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## California Registered Warrants

[Angelee J. Harris](#)

**On July 2, 2009, California began issuing registered warrants to businesses and individuals, rather than cash payments, after lawmakers failed to come to an agreement about how to balance the state budget. Although registered warrants may look like checks, they operate essentially as IOUs by the State and are not immediately payable upon presentment. Financial institutions will need to consider whether and to what extent they will accept such warrants.**

### What are registered warrants?

Registered warrants are interest-bearing claims against the State of California's general fund. They are issued by the State Controller when there are insufficient funds available in the general fund to meet California's obligations. The State Controller has issued IOUs only twice before in California's history: once during the Depression, and again in the early '90s.

### What are the terms of the registered warrants?

California Controller, John Chiang, has issued the first group of registered warrants with a maturity date of October 2, 2009. The interest rate for the warrants, which is capped by statute at 5% per annum, has been set at 3.75% by the Pooled Money Investment Board, a committee composed of the California Controller, the California Treasurer and the Director of the California Department of Finance. Registered warrants will be identified with the word "REGISTERED" printed on the face of the warrant. They also contain a special endorsement stamp on the reverse side. You can find a sample of a typical warrant at the Controller's website by clicking [here](#).

### Do banks have to accept registered warrants?

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No, banks do not have to accept registered warrants. Each bank will need to consider whether and to what extent it will accept registered warrants from its customers. In accepting warrants, banks will need to consider what conditions must be met for the bank to honor the warrants, potential liquidity and credit concentration issues, and the need to implement additional policies or procedures relating to processing, monitoring and holding the warrants.

**If banks do accept registered warrants, do they need to obtain a legal opinion that the registered warrants represent valid and enforceable general obligations of the state of California?**

As a matter of prudence, banks have been advised to obtain appropriate legal opinions about the validity of the registered warrants. On June 30, 2009, California's Attorney General issued a written opinion to the State Controller that the registered warrants he proposed to issue would be valid and binding obligations of the State. Banks should be able to rely on this opinion and may also obtain additional guidance and opinions from their own advisors.

**If banks accept registered warrants, do they have to allow depositors to withdraw those funds or write checks against them as they would for checks or unregistered warrants?**

No, banks do not need to provide immediate credit. Prior to their maturity or redemption date, registered warrants are not subject to Regulation CC. Banks also can elect to accept registered warrants on a collection basis. If a bank agrees to provide immediate credit (or credit after the bank confirms the validity of the warrant), it can require by contract that its customer reimburse the bank if the warrant, ultimately, is not paid. The bank should clarify this right and set forth any conditions that must be met for it to grant provisional credit in a short agreement with its customer. A number of banks have indicated, for example, that they will provide provisional credit only for persons and businesses that were customers of the bank as of July 1. Others have indicated a willingness to provide provisional credit only for items received before a specified date (e.g., July 10th). Most will not accept such items from correspondent banks, check cashers or other money services businesses. Many will not accept their deposit by remote deposit, ATM or night depository.

**What terms and conditions should a bank consider including in customer agreements relating to registered warrants or in notices to customers who deposit registered warrants?**

Consideration should be given to including the following terms, among others:

- The right to charge the amount back against the customer's account if the bank does not ultimately receive funds from the State (e.g., on the maturity date or by a specified date);
- The right to place an extended hold on any funds credited to the account, if only to verify the validity of the registered warrant and confirm that a stop payment order has not been placed on the warrant;
- Wording that the customer assigns and transfers all rights in the warrant (and in any replacement warrant) to the bank;
- Representations that the customer is the original payee of the warrant, the warrant is valid, the customer is eligible to receive interest on the warrant, and it is free of any liens and claims by others;
- The bank's right to a fee for processing the warrant and/or to retain interest earned on the warrant from its date of issue;
- The bank's right to hold the warrant and delay its presentation until after its maturity or redemption date; and
- The bank's right to refuse to cash or accept registered warrants for deposit without cause or prior notice.

A bank may want to incorporate some or all of the terms of its account agreement and reserve the right to amend the terms applicable to its ongoing acceptance of warrants

#### **Who is entitled to the interest that accrues on the warrants?**

The holder of the warrant is entitled to the interest that accrues on the warrants. If a bank "purchases" the registered warrant at the time the warrant is deposited by its customer, then the bank is entitled to the interest. [Note: Banks should be wary of Government Code §17280.1, which allows a taxpayer to present a check for the payment of taxes along with a copy of its registered warrant. Interest on those warrants (which should contain a special legend on the reverse) ceases to accrue as soon as the check is submitted to pay the taxes.]

If a bank provides provisional credit, but merely processes registered warrants as a collection agent for its customers, then the customers may be entitled to any interest earned on the warrants. If applicable, banks should provide in their agreements that, by depositing registered warrants, customers agree that the bank may keep any interest that accrues on the warrant from the date it is issued.

**If a bank decides not to accept warrants, what other options are available to the bank's customer?**

The customer may need to open an account with another financial institution that will accept registered warrants. Otherwise, unless a market becomes available for registered warrants (most likely involving a discount, as well as the transfer of all right to interest), the customer will have to hold the warrant until it matures in October (or later, if funds are not available for payment at that time).

**How are the warrants treated for regulatory purposes?**

There are many issues that remain unsettled with respect to registered warrants that will need to be clarified over the next few weeks (including tax treatment and investment limits). Based on positions taken by banking regulators during the early '90s, when registered warrants were last issued, there may not be any limit on the power of a bank to purchase, deal in or underwrite registered warrants that qualify as state general obligations. Federal regulators took the position that registered warrants should be considered as having the same regulatory requirements as general obligation bonds issued by the state. Likewise, the California Department of Financial Institutions took the position that there were no specific limitations on the amount of registered warrants that could be accepted by California banks, although the aggregate amounts remained subject to general principals of safety and soundness. It is likely that these positions will apply to registered warrants issued during 2009.

**Is there additional guidance available about how the warrants should be processed, validated, and redeemed?**

Yes, the office of the Attorney General, Controller, and Treasurer have provided initial guidance about how the state intends to assist banks to validate the warrants and the process for redeeming the warrants. Please click [here](#) to view this article.

**What are the next steps?**

Guidance about treatment of registered warrants from the State of California and banking regulators will evolve over the next few weeks. In the meantime, each bank should undertake an analysis as to whether it should accept registered warrants. If a bank decides to accept warrants, it should determine the conditions for that acceptance and any limits necessary for safety and soundness purposes. It will then need to notify customers of the terms and conditions associated with its acceptance of registered warrants for deposit.

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**FOR ADDITIONAL INFORMATION ON THIS ISSUE, CONTACT:**



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