

SUPPLEMENTAL ADVISORY FOR THE REDEMPTION OF REGISTERED WARRANTS

Prepared by:

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1. Background. Under an approval granted by the Pooled Money Investment Board on August 21, 2009, the State Treasurer's Office ("STO") announced that all outstanding registered warrants are redeemable effective on and after September 4, 2009. This redemption is announced notwithstanding the maturity of October 2, 2009, provided on all registered warrants. The registered warrants are redeemable within a one-year period subsequent to the redemption announcement of September 4, 2009. Registered warrants accrue interest at the rate of 3.75%, based on a 360-day year; however, they cease accruing interest after September 4, 2009.

The State Controller's Office will cease issuing registered warrants on or prior to September 3, 2009. The validation process established by the STO to validate registered warrants accepted by banks and other financial institutions (collectively, "banks" and individually "bank") will cease as of September 4, 2009.

2. Redemption of registered warrants. To supplement the information provided by the Cash Management Division of the STO, dated July 1, 2009, we are providing this additional information to you as and when you present registered warrants to the STO for your own account or for the account of your customers.

A bank has three principal options for presenting registered warrants:

Direct presentment by the bank to the item processing section within the STO.

By mail to the STO.

Through the services of the Federal Reserve Bank of San Francisco (the "fed").

Let's explore these options in more detail:

A. Direct presentment. We strongly recommend that a bank present registered warrants in a segregated cash letter holding only registered warrants. While we understand that the STO will accept mixed cash letters holding both registered warrants and regular warrants, a mixed cash letter may delay the provisioning of a detailed report of paid interest to be generated by the STO to the presenting bank. This paid interest report will contain the interest paid on each and every registered warrant by serial number, principal amount, and paid interest amount. This detailed paid interest report may be of value to the bank, especially if that bank is collecting such interest payment on behalf of some of all of its customers.

We understand that, upon request by the presenting bank, the STO will not pay interest on specific cash letters holding registered warrants if the presenting bank does not wish to have interest paid as to such warrants.

B. By mail. We again strongly recommend that a bank present registered warrants by mail in a segregated cash letter holding only registered warrants for the reasons detailed above. The registered warrants may be mailed to the following address:

State Treasurer's Office

915 Capitol Mall

Sacramento, CA 95814

Attn: Item Processing Section

C. Through the fed. While the fed regularly presents to the STO regular warrants, such warrants do not involve the payment of interest. Consequently, we have been informed by officials of the STO that registered warrants presented through the fed may not be paid the accrued interest. The STO does not have the staff to examine the back of each and every registered warrant presented by the fed and identify the depository bank entitled to the interest. Further, even if the STO paid the interest to the fed as to registered warrants presented by the fed, we understand that the fed does not have the ability to in turn pay the interest to the depository banks for which it is collecting the registered warrants. In short, if a bank wants to have the accrued interest payable on registered warrants, it may be advisable to present the registered warrants directly as described in A or B above.

3. Collection of interest on registered warrants. If a bank were to collect the interest payable on registered warrants on behalf of its customers, it is advisable to present the registered warrants in a segregated cash letter to facilitate the creation of a report by the STO as to the interest paid on each and every registered warrant. If the bank pays its customers, consider the following.

A. Tax reporting. If a bank elects to collect the interest payable on registered warrants on behalf of its customers, unless the payee customer of the bank is exempt from tax reporting (e.g., a corporation) that bank is under an obligation to file Form 1099-INT even if the interest accruing on registered warrants may be tax-exempt under both federal and California state law. A "middleman" collecting interest on behalf of another person is required to report the interest on Form 1099-INT (Internal Revenue Code Reg. Sec. 1.6049-4(a)(2)(ii) and (f)(4)). In this case the interest would be tax exempt interest and would be reportable in box 8 of the Form 1099-INT. Further, subject to the domicile of the customer, the bank may have an obligation to provide such information reporting to the state tax authority of the customer.

B. Backup withholding. If the bank paying the interest has a non-taxpayer identification number ("TIN") certified payee or account, the bank may also have an obligation to

invoke backup withholding of 28%, even if the bank is not paying interest accruing through a deposit account relationship and even if that interest may be tax-exempt for both federal and state tax purposes. Because the tax-exempt interest is subject to reporting as detailed above, the tax-exempt interest is also subject to backup withholding and the bank would need a certified TIN for the account/payment of the tax-exempt interest or the bank would have to backup withhold tax of 28% from the payment.

The Internal Revenue Service provides a limited exception when the new tax-exempt interest reporting requirement became law in 2006. If the account was established on or before October 4, 2006, and the account has a TIN, backup withholding is not required on payments of tax-exempt interest to the account even if the TIN on the account is not certified with a Form W-9. A TIN is still required on the account. As a practical matter, this limited exception may be of little use to a bank, but some may find it helpful. (IRS Notice 2006-93.)

4. Waiver of interest. In lieu of collecting interest on behalf of a customer, on or after September 4, 2009, a bank cashing a registered warrant or accepting a registered warrant for deposit may in that connection elect to retain the interest payable on the registered warrant for its own account. Because a bank electing to retain the interest for its own account may suffer a claim from its customer for that interest, it may be advisable to secure a waiver from the customer that the customer is waiving its rights to the interest.

5. Conclusion. If a bank wants to collect the interest payable on registered warrants on and after September 4, 2009, we would recommend direct presentment of such warrants through a segregated cash letter holding only registered warrants. Alternatively, the bank may mail the registered warrants. If the bank also wants to collect the interest payable on registered warrants on behalf of its customers, be mindful of the tax reporting obligations and the possible backup withholding obligations that may attach to such payment.