

**MEMO# 23622**

July 13, 2009

## **SEC and MSRB Issue Statements Regarding California IOUs**

[23622]

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TO: MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 30-09  
FIXED-INCOME ADVISORY COMMITTEE No. 17-09 RE: SEC AND MSRB ISSUE STATEMENTS  
REGARDING CALIFORNIA IOUS

The staff of the Securities and Exchange Commission ("SEC") issued a press release stating that California's recently-issued "registered warrants" (known as "IOUs") [\[1\]](#) are "securities" under federal securities law. [\[2\]](#) Accordingly, the SEC press release reminds broker-dealers, and other market participants, that the requirements of the securities laws, including the antifraud provisions, and the rules of the Municipal Securities Rulemaking Board ("MSRB") apply to the IOUs. In addition, the press release clarifies that there is no registration requirement that applies to the IOUs because they are municipal securities, despite the fact that the IOUs are labeled "registered warrants."

The MSRB also issued a press release providing guidance regarding the IOUs. [\[3\]](#) Specifically, the MSRB press release reminds persons acting as intermediaries between buyers and sellers of the IOUs that they may need to register as brokers, dealers, or municipal securities dealers ("dealers"), or as alternative trading systems or national securities exchanges. As such, they must comply with MSRB rules on professionalism and fair practice, including Rules G-30, G-17, and G-19. Rule G-30, requires dealers to effect purchases and sales of municipal securities at fair and reasonable prices based on the dealer's best judgment of their fair market value, and also requires dealers to charge fair and reasonable commissions in connection with brokered transactions. The MSRB press release states, therefore, that dealers must deal fairly with customers and must not take advantage of a customer's need for cash by offering to purchase the IOUs at deeply discounted prices that are below what could reasonably be viewed as their fair market

value.

Rule G-17 requires that, at or prior to the time of entering into a transaction, dealers must disclose to their customers material information about the transaction that is known to the dealer or is otherwise available from established industry sources. Thus, the MSRB press release explains that dealers selling the IOUs to customers must ensure that purchasing customers are aware of the terms on which the IOUs are expected to become payable (including information about the contingent nature of the stated maturity date, the potential for early redemption, and any contingencies concerning tax exemption of interest on the IOUs). The press release also emphasizes that dealers are required by Rule G-19 to consider such information when determining whether recommended purchases or sales of the IOUs are suitable for their customers.

The MSRB press release notes that the IOUs may not have CUSIP numbers, and clarifies that transactions in such IOUs need not be reported to the MSRB's Real-Time Transaction Reporting System under Rule G-14. The MSRB states, however, that dealers must still maintain all appropriate records of their transactions with customers under Rule G-8, and such records are subject to examination by the appropriate regulatory agencies.

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#### **endnotes**

[1] California began issuing the IOUs on July 2, 2009 to certain individuals and entities, including citizens who were entitled to a tax refund or vendors who were entitled to payments. The IOUs are obligations of the State of California, are negotiable, and bear interest.

[2] SEC Staff Statement on California IOUs, SEC Press Release 2009-154, July 9, 2009, available at: <http://www.sec.gov/news/press/2009/2009-154.htm>.

[3] Applicability of MSRB Rules to California Registered Warrants, MSRB Notice 2009-41, July 10, 2009, available at: <http://www.msrb.org/msrb1/whatsnew/2009-41.asp>.