business of banking and is, thus, permissible for national banks.

Transmission of electronic messages related to payments: It is well established that a national bank may use electronic means to perform services expressly or incidentally authorized to national banks.[6] The OCC Interpretive Ruling setting forth this authority was recently revised, in recognition of the rapid advancement of technology, to authorize a national bank to "perform, provide, or deliver through electronic means and facilities any activity, function, product, or service that it is otherwise authorized to perform, provide, or deliver." 61 Fed. Reg. 4849 (1996) *codified at* 12 C.F.R. § 7.1019.

Accordingly, the OCC has found that, as part of the business of banking, national banks may provide for the electronic transmission of banking, financial, or related economic data and thereby establish communication or data networks that support banking and financial transactions.[7] Thus, for example, in OCC Interpretive Letter No. 732, supra, the OCC

---

[5] "Banks are the most important institutional participants in the nation's payment system. 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." OCC Conditional Approval Letter No. 220, 1996 OCC Ltr. LEXIS 140 (Dec. 2, 1996) (the "Mondex Letter").

[6] See OCC Interpretive Letter No. 677, reprinted in [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (June 28, 1995); OCC Interpretive Letter No. 284, reprinted in [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,448 (Mar. 26, 1984); and OCC Interpretive Letter No. 449, reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,673 (Aug. 23, 1988).

[7] See OCC Interpretive Letter No. 653, reprinted in [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601 (December 22, 1994)(national bank may establish a network to act as an informational and payments interface between insurance underwriters and their agents); OCC Interpretive Letter No. 516, reprinted in (1990-91 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,220 (July 12, 1990) (national bank may provide electronic communications channels for persons participating in securities transactions); OCC Interpretive Letter No. 513, reprinted in [1990-91 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,215 (June 18, 1990) (national bank may provide an electronic network for the transmission of visual, voice and data communications for other financial institutions); OCC Interpretive Letter No. 346, reprinted in [1985-1987] Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 85,516 (July 31, 1985)(national bank may establish an electronic gateway for financial settlement services).

permitted a national bank to assume a minority ownership in a company engaged in the design, development, and marketing of a network for electronic funds transfer and electronic commercial data interchange.[8] Indeed, the OCC recently noted that electronically transmitted payments through clearing houses like CHIPS account for a very large portion of the total dollar value of all financial transactions. Mondex Letter, supra, at n. 10.

Electronic payments processing: The information and transaction processing that [XXX] and the other Clearing House LLCs will provide for participating institutions is permissible. The processing will involve banking, financial, or related economic data and, thus, is part of the business of banking. An earlier version of 12 C.F.R. § 7.1019 stated that "as part of its banking business and incidental thereto, a national bank may collect, transcribe, process, analyze, and store for itself and others, banking, financial, or related economic data." Interpretive Ruling 7.3500, 39 Fed. Reg. 14195 (Apr. 22, 1974). Although in its 1984 revision of the ruling, the OCC deleted this statement because it believed that "specific examples [of permissible electronic activities] are inappropriate given the imprecision of terms and rapid pace of change in the data processing industry," 49 Fed. Reg. 11157 (Mar. 26, 1984), the "analytical framework" embodied in the ruling remained the same. Id. There was no intent to narrow or restrict the substantive effect of the rule.[9]

Clearing and settlement of payments among members: The OCC has long held that national banks may invest in and hold stock in clearing house associations in which they participate. Unpublished letter from James J. Saxon dated October 12, 1966; Unpublished letter from William B. Camp, dated November 18, 1966; Unpublished letter from Peter Liebesman dated January 26, 1981. Cf., Unpublished letter from James J. Saxon dated

[8] The Clearing House LLCs will transmit not only payment instructions, but also information related to payments instructions. This will be permissible. As part of the business of banking, national banks can transmit data or information and electronic documents connected with funds transfer, such as electronic data interchange ("EDI") services. See Interpretive Letter No. 732, supra (a national bank may offer EDI services that allow businesses to electronically send and receive payments, invoices and orders worldwide). See also Interpretive Letter No. 419, reprinted in [1988-1989 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 85,643 (February 18, 1988) (national bank providing specialized electronic payment systems for health care providers and insurance carriers can also transmit as part of that payment service treatment information from the health care providers to the insurance carriers that was used by the insurance carrier to determine how the amount to be payed should be allocated among potential payors).

[9] OCC Interpretive Letter No. 677, supra. See also OCC Interpretive Letter No. 737, reprinted in, [Current Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81-101 (Aug. 19, 1996) (to be published) (national bank may provide transaction and information processing services to support an electronic stored value system); OCC Interpretive Letter No. 653, supra, (national bank may act as an informational and payments interface between insurance underwriters and general insurance agents); OCC Letter No. 346, supra, (national banks may maintain records on commodities transactions).

January 28, 1964; Unpublished letter from Robert B. Serino dated July 26, 1989; and OCC Interpretive Letter No. 692, supra. Case authority also holds that this is a permissible activity for national banks. Philler v. Patterson, 168 Pa. 468, 32 A. 26 (1895); Crane v. The Fourth National Rank, 173 Pa. 556, 34 A. 296 (1896). Cf., Andrew v. Farmers & Merchants Savings Bank, 245 N.W. 226, 229 (Iowa 1932). The use of electronic technology to conduct clearing and settlement activities does not change this conclusion. OCC Interpretive Letter No. 737, supra (the collection, processing, and settlement of payments in a stored value system is part of the business of banking).[10]

b. Facilitating Activities and Supporting Services

The Holding Company and ServiceCo will not conduct any payment systems activities, but instead will provide general services to facilitate and support the business operations of the other Clearing House LLCs. These supporting activities are not part of the business of banking per se, but they are permissible incidental activities because they facilitate, support and, hence, are "necessary to" the operation of the other LLCs as businesses.

Some permissible incidental activities of national banks are not necessarily incident to specific banking services or products, but rather to the operation of the bank as a business: they facilitate general operation of the bank as a business enterprise. These facilitating activities include hiring employees, issuing stock to raise capital, owning or renting equipment, borrowing money for operations, purchasing the assets and assuming the liabilities of other financial institutions. While no express grants of authority to conduct these activities exist, various federal statutes have implicitly recognized and regulated these business activities of national banks. For example, the statutes refer to limits on persons who can serve as bank employees.[11] In each case, the statutes have assumed the existence of the corporate power to conduct the activity. These powers are incidental to the general grant of power to conduct a "business" under 12 U.S.C. 24(Seventh) and do not need express enumeration.[12]

---

[10] See also Mondex Letter (national banks may invest in an LLC providing clearing and settlement for an open stored value system); OCC Interpretive Letter No. 731, reprinted in [Current Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81,048 (July 1, 1996) (national banks may enter into a contract with a public authority to operate on behalf of the authority an electronic toll collection system); OCC Interpretive Letter No. 732, supra (national banks may provide electronic data interchange services that, among other things, provide for payments by EFT); and OCC Interpretive Letter No. 419, supra (national bank may provide a service that facilitates settlement and payment of health claims using EFT technology).

[11] See, e.g.,12 U.S. C. 78 (persons ineligible to be bank employees).

[12] Memorandum dated November 18, 1996, to Eugene A. Ludwig, Comptroller of the Currency, from Julie L. Williams, Chief Counsel, "Legal Authority for Revised Operating Subsidiary Regulation," reprinted at [Current Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 90-464 ("Williams Memo").

The power to operate through optimal corporate structures, such as subsidiary corporations or joint ventures is an example of such permissible operational incidental activities. Such stock ownership is not among the powers expressly granted to national banks in 12 U.S.C. 24(Seventh) nor does it fall within the "business of banking" in the sense that it is a banking activity. Nevertheless, statutes refer to the existence of bank subsidiaries, indicating that subsidiaries were contemplated as permissible and that the incidental power to hold and operate them is implied.[13]

In this case, the Holding Company will hold interests in its subsidiaries. This would be a permissible activity for a national bank; it is an exercise of the business facilitating incidental power to reconfigure the structure of what the banks own, i.e., the Clearing House, into a more desirable structure through which to conduct payments related activities on behalf of the investing banks.

Another "trade association service" provided by the Holding Company will be external communications and relations. The external communications conducted by the Holding Company will be relevant to banking industry issues and, specifically, payment system issues. Also, as part of this function, the Holding Company will become involved in litigation relating to issues of concern to the Holding Company's owners. These are permissible incidental facilitating activities.[14]

2. *The Banks must be able to prevent the LLC from engaging in activities that do not meet the foregoing standard, or be able to withdraw their investment*

This is an obvious corollary to the first standard. It is not sufficient that the LLC's activities are permissible at the time the bank initially purchases LLC membership shares; they must also remain permissible for as long as the bank retains an ownership interest in the LLC.

The LLC Agreements will effectively provide that the LLC will only engage in activities that are part of or incidental to the business of banking. In addition, investing banks may withdraw

[13] 12 U.S.C. 24(Seventh) (limitations on presupposed authority of national bank to own a subsidiary engaged in the safe deposit business); 12 U.S.C. 371d (limitations on the amount of investment permitted in a bank premises corporation subsidiary); and 12 U.S.C. 371c ("affiliates" includes subsidiaries owned by national banks). See also Williams Memo, supra.

[14] The Holding Company may also own the real property currently owned on behalf of the Clearing House that is used to house it operations. Under 12 U.S.C. § 29, national banks are permitted to own real property "as shall be necessary for its accommodation in the transaction of its business." The ServiceCo will own and operate the computer facilities and related licenses used by the Holding Company's subsidiaries in the conduct of their activities. These activities are clearly permissible for national banks.

from the Clearing House LLCs without the consent of the other investors for any reason. including that an LLC is engaged in activities that are not permissible for a national bank.[15]

3. The Banks' loss exposure must be limited, as a legal and accounting matter, and the Banks must not have open-ended liability for the obligations of the enterprise

a. Loss exposure from a legal standpoint

A primary concern of the OCC is that national banks should not be subjected to undue risk. Where an investing bank will not control the operations of the entity in which the bank holds an interest, it is important that a bank's investment not expose it to unlimited liability. This is the case here. As a legal matter, investors in a Delaware LLC will not incur liability beyond their investment in the LLC by virtue of being a member or manager of the LLC -- even if they actively participate in the management or control of the business. Del. Code Ann. Tit. 6, § 18-303(a) (1994). Additionally, the LLC Agreements will provide that the investing banks will not be liable for any debt, obligation or liability of an LLC by reason of having invested in the LLC.

b. Loss exposure from an accounting standpoint

In assessing a bank's loss exposure as an accounting matter, the OCC has previously noted that the appropriate accounting treatment for a bank's less than 20 percent ownership share or investment in an LLC is to report it as an unconsolidated entity under the equity method or cost of accounting. Under the equity method of accounting, unless the investor has extended a loan to the entity, guaranteed any of its liabilities, or has other financial obligations, the investor's losses are generally limited to the amount of the investment shown on the investor's books.[16] Similarly, under the cost method of accounting, the investor records an investment at cost, dividends, or distributions from the entity are the basis for recognition of earnings, and losses recognized by the investor are limited to the extent of the investment. In sum,

[15] Under the LLC Agreements, thirty days written notice will be required to withdraw from **[*XXX*]** and the SVPCos.

[16] See generally, Accounting Principles Board, Op. No. 18 § 19 (1971). Under the equity method, the investor records the initial investment at cost and, then, adjusts the carrying amount to recognize the investor's pro rata share of subsequent earnings or losses in the LLC. When losses equal or exceed the carrying amount of the investment plus advances, the investment is reduced to zero value and no further losses need be recognized unless the investor has guaranteed obligations of the LLC or is otherwise committed to provide further financial support of the LLC. In contrast, under the cost method, the investor records the initial investment at cost and, then, adjusts the carrying amount to recognize dividends actually received. Operating losses are recognized if a series of losses or other factors indicate that a decrease in the value of the investment has occurred which is other than temporary. However, losses under the cost method are generally recognized only to the extent of the adjusted carrying amount of the investment.

regardless of which accounting method is used, the investing banks' potential loss is limited to the amount of its investment. The banks investing in the Clearing House LLCs will meet this requirement.

4. The investment must be convenient or useful to the Bank in carrying out its business and not a mere passive investment unrelated to that Bank's banking business

A national bank's investment in an enterprise or entity that is not an operating subsidiary of the bank also must satisfy the requirement that the investment have a beneficial connection to the bank's business, i.e., be convenient or useful to the investing bank's business activities, and not be a mere passive investment unrelated to that bank's business activities. "Necessary" has been judicially construed to mean "convenient or useful." See Arnold Tours, 472 F.2d at 432. The provision in 12 U.S.C. § 24(Seventh) relating to the purchase of stock, derived from section 16 of the Glass-Steagall Act, was only intended to make it clear that section 16 did not authorize speculative investments in stock. See OCC Interpretive Letter No. 697, reprinted in [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-102 (November 15, 1995). Therefore, a consistent thread running through our precedents concerning stock ownership is that it must be convenient or useful to the bank in conducting that bank's banking business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment.

That requirement is met here. The Clearing House LLCs will be providing services to the investing banks that will enable the banks to offer payments services and carry out their banking business more efficiently and effectively. [XXX] will provide the investing banks with wholesale international electronic payments support. The SVPCo will provide the investing banks with small value payment support through [ ]CH, CHECCS, and a paper check clearing system. Thus, the LLCs will provide direct suppport for the business operations of the investing banks. Moreover, while the Clearing House LLCs may be established as for-profit organizations, it is expected that revenues from fees will be priced on a basis that will approximate expenses. Finally, there are substantial restrictions on the ability of investing banks to sell their interests in the Clearing House LLCs. T hese factors establish that the investment in these LLCs will be neither passive nor speculative.

C. Conclusion

On the basis of the representations specified in your letter and other submitted materials, the OCC finds that national banks may invest in the LLCs in the manner and as described herein, provided:

(1) the LLCs will engage only in activities that are part of, or incidental to, the business of banking;

(2) the banks will withdraw from any LLC in the event it engages in an activity that is inconsistent with condition number 1;

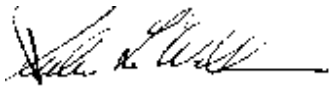
(3) the banks will account for their investment in the LLCs under the equity or cost method of accounting;

(4) the LLCs will be subject to OCC supervision, regulation, and examination; and

(5) a copy of this letter will be provided to all national banks proposing to invest in the LLC's.

These conditions are imposed in writing by the OCC in connection with its action on the request for a legal opinion confirming that the proposed investment is permissible under 12 U.S.C. § 24(Seventh) and, as such, may be enforced in proceedings under applicable law.

Sincerely,



Julie L. Williams
Chief Counsel