The Federal Reserve Board (the Fed) recently expanded the scope of permissible international banking activities of United States banking institutions by permitting the establishment of international banking facilities (IBFs) within the United States. IBFs allow banking institutions to conduct business directly in the $1.5 trillion Eurocurrency markets by taking deposits from, and making loans to, foreign customers without the burdens of reserve requirements, interest-rate ceilings, state taxes, and insurance premiums. This adjustment in banking practices should cause the domestication of a significant portion of the foreign dollar markets by bringing "offshore" dollars onshore.

This Comment examines how IBFs will affect the banking....
industry, its customers, and the Pacific Basin by focusing on the development, capabilities, and limitations of IBFs, their benefits to bankers and the federal regulators, the costs and benefits of California's implementing legislation, and the potential impact of IBFs on the Asiadollar market.

I. WHY IBFS

In the mid- and late 1960s, balance of payments considerations led to the creation of barriers against fund flows from the United States. Domestic banks thus found themselves at a disadvantage when competing with foreign banks to finance international trade, because the major foreign banking centers did not subject their banks to similar regulatory regimes to control international financing activities. To remain competitive, United States banks had to establish overseas or "offshore" branches to escape the rigid domestic regulation.6

Banks that obtained offshore deposits denominated in United States dollars were often subject to less extensive regulation and taxation than banks that obtained similar deposits in the United States. As a result, offshore banks incurred lower costs when making loans,7 and could then charge lower interest rates on those loans. Offshore banks were also able to draw deposits away from domestic banks because with no interest rate ceilings, they were able to pay the market value for those deposits.8 The development of offshore branches9 allowed United States banks to take

4. These barriers included: the Interest Equalization Tax, Pub. L. No. 88-563, 78 Stat. 809 (1964) (repealed 1969); Voluntary Foreign Credit Restraints, Dep't of Commerce Press Release, Feb. 18, 1965, Federal Reserve Board, Cir. No. 5628, March 5, 1965, and Cir. No. 5627, March 4, 1965; and the Regulations of the Office of Foreign Direct Investments, 15 C.F.R. Part 1000 (1969) (removed 1974). See Hynning, Balance of Payments Controls by the United States, 2 INT'L LAW 400 (1968). These restraints reduced the availability of funds in this country, because at the same time, the foreign banks and foreign branches of United States banks, not constrained by Regulation Q on the amount of interest they were able to pay as domestic banks were, were paying higher interest rates on dollar deposits abroad—up to 13 percent vs. 6-7 percent in the United States. These higher interest rates attracted depositors away from domestic accounts. American banks in need of funds, then borrowed these Eurodollars for lending to their regular customers. R. RODRIGUEZ & E. CARTER, INTERNATIONAL FINANCIAL MANAGEMENT, 528-31 (2d ed. 1979).

5. The principal centers and their percentage share of the world-wide eurocurrency markets are: United Kingdom, 32.4%; the Bahamas and Caymans, 11.1%; France, 10.1%; Luxembourg, 8.1%; Japan, 3.9%; Singapore, 3.5%; and Hong Kong, 2.2% (Data as of June 1980). See Ashby, Will the Eurodollar Market Go Back Home?, THE BANKER, Feb. 1981, at 97.


8. Id.

9. United States banks have established more than 750 branches overseas; 180
advantage of these benenfits, and thus prevent foreign banks from luring away their customers.10

Recently, however, state tax authorities took the position that some of the income derived from these offshore facilities of domestic banks should be subject to state taxation.11 These state taxes led United States bankers to complain that they were being put at an unfair disadvantage with foreign banks when financing international trade because the taxes imposed a cost on their operations that foreign banks did not have to pay. These bankers proposed the creation of IBFs as a method of avoiding state taxation. Because IBFs were to be located within the United States, however, their transactions would also have to be free of the reserve and interest rate restrictions imposed on domestic transactions, or the IBFs would be at a severe disadvantage with offshore branches. This meant that before IBFs could become a reality, the bankers had to get Congress, state authorities and the Fed to make several legislative and regulatory changes.

II. CONVINCING THE LAW MAKERS

The first step in gaining approval for IBFs was to convince state legislators to exempt them from state taxation.12 The bankers first lobbied in New York.13 IBFs were promoted as a way to create jobs within the local banking industries, finance more sales of local goods abroad, and enhance the state’s status as an international banking center.14

have been established in the Caribbean alone. See THE BUREAU OF NATIONAL AFFAIRS, INC., SPECIAL REPORT No. 43, SHELLS MOVE ONSHORE, Nov. 2, 1981, at C-4 [hereinafter cited as SPECIAL REPORT]. These branches are often “shell” branches or “letter drops.” Shells are usually one-man operations, controlled from the home office, and have little or no contact with the local public. See P. JESSUP, MODERN BANK MANAGEMENT, 547-48 (1980).

10. For more information about the development of the Eurodollar market, see The Eurodollar Market, ECONOMIC REVIEW (Federal Reserve Bank of Cleveland), March 1970, at 3-19; April 1970, at 3-18; and May 1970, at 3-14.


12. Until recently, offshore branches were not subject to state taxation. The prospect of state taxation threatened the competitiveness of the offshore branches of United States banks by imposing increased costs on doing business. The margin on international lending is small enough that without legislation, state taxes would counterbalance all the positive effects gained through the regulatory changes. See FORBES, Aug. 17, 1981, at 10.


On June 19, 1978, New York became the first state to exempt the income of IBFs from most state and city taxation. The provisions of this statute, however, were made contingent on the Fed's promulgating the necessary regulatory changes. A formal proposal was presented to the Fed by the New York Clearing House Association, the principal backer of the IBF legislation.

Congress responded to the problem of providing for IBFs in the Depository Institutions Deregulation and Monetary Control Act of 1980. The Act indicated tacit Congressional approval for IBFs and thereby encouraged the Fed to enact the necessary regulatory changes.

The Fed, however, had to be convinced that IBFs would not undermine its attempts to control the money supply. Many of the limitations the Fed put on its proposal were principally designed to prevent uncontrolled leakage of dollars traded in the international dollar market, over which it has little control, into the domestic market. The Fed has been concerned about its lack of control over the Eurodollar market since its inception. The Fed recognized early in the approval process that by bringing part of the Eurodollar market into the United States, it would be easier to monitor and thus, potentially, to control.

After receiving public comments on its proposal, the Fed promulgated the necessary regulatory changes effective December 3, 1981. This date was set to allow states other than New York to enact the necessary tax exemptions for IBFs to be established within their jurisdictions. The necessary legislation was soon passed in the important banking states, including California. The principal motivation for these states enacting this legislation was to allow their banks and banking centers to compete with New York.

16. Id. History §§ 1, 10, at 671-72.
17. See Federal Regulation, supra note 13, at 163.
19. The Act indicated Congressional approval for IBFs when they were specifically included in its provisions. 12 U.S.C. § 461(b)(5) (1980).
21. Id.
22. Ashby, Will the Eurodollar Market Go Back Home?, THE BANKER, Feb. 1981, at 93. With the market partially within the United States, it will be easier to inspect. The more information the Fed has, the greater the potential for the Fed to control some aspects of the market, which may enhance its ability to control the money supply.
23. See supra note 1.
24. The states include: Connecticut, Florida, Georgia, Maryland, New York,
III. ESTABLISHMENT, CAPABILITIES, AND LIMITATIONS OF IBFs

A. Establishment

IBFs may be established by United States depository institutions, Edge and Agreement corporations, and United States branches and agencies of foreign banks. Legal requirements are easily satisfied. An establishing entity is required to segregate its IBF accounts from other accounts in the office in which the IBF is located, and report its IBF assets and liabilities to the Fed. It must notify the Federal Reserve Bank in its district at least fourteen days before accepting IBF deposits, and it must agree to abide by the conditions established by the Fed. There is, however, no need to apply to or obtain advance approval from the Fed.

An establishing entity is not required to maintain a separate organizational structure for its IBF. IBFs are intended to be operated primarily as recordkeeping entries. They are arms of their establishing entities, similar to offshore branches, but in the same location as the domestic parent.

B. Permitted IBF Liabilities

With few exceptions, IBFs are permitted to accept deposits only from foreign residents. IBF time deposits of foreign non-bank residents are subject to minimum maturity and withdrawal-
notice periods of two business days.\textsuperscript{34}

The two-day nonbank maturity requirement will pose few problems for customers. Most of the money that will be placed on deposit will be dated,\textsuperscript{35} and notice of withdrawal may be given at the time of deposit. There are also no restrictions on the automatic transfer of funds from an IBF to a demand account at the parent institution.\textsuperscript{36} Early withdrawals are permitted, with penalty, if funds have been on deposit at least two days. A minimum maturity is not uncommon. Some Caribbean shells have a two-day notice requirement,\textsuperscript{37} and London has a one-day notice period.\textsuperscript{38}

IBFs are not permitted to accept transaction accounts\textsuperscript{39} because IBFs are not intended to enable foreign customers to maintain such accounts in the United States exempt from interest-rate restrictions and reserve requirements. This limitation also prevents United States firms from using IBF deposits as substitutes for transaction balances, and avoids imposing an adverse competitive impact on regional banks.

The Fed believes that IBFs should be established primarily to engage in the wholesale international banking business and accordingly has required that all deposit and withdrawal transactions by nonbanks be at least $100,000.\textsuperscript{40} A withdrawal of less than $100,000 will be permitted only if it closes an account.\textsuperscript{41}

IBFs are not required to insure deposits. Originally, the FDIC decided that IBF deposits should be insured, but banks argued that deposit insurance fees would add a cost to acquiring funds that offshore branches did not have to pay. Congress enacted legislation\textsuperscript{42} freeing IBFs from insurance fees on the theory that depositors who are able to meet the $100,000 minimum deposit requirement are sophisticated enough not to need the consumer protection the FDIC was intended to provide.

\begin{itemize}
\item \textsuperscript{34} Deposits from other sources have overnight maturities. 12 C.F.R. § 204.8(a)(2)(ii) (1982).
\item \textsuperscript{35} Dated money is money deposited for a specified length of time for a specified rate of return. See Aliber, Monetary Aspects of Offshore Markets, COLUM. J. WORLD BUS., Fall 1979, at 13.
\item \textsuperscript{36} Questions and Answers, supra note 33.
\item \textsuperscript{37} 12 C.F.R. § 217.4(d) (1982).
\item \textsuperscript{38} Ashby, Will the Eurodollar Market Go Home?, THE BANKER, Feb. 1981, at 93.
\item \textsuperscript{39} A transaction account is an account on which its holder is permitted to make withdrawals by negotiable or transferable instruments or other means to make payments of transfers to third persons. 12 C.F.R. § 204.2(d)(3)(e) (1981).
\item \textsuperscript{40} 12 C.F.R. § 204.8(a)(2)(ii)(c) (1982).
\item \textsuperscript{41} Id.
\end{itemize}
C. Permissible IBF Assets

An IBF is permitted to extend credit only to foreign customers, other IBFs, and its establishing entity. Credit can be extended in the form of loans, deposits, placements, advances, investments, or any similar asset. When funds are loaned to nonbank borrowers, they may be used only to finance the foreign operations of the borrower.

Borrowers are allowed to use funds obtained from IBFs only in their non-United States operations when they purchase goods and services in the United States. This restriction is designed to promote exports and to limit increases in the domestic money supply from a source over which the Fed has no control.

To ensure that the Fed's policy is not circumvented, Fed restrictions must be communicated in writing to all nongovernmental and nonbank customers when a credit or deposit relationship is first established. In addition, IBFs are required to obtain acknowledgement of the receipt of the notice from those nonbank customers which are foreign affiliates of United States residents. If customers should find the capabilities of an IBF too limited,

43. 12 C.F.R. § 204.8(a)(3) (1982).
44. Id.
45. Id.
46. The determining factor as to whether IBF credit can be used is where the goods and services will ultimately be used, rather than to whom the funds will be paid. Letter from the Board of Governors of the Federal Reserve System to the Presidents of all Federal Reserve Banks, S-2451 (Nov. 9, 1981).
47. Borrowed funds can thus be used to purchase goods and services from the United States if such goods and services are themselves used to support the non-United States operations of the borrower. Id. The funds could not, therefore, be used to finance a take-over of a United States company by a foreign borrower, whereas a foreign branch could finance such a take-over. The regulatory distinction seems to lack any particular justification, particularly because the funds can be transferred freely between foreign banks and IBFs. See Federal Regulation, supra note 13, at 177.
48. The Fed wants to prevent corporations within the United States from transferring excess cash to their foreign offices so that the foreign offices could deposit the money in an IBF and earn a higher rate of return than would have been possible within the United States. Also, the Fed wants to prevent the foreign offices from borrowing funds from IBFs for the use by their parents at a lower rate than would be available in the domestic market. Lascelles, Fed Clears the Way for Offshore Banking, THE BANKER, Feb. 1981, at 89-91.
49. A model statement provided by the Fed reads:

It is the policy of the Board of Governors of the Federal Reserve System that, with respect to nonbank customers, deposits received by international banking facilities may be used only to support the non-U.S. operations of a depositor (or its foreign affiliates) located outside the United States and that extensions of credit by international banking facilities may be used only to finance the non-U.S. operations of a customer (or its foreign affiliates) located outside the U.S.
50. Id.
they still have the option of turning to domestic banks or banks outside of the United States, as they have done in the past.

D. Secondary Market Transactions

IBFs may buy and sell in the secondary market such assets as securities, Eurodollar certificates of deposit, loan participations, and bankers' acceptances. The obligor or issuer of the instruments, or, in the case of bankers' acceptances, the customer and any endorser or acceptor, must be an IBF-eligible customer.51

E. Other Activities

Except as expressly limited by the Fed, IBFs are not restricted in the activities in which they may engage.52 An IBF thus may exercise any power its establishing entity may exercise. It may accept deposits and make loans in currencies other than United States dollars and provide fiduciary services.

IV. BENEFITS OF IBFs

IBFs promise benefits both to their establishing entities and to the Federal government, in its capacity as a regulator and as a tax collector.

A. The Bankers' Perspective

The principal beneficiaries of IBFs are the large domestic international banks. IBFs should allow them to improve their profitability53 and competitiveness by reducing their state tax burdens, and by allowing them to operate free of the restrictions of reserve requirements, interest rate limitations, and insurance premiums when financing international trade. Banks had this ability before, but are now able to operate under these conditions at their home offices rather than at their offshore branches.54

51. Letter from the Board of Governors of the Federal Reserve System to Mr. John J. Balles, President of the Federal Reserve Bank of San Francisco, S-2455 (revised) (Jan. 12, 1982).
53. With no reserve requirements, insurance premiums, or local taxes, IBFs may be able to save up to 25 basis points (a measure for small differences in yields—100 basis points equals one percent) for the funds they borrow and thus pass on part of the savings to their corporate customers. Bus. Wk., June 29, 1981, at 100.
54. Most banks, however, will probably retain their shells. They will want to keep a token presence offshore as a precaution against a change of mind by the United States regulators. The history of the Euromarket's development serves as a reminder that governments retain the right to impose or reimpose regulations. See generally R. RODRIGUEZ & E. CARTER, supra note 4, at 528-31. Also, offshore branches will still generate business from customers in countries with unstable governments which want to maintain secrecy about where they keep their money. The
Operating through the home offices will do more than merely preserve the benefits of offshore branches while escaping state taxation. The banks should be able to attract funds at slightly better terms when operating in the foreign-dollar market under the name of the parent.\textsuperscript{55} IBFs should also help reduce transaction costs by allowing centralized lending and management decisions and the more efficient use of resources and personnel.\textsuperscript{56}

IBFs will also help reduce their establishing entities' risks. The sovereign risks\textsuperscript{57} that exist whenever money is exposed to the will of foreign governments will be reduced, as will the possibilities for managerial error. There are also few start-up costs and risks in establishing an IBF because they are basically bookkeeping entities—not new ventures.

United States banks will also be better able to serve their foreign clients and the overseas subsidiaries of United States corporations through their IBFs. Much of the $250 billion in offshore funds that IBFs are expected to attract is from United States corporations.\textsuperscript{58} Although attracted by the higher yields, many corporations have been cautious in placing their excess cash in such places as Nassau and the Caymans or far-off Bahrain or Singapore. Many have policy limits on investments in certain markets.\textsuperscript{59} Even London is too distant for some firms.\textsuperscript{60} Their exposure to risk extends beyond the dangers of political upheaval to the problems of unexpected impositions of exchange controls, increased taxes, and new regulations that hinder owners’ access to their deposits.\textsuperscript{61} Through IBFs United States corporations will be able to avoid sovereign risks and yet retain Eurodollar rates of return on their liquid assets.

IBFs’ higher interest rates and lower sovereign risks should

\textsuperscript{55} The interest rate a bank must pay to attract deposits is a function of the risks depositors perceive. Judgments of risk reflect, among other things, the size of the bank and its capital-deposit ratio. Larger depository institutions should be able to get slightly better terms than an Edge, or at least a larger share of the more risk conscious investors’ funds. \textit{See}, Aliber, \textit{Monetary Aspects of Offshore Markets}, COLUM. J. WORLD BUS., Fall 1979, at 11.

\textsuperscript{56} \textit{SPECIAL REPORT, supra} note 9, at C-5, 6.

\textsuperscript{57} \textit{Id} at C-5. Sovereign risks include all the financial, political, regulatory, and tax risks that exist whenever money or investments are subject to the will of a foreign government, which may deny foreigners access to or control of their funds.

\textsuperscript{58} BUS. Wk., June 29, 1981, at 100.

\textsuperscript{59} \textit{Id}. Even aside from political risk, the time zone advantages of dealing in United States markets will prove attractive to those corporations that do a lot of business in Canada and Latin America. To place deposits in London, positions have to be set by 10:00 to 10:30 EST in the morning, which is too early for many corporate treasurers.

\textsuperscript{60} \textit{Id}.

\textsuperscript{61} \textit{Id}.
also encourage some foreign residents to return expatriated dollars to the United States. Although the decision of the United States to freeze Iranian assets in 1979 will probably deter some foreign investors, particularly those in the Middle East who hold Eurodeposits of roughly $110 billion, many foreign investors still regard the United States as the nation least likely to impose restrictions on investor access to dollar accounts. In any event, foreign investors will be able to set up IBF accounts at no cost and in many cases will be able to retain their established relationships with the same banking institution.

Medium and small regional banks will also benefit from establishing IBFs. These banks can now engage in international banking without incurring the expense of offshore shells. They can gain inexpensive and direct access to the enormous Eurocurrency market. Through their IBFs they can borrow from foreign offices of other depository institutions and from other IBFs.

B. The Federal Perspective

Not only will IBFs give the Fed more information about Eurocurrency transactions and their impact on the domestic money supply, the Fed will have a stronger justification for seeking international cooperation in controlling the Euromarkets now that a share of those markets has moved into its own territory. Such cooperation, which has remained an elusive goal for the Fed, is necessary for the Fed to achieve any control over the Euromarkets because these markets are not confined to any one jurisdiction.

The impact of IBFs on the domestic money supply could be far reaching. Easier access to the Eurodollar market will encourage more borrowing from foreign sources, and although an IBF is not permitted to finance domestic trade, it can loan money to its parent, which can then loan the money to its customers with only the three percent Eurodollar reserve requirement. Further, although most of the foreign deposits currently held by domestic banks will be withdrawn and deposited in IBFs, these funds can be loaned back to the parent, which will then have the advantage of the three percent reserve requirement over the twelve percent reserve required before the shift.

66. Id.
67. See SPECIAL REPORT, supra note 9, at C-4.
IBFs should also produce greater federal tax revenues from banks. IBFs, like offshore branches, receive no federal tax breaks. Foreign tax payments, however, can generally be taken as credits against United States taxes.\(^{68}\) Therefore, as banking business is shifted to the United States, the federal government will collect payments that were previously received by foreign governments. In addition, to the extent that corporate taxes in the United States are lower than those abroad, banks will have an incentive to shift some business from their full service branches in foreign money centers to their IBFs.\(^{69}\)

V. CALIFORNIA'S IMPLEMENTING LEGISLATION

Bankers in California\(^ {70}\) convinced the state legislature to enact the necessary legislation exempting IBFs from state taxation.\(^ {71}\) The bill provides that an IBF shall, for the purpose of allocation or apportionment of its income, be considered as located out of state.\(^ {72}\) IBFs will thus be taxed as offshore branches are—if not more leniently.\(^ {73}\)

A. Constitutional Issue

The constitutionality of the California legislation became an issue during the consideration of the bill in the Senate.\(^ {74}\) The question arises from the recent case of Zee Toys, Inc. v. County of Los Angeles.\(^ {75}\) In Zee Toys, the court ruled that a state action allowing a tax exemption for foreign goods, is a regulation of interstate and foreign commerce and is thus in violation of the Com-

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68. Letter to the Board of Governors of the Federal Reserve System from Shafer, Gemmill and Simpson (Subject: International Banking Facilities), Oct. 31, 1980. Notice that agencies and branches of foreign banks in the United States would not have, in general, the same incentive that United States banks would have to move business from offices abroad to IBFs, because they are not now subject to federal taxes as they would be if they operated within the country through IBFs. However, foreign banks might use IBFs rather than shift foreign business offshore to avoid the new reserve requirements established by the Fed under the International Banking Act of 1978, Pub. L. No. 95-369, 92 Stat. 607 (1978) and the Monetary Control Act, supra note 18.

69. Shafer, Gemmill & Simpson, supra note 68.


73. See infra text accompanying notes 88-90.

74. Cal. Legislature, Senate Committee on Rev. & Tax., Analysis of Senate Bill 499, Hearing date, April 22, 1981.

The case involved a statute that exempted goods manufactured outside the United States from taxation when they were brought into California for transshipment out of California for sale in the ordinary course of business. The court determined that this different treatment was accorded to such goods solely on the basis of their place of origin, and the foreign goods were therefore being given an impermissible competitive advantage over interstate goods of the same nature, competing in the same market.

The Zee Toys court found it particularly objectionable that the state’s action “limited, qualified, or impeded” the exclusive grant to the federal government of the power to regulate commerce with foreign nations under the Commerce Clause. The Court stated specifically that “discriminatory taxes, if applied selectively to encourage or discourage . . . importation in a manner inconsistent with federal regulation” interferes with Congress' power to regulate the field.

California’s IBF legislation, however, does not interfere with federal regulation of foreign commerce. It is merely an implementation of federal policy as put forth by the Federal Reserve Board. This policy was specifically approved by Congress as well when IBFs were provided for in the Monetary Control Act of 1980, and when IBFs were exempted from having to purchase deposit insurance.

The IBF legislation also can be distinguished from the legislation examined in Zee Toys because no one is hurt by the encouragement of IBFs. The tax law in Zee Toys was objectionable because it was enacted out of the state’s desire to avoid business flight to another state. However, the California banks, which are the principal beneficiaries of this legislation, are already constrained to remain in California under the McFadden Act; thus other states are not hurt by this legislation because the banks cannot branch out of state anyway.

It is very doubtful, therefore, that California’s IBF legislation

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76. U.S. CONST. art. I, § 8, cl. 3.  
77. 85 Cal. App. 3d at 769, 149 Cal. Rptr. at 754-55.  
78. CAL. REV. & TAX. CODE § 225 (West 1979).  
79. 85 Cal. App. 3d at 773, 149 Cal. Rptr. at 757.  
80. Id. at 774, 149 Cal. Rptr. at 757.  
81. Id. at 775, 149 Cal. Rptr. at 759. To regulate commerce is to prescribe the conditions upon which it shall be conducted; to determine how far it shall be burdened by duties and imports, and how far it shall be prohibited. Welton v. Missouri, 91 U.S. 275, 279-80 (1875).  
82. See supra note 18.  
83. See supra note 42.  
84. 85 Cal. App. 3d at 777, 149 Cal. Rptr. at 761.  
would be found unconstitutional. It fosters rather than impedes federal policy; it does not impede (and may increase) the collection of federal taxes; and it has no adverse effects upon California's sister states. No one is hurt by this legislation, except, perhaps, the taxpayers of California.

B. Costs and Benefits of California's Implementing Legislation

The cost to California is in lost revenues. For the 1979 income year, banks contributed $145 million in self-assessed corporate taxes out of a total of $2.3 billion collected in California. IBFs will decrease this revenue as the legislation exempts IBFs from state taxation imposed on offshore branches. The California Franchise Tax Board has determined that the potential revenue loss from the IBF bill is unknown, indeed, probably indeterminable inasmuch as "factors attributable" to IBFs would not normally be identified on tax returns. The actual fiscal effect of the bill will depend upon the business sources from which IBFs will obtain money.

IBFs may obtain business in several ways. First, they may generate business which the establishing entity would not obtain without an IBF. Second, the establishing entity's foreign offices may transfer deposits and loans home to the IBFs. Third, eligible business on the books of the establishing entity may be transferred to the IBFs.

If IBFs generate their own business, there will be no loss to the state. As defined, any income generated by business the parent would not obtain without an IBF, would not generate taxable income for the state.

The potential loss resulting from business transferred to IBFs from foreign offices, depends upon how those offices are operated. If the establishing entity maintains a real presence in a foreign country (actual offices and loan officers), then income derived from these operations is beyond California's power to tax, and thus the state would lose no income when such business is trans-

86. See supra text accompanying notes 68-9.
87. See infra text accompanying notes 88-90.
88. See supra note 74.
89. California taxes corporate income earned both inside and outside the state, by means of an allocation method which takes into account California's share of the firm's personal property, payroll and sales. If, for example, an average of 80% of a corporation's total property, payroll and sales is attributable to California, then 80% of the corporation's total worldwide income is subject to California bank and corporation tax. The greater the percentage attributable to its property, payroll and sales outside of California, the smaller the percentage of its income California can tax. cal. rev. & tax. code §§ 25100 et seq. (West 1979).
90. California Legislature, Senate Committee on Rev. & Tax., Analysis of Senate Bill 499, Hearing date, April 22, 1981.
ferred to the books of the IBF. If the foreign office is only a mere letter-drop91 the transfer of business to the books of the IBF will exempt previously taxed income from California taxation.92

Finally, income derived from business previously booked at an establishing entity, and then transferred to the books of the IBF, will prove to be an absolute loss to the state. Business previously attracted to domestic banks for reasons of convenience or security in lieu of higher returns available elsewhere, will now shift to IBFs for the extra returns they can earn. The state would thus reap no taxes in return for the benefits it provides;93 yet it would lose taxes which it could otherwise collect from establishing entities.

Total assets of $4.38 billion have already been transferred to IBFs in California.94 Although it is too early to determine exactly how this will affect the amount of taxes which the state will be able to collect from banks in California, the Franchise Tax Board has estimated a loss in revenue to the annual General Fund of at least $3 million.95

The potential benefits of California's IBF legislation are not as easily demonstrated as its costs. The stated purpose of the bill96 was to expand international banking in California by encouraging foreign banks and large international banks, centered and constrained to California by prohibitions against interstate banking,97 to establish IBFs in California. More importantly, however, IBFs

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91. See supra note 9.
92. See supra note 89.
95. California Legislative Analyst, Analysis of Senate Bill No. 499, June 22, 1981. This amount was said to be subject to an unidentified audit dispute between banks and the Franchise Tax Board.
97. The principal restraint against the establishment of interstate branches is the McFadden Act, 12 U.S.C. §§ 36, 332 (1945). If California had not enacted this legislation, large banks based within the state still would have been able to establish IBFs through their Edge subsidiaries in New York. See supra note 25. Edge IBFs, however, are at a competitive disadvantage with the IBFs of major domestic banks (to the extent that banks and Edges compete for the same business), because there are limits to the amount of capital a parent bank may invest in an Edge Act Corporation (10% of its capital and surplus, Federal Reserve Act, 12 U.S.C. § 618 (1978)) and corresponding limits to the amount of money an Edge can lend to any one customer (10% of its capital and surplus, 12 C.F.R. § 211.6(6)(i) (1980)). Given the size of the market which may enter the United States, these limitations on lending capacity would limit the usefulness of an Edge's IBF to its parent.

A California bank would not have the option of establishing an independent IBF in another state where a tax exemption exists, because the Fed's regulations only per-
should improve the competitive position of United States banks vis-a-vis foreign banks, and maintain the competitive position of California banks vis-a-vis banks in other states which have also authorized IBFs.98

Although it was originally claimed that IBFs could potentially create thousands of new jobs during the next few years,99 there is little evidence that they will have that effect. Given the present emphasis on automation and computerization in the banking industry, it should not be difficult for existing software to absorb the additional numbers. In the past most of the offshore booking had been done from the home office anyway, so the extra work should be readily absorbed by existing personnel. Indeed, the major banks establishing IBFs in California (54 as of Feb. 8, 1982) report that IBFs have not created a need for additional staff.100 However, because IBFs will help California banks retain or improve their competitiveness in international banking, their general growth should indirectly lead to more employment within the industry.

VI. IBFs EFFECT ON THE ASIADOLLAR MARKET

The Asiadollar market is a good example of the extent to which a foreign dollar market can develop a life of its own. Appreciating the effect that IBFs will have on the Asiadollar market requires that one understand the development of that market. Special attention will be paid to Singapore as the emerging Asiadollar center.

The Asian version of the Eurodollar market began in 1969 when the Bank of America convinced Singapore banking officials to liberalize the acceptance of foreign currency deposits by commercial banks in Singapore.101 The market was set up to take in dollars (and other currencies) from the many Asians who held them and did not wish to reveal these holdings to their local governments. Deposits were also available from governmental units and multinational American and Japanese firms operating in the area. The money typically had been left in foreign banks at no

mit an IBF to exist as a set of accounts segregated on the books of its establishing entity. 12 C.F.R. § 204.8(a)(1) (1982).

98. See supra note 24.

99. See U.S. NEWS & WORLD REP., July 6, 1981, at 65, in which John Lee of the Clearing House Association predicted that IBFs will create up to 5,000 new jobs in New York alone in the next few years.

100. Telephone calls to Security Pacific Bank Corp., First Interstate Bank Corp. and Chase Bank International (an Edge Act corporation) verified that IBFs have created no anticipated need for additional personnel as of Feb. 15, 1982, citing as a reason an IBF's nature as a bookkeeping entry.

interest or deposited in the distant Eurodollar market. These funds were then generally loaned to businesses in the United States or Europe. By providing an Asian-located pool for such funds, it was believed that the money would be more readily drawn into the financing of Asian economic development. By mid-1980, the Asiacurrency market had grown to over $140 billion. The principal centers were Tokyo, Singapore and Hong Kong.

A. The Singapore Market

The Singapore market developed out of many of the same factors that led to the development of the offshore market in the Caribbean—principally regulations restraining banks within the United States. However, because of restrictive regulations in Japan, the Japanese eventually became the most active participants in the market. Because of Japan's extensive participation in the Asiadollar market, it is more dependent upon regulatory change from Tokyo than from the United States. Therefore, it is less likely that the Asiadollar market will respond to IBFs to the degree expected of the Caribbean market.

Reinforcing this hunch is Singapore's location at the hub of so many rapidly growing economies. These local economies provide more attractive borrowers of Asiadollars than the borrowers in the Caribbean do for Eurodollars.

Also, there are many incentives to keep the corporate cash

102. Id.
103. See Ashby, Will the Eurodollar Market Go Back Home?, THE BANKER, Feb. 1981, at 95. The size of Singapore's portion of the Asiacurrency market is estimated at $47 billion; Japan's is estimated at $51 billion; and Hong Kong's at $30 billion. By comparison, the size of the London market is $429 billion, and the Bahamas and Caymans have $147 billion. Id.
104. Over 100 foreign banks have opened facilities in Singapore alone. Wilson, Singapore's Maturing Markets, THE BANKER, April/May 1980, at 125. The market has developed primarily into an interbank market with most of the loans going to banks outside Singapore. In 1975, 72% of all the loans were to banks (70% to banks outside of Singapore), and 81% of all deposits were also from banks (77% from banks outside of Singapore). Monetary Authority of Singapore, Annual Report, 1976, at 89. D. Eiteman & A. Stonehill, MULTINATIONAL BUSINESS FINANCE, 324 (2d ed. 1979).
105. See supra notes 4-10 and accompanying text.
106. See A.B.A. BANKING J. Feb. 1980, at 37; and Wilson, Singapore's Maturing Markets, THE BANKER, April/May 1980, at 127-28. Japan has established a withholding tax, exchange controls and reserve requirements that have led their banks to Singapore's market to issue certificates of deposit, and their trading companies to issue commercial paper to provide the dollars their banks cannot provide.
107. See Wilson, supra note 106.
108. See Ashby, supra note 103, at 97-8.
invested in the Asiadollar market. One of the main advantages of the market is that it is located in the Asian time zone—filling the gap between the United States Pacific Coast time zone and the European time zone. The location thus contributes to the existence of a twenty-four hour market in dollar deposits.\textsuperscript{110} In addition, Singapore itself acts as an important foreign exchange center located between Tokyo and Bahrain.

In sum, although some dollars will probably move to the United States, unless investor confidence is shaken in the region,\textsuperscript{111} or new and significant government controls or taxes are imposed on the markets, IBFs will provide little incentive for domesticating the Asiadollar in the United States.

\textbf{CONCLUSION}

International Banking Facilities are regulatory creations that allow United States banks to participate in the foreign dollar market from within the United States, rather than participating solely through their offshore branches. They represent the Fed's attempt to somehow control the foreign dollar market without threatening its control over the domestic money supply. New York sought IBFs to improve its competitiveness as an international banking center, and its sister states, including California, enacted tax relief necessary to remain competitive with New York.

IBFs also represent an attempt by domestic banks to avoid certain federal regulations and state taxation that threatened their competitiveness in foreign financing. The increased competitiveness comes from the ability of IBFs to raise capital and service foreign clients' needs free of domestic reserve requirements, interest rate ceilings, burdensome state taxation, and deposit insurance, while incurring less risk.

IBFs may bring a major share of the foreign dollar market to the United States—mostly from the Caribbean, but also from European and Asian centers as well. The foreign dollar market will continue to thrive, however, having developed a life of its own. It has outgrown the confines of any one nation state; yet, if it is ever to be controlled, IBFs may provide that important first step.

\textsuperscript{110} During the morning in Singapore, business is conducted with Sydney (three hours ahead), Tokyo (two hours ahead) and Hong Kong (one half hour ahead). By afternoon, business can be conducted with London (six and one half hours behind) and the rest of Europe.

\textsuperscript{111} The market has been shaken badly recently, however, by a shake-up at the Monetary Authority of Singapore in early 1981. \textit{See} INSTITUTIONAL INVESTOR, April 1981, at 223.