



INTELLECTUAL PROPERTY FINANCING UNVEILED

Unlike physical assets, IP financing may seem daunting to many but rest assured that experts in the field will introduce the different types of it.

Johnny Chan reports.

In general, the market for IP-collateralized debt is primarily served by specialty lenders, says Ruey-Sen Tsai, a partner at Lee and Li in Taipei. “Nonetheless, there are more and more traditional banks and finance companies involving in such financing.”

“The market for IP-collateralized debt should probably be served by specialty lenders, because banks have gotten into it and gotten burned,” says John Eastwood, a partner at Eiger in Taipei.

Varun Kalsi, a partner at PSA (Priti Suri & Associates) in New Delhi thinks that there is no one answer as the nature of lenders differs geographically. “For instance, in the United States, lenders providing a loan against the borrower’s IP as collateral could either be commercial banks or private equity funds and venture capitalists. On the contrary, in India, while IP-collateralized debt is recognized by the Indian IPR Policy, 2016, instances of such debt are restricted to banks. A prominent example was money raised by Kingfisher (the Vijay Mallya-led enterprise) from the State Bank of India, the Bank of India and others while offering the Kingfisher trademark as collateral. However, banks failed to monetize the IP as they found no bidders and [the attempt to do so was happening] amidst concerns raised by the Central Bureau of Investigation regarding IP-collateralized debt.”

Furthermore, Kalsi notes, the practice of raising IP-collateralized debt in India has taken a beating due to the Supreme Court’s ruling in 2018 in *Canara Bank v. N.G. Subbaraya Setty*, in which the court held that a defaulter-borrower cannot assign its trademark to the lender bank, as this is against the Trade Marks Act and the Banking Regulation Act. “It also observed that banks

cannot utilize royalties from such IP as they are not permitted by law to conduct such business,” Kalsi said.

Intellectual property-backed loans

To use IP as collateral, there are arrangements which must be followed – and which, of course, vary from jurisdiction to jurisdiction.

In the Philippines, Republic Act No. 11057, otherwise known as the Personal Property Security Act (PPSA), was signed into law on August 17, 2018. “The PPSA aims to promote economic activity by increasing access to least cost credit, particularly for micro, small, and medium enterprises, by establishing a unified and modern legal framework for securing obligations with personal property,” says Ramon S. Esguerra, managing partner at Esguerra & Blanco in Manila. “The PPSA aims to strengthen the secured transactions legal framework in the jurisdiction, which shall provide for the creation, perfection, determination of priority, establishment of a centralized notice registry, and enforcement of security interests in personal property, which includes IP.”

A security interest is defined in the law as a property right in collateral that secures payment or other performance of an obligation, regardless of whether the parties have denominated it as a security interest and regardless of the type of asset, the status of the grantor or secured creditor, or the nature of the secured obligation, including the right of a buyer of accounts receivable and a lessor under an operating lease for not less than one year. It is created by a security

"The market for IP-collateralized debt should probably be served by specialty lenders, because banks have gotten into it and gotten burned."

—JOHN EASTWOOD, partner,
Eiger, Taipei



"Banks failed to monetize the Kingfisher trademark as they found no bidders and the attempt to do so was happening amidst concerns raised by the Central Bureau of Investigation regarding IP-collateralized debt."

—VARUN
KALSI, partner,
PSA (Priti Suri &
Associates), New
Delhi



"The Personal Property Security Act aims to promote economic activity by increasing access to least cost credit, particularly for micro, small, and medium enterprises, by establishing a modern legal framework for securing obligations with personal property."

—RAMON S. ESGUERRA, managing
partner, Esguerra & Blanco, Manila



agreement, says Esguerra.

The creation of a security interest in an account receivable arising from a contract for the sale, lease or license of IP cannot be limited by agreement, or be subjected to contractual limitation, he says.

The Land Registration Authority (LRA) is mandated to establish and administer a registry for security interests, he says.

The Department of Finance, in coordination with the Department of Justice and the LRA, is required to promulgate the implementing rules and regulations of the PPSA within six months from the passage of said law. The DOF released and posted on July 15, 2019, a draft set of implementing rules and regulations for comments and consultation with the public, he adds.

In Malaysia, the concept of IP collateralization has been around for a long time, says Pauline Khor, head of the intellectual property and technology department at Rahmat Lim & Partners in Kuala Lumpur. “Be that as it may, and despite the steady growth of IP over the years in Malaysia, IP as an acceptable form of collateral has never really taken off full swing here and remains to be an untapped source of collateral in many industries due to a lack of understanding or awareness in this innovative approach of obtaining financing through IP securitisation.”

In the finance industry, many local banks and financial institutions do not widely promote the use of IP as collaterals and are generally slow to accept them as collaterals due to the lack of framework on IP-based loans and how to value IP as an asset. “Nevertheless, there has been a surge in interest from Malaysian banks and financial institutions in venturing into this area as Malaysia eagerly anticipates the long-awaited new trademark legislation, the Trademarks Act 2019, which is slated to come into force at the end of 2019, and which will replace the current Trade Marks Act 1976. The new act explicitly recognizes that a registered trademark may be the subject of a security interest or a charge in the same way as other personal or moveable property (Sections 62 and 64(5) of the act). Further, a register of registrable transactions which permits the recordal of security interest or charge created over registered trademarks is also expected to be instituted following the coming into force of the act (Section 65(1) of the act),” Khor says. “In an increasingly globalized and digitalized landscape which opens doors to new trends in collateralizing loans and financings, we anticipate that it is only a matter of time before the use of IP as collaterals will increase in prevalence in Malaysia.”

Intellectual property collateral enhancements and time to adopt

Collateral enhancements are insurance or guarantees on the value of the IP for a defined period of time. “An example happens where a borrower pledges his IP assets as collateral to the lender, and the lender simultaneously purchases an insurance policy from an insurer which provides that in the event of the

borrower’s default, the policy will provide the lender with an insured value for the borrower’s IP asset collateral upon transfer of the title from the lender to the insurers. The insured value for the collateral is generally predetermined based on a pre-agreed schedule over the loan period at the commencement of the loan. The lender is not always compelled to sell the insured IP assets to the insurer and, in many cases, the insured value acts as a ‘floor’ value in the bankruptcy liquidation process,” says Lin Li Lee, a partner at Tay & Partners in Kuala Lumpur. “In this way, the lender is guaranteed to get no less than the insured value while maintaining any upside should the assets be worth more than the insured value.”

Such insurance or guarantees function to reduce credit and foreclosure risk of the borrower which in turn improves the borrower’s overall credit profile thereby increasing the leverage available to it, Lee says. “Collateral enhancements also possibly lower interest rates demanded by the lenders. By guaranteeing the value of the IP, firms offering collateral enhancements make it easier for companies to use IP as collateral for financing. Collateral enhancement is an important secondary tool to improve a lender’s confidence level in the borrower’s intangible assets. In Malaysia, there is presently only one bank which accepts IP as collateral as there is still a lack understanding of IP as an asset and the actual and perceived uncertainties surrounding the IP valuation process.”

Intellectual property royalty securitization

In the Update to the Intellectual Property Hub Master Plan published in May 2017 by the Singapore government and the Intellectual Property Office of Singapore, one of the recommended initiatives in the realm of IP commercialization is the pilot of new financing models for IP assets, says Siau Wen Lim, a director in the intellectual property at Drew & Napier in Singapore. “A year-long consultation concluded that companies, especially those which are IP-centric and light on physical assets, would be in a better position should initiatives be put in place to facilitate the leverage of IP assets in exchange for finance.”

Indeed, using IP as collateral appears to be an emerging practice in today’s economy, Lim says. “There are various financial arrangements in the context of collateralization of IP, two of which are IP royalty securitization and IP-backed loans.”

Intellectual property royalty securitisation involves obtaining a lump sum payment through the process of consolidating and selling of potential IP-related incoming cash flows and/or future receivables. The intangible assets may be held in a separate legal entity, she says. “The advantage is that the separate legal entity would isolate the financial risk and ensure that the assets are ring-fenced, unaffected by the solvency of the original IP holder.”

Intellectual property-backed loans enable the obtaining of a sum of money at a fraction of the value of the IP assets, with the same being granted a security interest as collateral for the loan, she says. “IP-backed

loans may be viewed in a parallel manner to loans taken out traditionally where physical assets are used as collateral. In the event of non-payment of loan, the lender will have recourse by enforcing its rights over these IP assets.

“Unlike in IP-backed loans, the original IP asset holder in an IP royalty securitization arrangement may, depending on the structure, cease to be the owner of the IP assets,” she adds. “A further difference between the two financing methods is that IP-backed loans involve borrowing money, whereas IP royalty securitization sells potential IP-related incoming cash flows and/or future receivables in exchange for a lump sum payment. Relatedly, while the obligation to repay rests directly on the borrower in an IP-backed loan transaction, the lender in an IP royalty securitization arrangement looks to the income generated by the pool of IP assets to recover the money.”

Usually, in IP royalty securitization transactions, IP assets are transferred to a special purpose vehicle, says Cyril Abrol, a partner at Remfry & Sagar in New Delhi. “Future earnings generated by such belong to the SPV and are passed on to the lenders.”

Intellectual property backed loans are useful for early stage organizations having limited tangible assets such as plant and machinery as well as real estate, Abrol says. “In India, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 as amended, *inter alia*, deals with the creation of security interests over intangible assets, including know-how, patents, copyright, trademarks, licenses, franchises or other business or commercial right. A security interest includes a right, title or interest in property created in favour of a secured creditor and includes a mortgage, charge, hypothecation or assignment.”

Where the copyright, trademark or design is registered or a patent has been granted, the creation of a security can be recorded by giving notice to the

Office of the Controller General of Patents, Designs and Trademarks, he says. “Moreover, if the security provider is a corporate entity, the security interest must be registered with the Office of the Registrar of Companies.”

Intellectual property sale and license-back financing arrangements

In addition to IP-backed loans and royalty securitizations, sale and license-back financing can also be considered.

In an intellectual property sale and license-back arrangement, a buyer purchases IP assets and assigns the assets to a licensing company, which then draws up a license with the former owner of the IP asset for royalty payments during a period of time. “Like a legal mortgage, it is a safe transaction, and requires the IP to be assigned to the lender with a license being granted back to the debtor. This financing mechanism allows the IP owner to secure funding through the sale of its IP portfolio, without preventing the utilization of the asset in its business operations. The company receives immediate funding to reinvest in the business and has the flexibility to structure the transaction in a manner to avail additional monetization of the asset,” says Abrol. “A sale license-back arrangement can also have a purchase option whereby the back-licensee can exercise the option to buy back the ownership of the asset at a fixed price at the end or during the back-license contract period.”

Intellectual property sale and license-back financing is usually considered as a method of raising capital, particularly for mezzanine-stage, private equity and venture-backed companies requiring additional, non-dilutive capital, he says.

It also depends on how desperate the company is and how important the technology is to their own core operations, Eastwood reminds. “If a technology is very important to their own core competencies, then getting into a sale-and-license-back arrangement might not be such a good idea.” **AIP**

"IP-backed loans may be viewed in a parallel manner to loans taken out traditionally where physical assets are used as collateral. In the event of non-payment of loan, the lender will have recourse by enforcing its rights over these IP assets."

—SIAU WEN LIM, director,
Drew & Napier, Singapore



"A sale license-back arrangement can also have a purchase option whereby the back-licensee can exercise the option to buy back the ownership of the asset at a fixed price at the end or during the back-license contract period."

—CYRIL ABROL,
partner, Remfry & Sagar,
New Delhi

