

FEDERAL RESERVE BANK OF SAN FRANCISCO
101 MARKET STREET, SAN FRANCISCO, CALIFORNIA 94105

June 30, 1992

**ISSUANCE OF REGISTERED WARRANTS
BY THE STATE OF CALIFORNIA**

To Depository Institutions in the
Twelfth Federal Reserve District.

The State of California has announced its intention to issue registered warrants if a budget has not been approved by July 1, 1992. These warrants will be issued within published ranges of warrant numbers, have the word REGISTERED printed on the face, and carry, on the back, a special endorsement from the State Treasurer's Office. Registered warrants differ from the warrants normally issued by the State in that **they are not immediately payable**. Instead, registered warrants will be redeemed only after they are "called"; call dates for specific warrants will be announced by the State.

The warrants will be redeemed chronologically by issue date. Under State law, when a registered warrant is called, the Treasurer must advertise this fact for six days in newspapers located in Sacramento, San Francisco and Los Angeles. In addition to the required newspaper advertisements, the Treasurer will operate a 24 hour, toll free, telephone hotline. By calling 800-531-9153, you will reach a recording which will provide information on the warrant numbers for all registered warrants issued to date and the warrant numbers of any registered warrants that have been called.

Because these items are not immediately payable, we ask that you **do not deposit them in cash letters prior to their announced call date**. The State will return any registered warrants presented prior to the call date.

The State has indicated that interest will be paid, from the date of issue until the call date, to the presenter of the warrant. If called warrants are deposited in a cash letter to the Federal Reserve, credit will be given only for the face amount of the warrant. You must apply directly to the State Treasurer's Office for payment on interest. A letter claiming such interest should be mailed, or hand delivered, to:

State Treasurer's Office
915 Capitol Mall, Room 1
Sacramento, CA 95814
Attention: Item Processing Unit

Alternatively, you may wish to present these items directly to the State Treasurer's Office, at the address shown above. Institutions presenting items directly to the State Treasurer's Office, after the call date for each warrant, will receive a payment for the face amount on the day of presentment and a payment for the accrued interest on the following day.

Regulation CC

Because a registered warrant is not immediately payable, it is not considered a "check" under section 229.2 (k) of Regulation CC, and the availability and processing requirement of that regulation do not apply, until the State has issued a "call" for the specific warrant.

Discount Window

In some cases, depository institutions that acquire substantial holdings of registered warrants may experience unexpected liquidity pressures because of the need to fund these assets until they are called. Institutions wishing to inquire about discount window assistance should contact the District Credit Unit at **(415) 974-2265**.

Additional Information

If you have any questions regarding processing of State warrants by the Federal Reserve, please contact Ms. Elizabeth O'Shea, Payments Officer, at (415) 974-3366. Questions regarding the State's registered warrant program, or its handling of these items, should be directed to Mr. Bruce Van Houten, Office of the Treasurer, at (916) 653-2917.

PATRICK K. BARRON
First Vice President

OCC**FDIC****FRB****OTS**

June 30, 1992

To The Chief Executive Officer of the Institution Addressed:

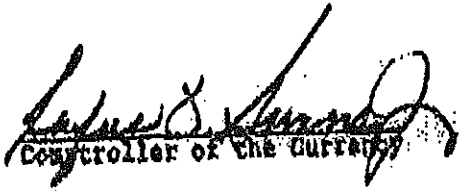
INTERAGENCY POSITION ON CALIFORNIA REGISTERED WARRANTS

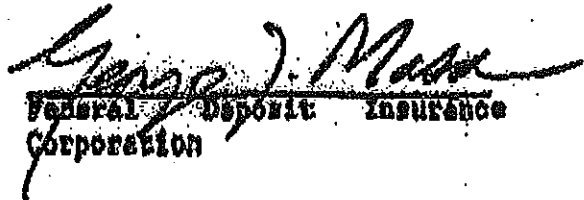
In the absence of a budget, the State of California (State) lacks authority to issue checks after June 30, 1992. Until a budget is passed, the State intends to issue registered warrants for payment of obligations, such as payroll, general disbursements, and personal income tax refunds. These warrants are essentially I.O.U.s issued by the State for obligations that are normally payable from the California General Fund. The State estimates that it could issue up to 500,000 warrants during the month of July totaling approximately \$2 billion.

The State Attorney General has provided an opinion (attached) that these warrants are valid and binding obligations of the State. They are supported by the full faith and credit of an obligor possessing general powers of taxation, and have the same credit quality characteristics of the State's general obligation bonds (currently rated AA).

It is the position of the Federal banking and thrift regulators that these warrants should be considered as having the same regulatory requirements as general obligation bonds issued by a state. Thus, there is no regulatory limit on a bank's or thrift's investment in such warrants. Additionally, the warrants will receive the same risk-based capital treatment as general obligation bonds.

Banks and thrifts should exercise prudent judgment in determining whether and the extent to which they should accept these warrants. Each institution should establish policies regarding concentration limitations for such investments based on liquidity and other safety and soundness considerations. Further, it is advisable that banks and thrifts obtain an opinion letter from outside counsel regarding whether such registered warrants constitute valid and binding obligations of the State.


Controller of the Currency


Federal Deposit Insurance
Corporation


Federal Reserve Bank of San Francisco


Office of Thrift Supervision

Attachment

BANKING ISSUANCES

Comptroller of the Currency
Administrator of National Banks

Type: Examining Bulletin

Subject: California Registered Warrants

TO: Department and Division Heads and All Examining Personnel.

The State of California has begun issuing registered warrants to cover a funding gap that exists pending the legislature's approval of a budget for the state's current fiscal year, which began July 1, 1992. This bulletin alerts examiners to safety and soundness considerations and provides further guidance as to the reporting treatment of registered warrants and certain other issues discussed in the "Interagency Position On California Registered Warrants," dated June 30, 1992.

Registered warrants drawn against unexhausted appropriations and otherwise issued in accordance with California law are extensions of credit to the state that constitute state general obligations as defined in the regulations of the Office of the Comptroller of the Currency (OCC). The term general obligation, defined in 12 CFR 1.3(g), means "an obligation supported by the full faith and credit of an obligor possessing general powers of taxation, including property taxation." 12 CFR 1 provides that banks may purchase state general obligation securities for their own account without limitation, subject to prudent banking judgment.

As a matter of prudence, banks should consider obtaining appropriate legal opinions that any registered warrants purchased represent valid and enforceable general obligations of the state. Banks should determine for this purpose the extent to which they should rely on opinions of the California Attorney General, counsel retained by other banks, or their own counsel, depending upon their particular situations.

Although the OCC has long recognized that certain obligations may be treated either as loans or securities depending upon the circumstances, the OCC and the other bank regulatory agencies recognize that interagency consistency is desirable whenever possible. Accordingly, assuming that banks have satisfied themselves that the warrants represent valid state general obligations, for regulatory reporting purposes, banks should account for them as "General obligations" on Schedule RC-B, under the category "Securities issued by states and political subdivisions in the U.S."

Although the warrants are not rated, and are subordinate to the state's general obligation bonds, the existence of general obligation debt ratings on the state simplifies credit evaluation. Examiners should review the warrants in accordance with Banking Circular 127, which defines sub-investment quality securities as those rated below "Ba" and "BB" (Moody's and Standard & Poor's, respectively). California's current ratings are "Aa" by Moody's (following a downgrade on July 6) and "A+" by Standard & Poor's (following a downgrade on July 15). Further credit downgrades are possible if the budget problem is not resolved shortly.

In the event of a prolonged budget stalemate, examiners should pay particular attention to potential liquidity and credit concentration ramifications. Examiners should urge banks to adopt procedures to protect against the purchase of unauthorized or fictitious warrants. This may include close consultation with appropriate state officials.

Because the timing of payments on the warrants is uncertain, national banks should have plans to address any undesired reduction in asset liquidity which might occur due to accumulation of the warrants. Banks should also have systems in place that accurately measure all accumulated credit exposure to the State of California, including other California state general obligation holdings. Banks should consider preparing appropriate disclosure statements clarifying customer rights and liabilities with respect to the warrants (e.g., distribution of accrued interest income, hold policies, late returns, etc.).

Examiners may direct legal questions to Laura Plaze, Legal Advisory Services Division (202-874-5330), and supervisory questions to Kurt Wilhelm, Chief National Bank Examiner's Office (202-874-5070).

Donald G. Coonley
Chief National Bank Examiner