IP Asset Securitization - A New Financing Model For Companies

Introduction

In April of this year, the Government announced plans to assist companies in unlocking the value of their Intellectual Property ("IP") assets as part of Singapore’s IP Hub Master Plan. This included the launch of an IP financing scheme in which the Government would partially underwrite the value of IP assets used as collateral with banks to secure financing, in order to help companies in Singapore who are rich in IP assets to gain easier access to capital for their growth and expansion.

IP Financing Scheme

On 27 August 2013, at the 4th Global Forum on IP ("GFIP") held at the Marina Bay Sands Convention Centre, Deputy Prime Minister Teo Chee Hean officially announced the IP financing scheme's impending launch. The new financing scheme, which will be launched in the first quarter of next year, will allow companies to use their IP assets as a form of security when seeking loans from financial institutions. The Government will partially underwrite the value of the IP assets being pledged so the financial institutions will not be made to bear the full extent of the risk should the borrower default in repayment of the loan. This move is aimed at encouraging banks to recognise IP as valuable assets, just like any other real, tangible assets, which is presently not the case. Such an IP financing scheme will be especially useful for small and medium enterprises ("SMEs"), who either individually or collectively generate a fair amount of IP in the course of doing business, but do not have much or any other assets against which loans may be securitised.

The IP financing scheme will also be especially useful for new start-up ventures where their physical assets are few as compared to their intellectual capital. The IP financing scheme aims to assist such companies by allowing banks to accord a greater amount of recognition to these intangible assets, which in turn will help those companies to have easier access to capital to support their business and growth plans.

The IP financing scheme is a key pillar of Singapore’s effort to create a robust IP marketplace and ecosystem that will support the commercialization and management of
IP assets in Asia. Such an ecosystem will include key players like IP intermediaries who will serve to connect IP asset purchasers, sellers, licensors and licensees with the IP asset financiers. The IP financing scheme will play a key role in supporting commercial transactions involving IP assets. In turn, the growth of an IP asset transactional market would spur financial market innovation to create more sophisticated financial products that trade in or leverage on IP assets, and would add to Singapore’s already robust and highly rated financial services sector.

**Importance of Carrying Out Due Diligence on IP Assets**

Although details of the IP financing scheme are yet to be released, an obvious challenge that will face banks in the securitization process will be to ensure that the IP assets being offered are indeed genuine and capable of being securitized by the bank. Just as in real property, part of the securitization process would invariably include the carrying out of due diligence checks on the IP asset being put forward as collateral for a loan. A proper IP asset due diligence check is essential towards assessing the quality of the IP asset in question, and can go a long way towards mitigating the risks in securitizing an intangible asset.

Typically, IP due diligence is carried out by a prospective purchaser in relation to the IP assets of the target company or business. However, IP due diligence can also be carried out by a company on its own IP assets in preparation for a transaction, such as a business sale or a major licensing deal. In the implementation of any IP financing scheme, the following issues are likely to be of key importance when carrying out any due diligence on IP assets:

(i) whether a borrower has a valid title to the IP asset;
(ii) whether there are encumbrances to the IP asset; and
(iii) whether the IP asset is adequately protected under the applicable law, and offers adequate commercial value to the interest holder.

**(i) Title to the IP Asset**

Checks on whether there are any issues with the purported ownership of the IP asset, such as claims by inventors, are of paramount importance and will provide an assurance to the bank that the entity offering the IP asset for securitization has the right to enter into such transactions. Another event that can potentially affect a party’s title to an IP asset is the prior assignment (partial or total) of rights in that IP asset from the owner to a third party.
In this regard, inquiries into the existence of any deeds of assignment and any underlying agreements executed in connection therewith would have to be made.

(ii) **Encumbrances to the IP Asset**

Examples of possible encumbrances to an IP asset may include the existence of licensing and sub-licensing arrangements on terms which may be unfavourable to the owner.

Other encumbrances to an IP asset may lie in the failure of the company seeking to monetize its IP asset to put in place the necessary measures to limit erosion of the value of the IP asset in question. Such measures may include confidentiality and non-disclosure agreements between inventors, employees, contractors, or other parties, and the failure to police and enforce against past misuse of the IP asset.

(iii) **Protection conferred on the IP Asset**

Where IP asset rights are not yet registered, it may also be necessary to check on the extent of protection enjoyed by the IP asset offered as collateral, and the consequences of non-registration. IP assets such as copyright and trade secrets are non-registrable, and proof of title and protection against infringement or common use will have to be established in other ways. Where the IP asset in question is registrable – e.g. trade marks and patents – the investigation into whether sufficient IP protection has been secured for the asset will involve searches of the relevant registers and, in the case of pending patents, an examination of documents concerning the patent application, and the results of any searches or examinations conducted in relation to the patent application.

Ultimately, the strength of protection given to an IP asset may affect the ability of the owner to prevent unauthorised exploitation by third parties, and in turn, the value of the IP asset. An IP asset which does not enjoy a sufficient level of protection, or whose validity is susceptible to legal challenge, may leave the bank that accepted the IP asset as security in negative equity.

**IP Due Diligence Exercise**

IP due diligence is a legal exercise carried out by IP counsels having the requisite qualifications and experience. Ideally, IP due diligence should be conducted as soon as there is a firm request from a company for a loan on the basis of its IP assets being offered as collateral. This is because IP due diligence can take a fair amount of time depending on the number of IP assets to be examined, especially if those IP assets include IP registered or created outside Singapore in foreign jurisdictions. By carrying out IP due diligence at an
early stage of the transaction, not only will there be more time for a proper and accurate valuation of the IP asset to be carried out, but if any potential issues are identified, remedial action can be instituted before the loan transaction is completed and funds disbursed.

Concluding Words

At Rajah & Tann LLP, we recognize the importance and potential offered to SMEs and financial institutions via the new IP financing scheme. Our Intellectual Property group comprises lawyers and paralegals who are very familiar with the various IP rights that go on to form the IP assets that companies rely on to grow and develop their businesses. Our approach towards performing IP due diligence checks on IP assets is methodological and thorough.

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