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Credit unions staying course on state IOUs

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Large banks are playing hardball with the fiscally troubled state by threatening to stop accepting its IOUs on Friday, but not all financial institutions are taking the same tough stand against Sacramento.

Instead of pressuring the state Legislature to end the practice of issuing registered warrants to pay many of California's bills, most credit unions have agreed to continue accepting them, said Daniel Penrod, spokesman for the California Credit Union League.

“The majority we have heard from have not set a deadline” to end the practice of accepting IOUs, Penrod said yesterday. “We have 56 credit unions that have confirmed they are accepting the notes.”

Credit unions are nonprofit, cooperative institutions owned and overseen by their members. Penrod said they are bucking the banks over the IOU issue to help their members, not to get a share of the business now controlled by banks. Rod Brown, president and CEO of the California Bankers Association, questioned whether their motives are purely altruistic.

“There is a new breed of larger credit unions that are trying to become more banklike,” Brown said. “They ought to have the same community reinvestment obligations that banks do. They ought to have the same rigorous regulatory oversight that banks do.”

Brown said banks want to help consumers who are caught up in the state's budget problems. However, continuing to accept IOUs will only prolong the state's budget problems, he added.

Setting a tone for the banking industry, Bank of America announced that it will redeem IOUs from its customers only through Friday. In 1992, the last time the state issued IOUs, lawmakers delayed passing a budget, in part, because of a willingness among banks to accept IOUs for deposit, said bank spokeswoman Julie Westermann.

Other large banks, including Union Bank, Wells Fargo & Co. and Citibank, have followed Bank of America's example by adopting the deadline. Some banks have not fallen into line, but they are not ruling out doing so. California Bank & Trust, which has 93 branches in California, recently announced that it would continue accepting state IOUs from established customers.

State Controller John Chiang is expected to issue about \$3.4 billion worth of registered warrants by the end of July. The state started issuing the IOUs on Thursday, after lawmakers and Gov. Arnold Schwarzenegger failed to agree on spending cuts and other measures to close a \$26.3 billion budget deficit. If the governor and the Legislature can't resolve their differences, billions more in IOUs could go out in the months ahead.

While credit unions say accepting IOUs isn't a tool to increase their business at the expense of banks, they acknowledge that they will be well-compensated by the state's 3.75 percent interest rate.

No one knows what the volume of IOUs will be, said Mission Federal Credit Union Chief Financial Officer Ron Araujo. Mission Federal is accepting IOU deposits of up to \$5,000 from members who joined before July 1. If the state warrants are larger than \$5,000, deposits must be approved by branch managers.

San Diego Metropolitan Credit Union, which primarily serves city of San Diego employees, also is honoring state IOUs, said Linda Rossi, senior vice president of operations and marketing. A two-day hold will be placed on warrants from members who have belonged to the credit union for less than 30 days.

Economist Jack Kyser of the Los Angeles County Economic Development Corp. thinks most people who receive state IOUs won't regard them as real money and will be eager to deposit them quickly. Despite that, analysts say banks and credit unions that accept IOUs are not taking a big risk.

Default is highly unlikely because of the economic chaos it would cause, said economist Christopher Thornberg of Beacon Economics in Los Angeles. The state likely would end up in court and would have a difficult time borrowing money, except at extremely high interest rates.


“It would be the kiss of death,” Thornberg said.

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