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## Banking Regulators Issue Guidance on California Registered Warrants

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*Federal and California banking regulators recently released guidance regarding several aspects of registered warrants issued by the State of California. This guidance clarifies regulators' positions on how registered warrants will be treated for risk-based capital purposes, as well as the applicability of California state regulations regarding investment in registered warrants by financial institutions.*

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On July 8, 2009, five federal banking regulators (the Federal Reserve Board ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the National Credit Union Administration ("NCAU"), the Office of the Comptroller of the Currency ("OCC") and the Office of Thrift Supervision ("OTS")) issued a joint statement entitled "Interagency Guidance on California Registered Warrants." The federal regulators stated that because the registered warrants share the same expected source of repayment as the State's general obligations, the warrants generally have the same credit quality characteristics as such obligations. In the interagency statement, the federal regulators also noted that for risk-based capital purposes, general obligation claims on a state receive a 20 percent risk weight. Therefore, the federal regulators concluded that registered warrants would also receive the same 20 percent risk weight.

The interagency statement advised further that financial institutions should exercise prudent judgment and sound risk management practices with respect to registered warrants. The federal regulators noted that financial institutions are individually responsible for understanding, managing, and controlling the risks and obligations arising from accepting and holding registered warrants. According to the interagency statement, banks should establish the following risk management practices with regard to registered warrants: evaluate the credit quality of the warrants, establish appropriate concentration limits, and ensure appropriate liquidity risk management.

This interagency statement augments the "Interagency Position on California Registered Warrants" issued by the OCC, FDIC, FRB and OTS on June 30, 1992, which the regulators issued the last time that California issued registered warrants. In 1992, the federal regulators broadly stated that the registered warrants would be subject to the same regulatory requirements as general obligation bonds issued by a state.

Recent guidance has also been forthcoming from the California Department of Financial Institutions. On July 9, 2009, DFI issued a statement to the effect that the limitations in California Financial Code section 1221, which limit the amount of obligations that any one person may be owing to a bank at any one time, are not applicable to registered warrants. Also, the limitations in Financial Code section 1330, which limit the amount a bank may invest in the security of any one obligor, are not applicable to registered warrants. Credit unions may invest in registered warrants in accordance with Financial Code section 14652 without a specific limitation on the amount. The DFI noted, however, that even though the amount of registered warrants that a licensee may cash and hold is without limitation pursuant to Financial Code sections 1221, 1330, and 14652, the amount remains subject to general principles of safety and soundness, including, for example, the avoidance of undue concentrations.

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