

RESCINDED

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BANKING ISSUANCES

Any attachments to this document are rescinded only as they relate to national banks and federal savings associations.

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 "BBB" (Moody's and Standard & Poor's, respectively). California's current ratings are "Aa" by Moody's (following a downgrade on July 1, 1992) and "A+" by Standard & Poor's (following a downgrade on July 1, 1992). 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).

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