

Big banks to reject state's IOUs after today

(07-09) 19:26 PDT -- With the state's biggest banks poised to spurn California IOUs after today, state and federal officials stepped in Thursday to try to lessen the pain resulting from California's inability to pay its creditors.

California Treasurer Bill Lockyer cajoled banks to change their stance. Meanwhile, the Securities and Exchange Commission said it would regulate IOUs to thwart exploitation by investors buying them cheaply.

Cash-strapped California is churning out IOUs to pay taxpayer refunds and vendors. From July 2 through Wednesday, Controller John Chiang's office said it issued 91,213 IOUs totaling \$354.4 million. The IOU total could hit \$2.87 billion if the situation continues throughout the month. The IOUs mature on Oct. 2.

Bank of America, Wells Fargo, JPMorgan Chase and Citibank plan to stop accepting the IOUs after today. Some smaller banks and credit unions will still accept them for existing customers.

"Our office will be contacting the banks to try and convince them to extend the July 10 cutoff date," said Tom Dressler, a spokesman for Lockyer. "That would lessen the likelihood that recipients are going to suffer hardship after Friday."

A secondary market for trading the IOUs sprang up on Craigslist and eBay this week, with entrepreneurs offering to buy them at a discount so they can cash them in later for full value plus their 3.75 percent interest rate.

That prompted the SEC to intervene. On Thursday, the agency said the IOUs should be classified as municipal securities, subject to regulation by the Municipal Securities Rulemaking Board.

That means anyone buying and reselling them must be registered as a broker-dealer, said the rulemaking board's general counsel, Ernesto Lanza.

"The price has to reflect fair market value, not extracting a significant discount from someone desperate for cash," he said.

New York's SecondMarket, a registered broker-dealer, said it is preparing to host online trading of the IOUs, unless the banks do an about-face.

"We'll step into the void if there's a need for a secondary market," spokesman Mark Murphy said, adding that hedge funds, distressed debt buyers and municipal bond investors have expressed interest.

Critics said it was hypocritical for banks to refuse IOUs when they had so recently accepted billions of dollars in government bailouts.

"Just as U.S. taxpayers had a responsibility to keep the banks' heads above water, they should be assisting Californians who are in difficulty through no fault of their own," said Alan Fisher, president of the California Reinvestment Coalition.

But the banks said they were trying to pressure California lawmakers to reach a solution, saying the longer they accept IOUs, the longer the budget crisis will drag on.

"The state of California - just like any household or business - must be responsible for living within its means," said Wells Fargo spokesman Chris Hammond. "Banks are not and cannot be the solution to California's budget problems."

Banks said they will try to assist IOU-holding customers in other ways.

"I'd encourage anyone who has one of these (IOUs) to talk to their bank about solutions such as short-term borrowing, or extension of a line of credit," said Beth Mills, spokeswoman for the California Bankers Association.

Even banks that are accepting IOUs condemned the state's budget morass.

"In making this decision, we hate to give a signal that we are supportive of nonproductive resolutions to the budget problems," said Steven Buster, CEO of Mechanics Bank, which has 33 branches in Northern California and will continue to accept IOUs for people who were customers before June 1.

