Nebraska Banker
MAY/JUNE 2012
NBA Nebraska Bankers Association

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OFFICIAL PUBLICATION OF THE NEBRASKA BANKERS ASSOCIATION

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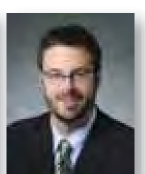
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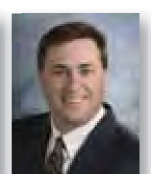
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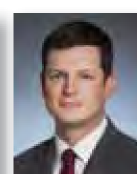
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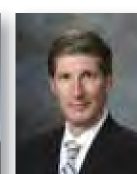
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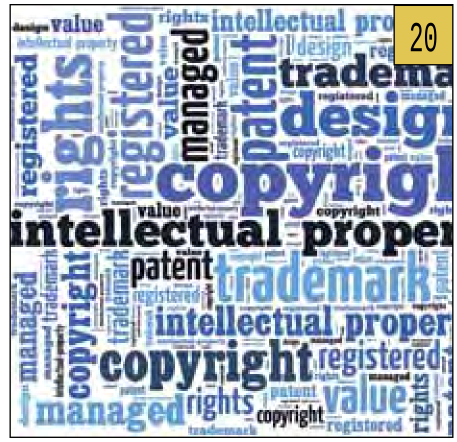


PRESIDENT'S MESSAGE

NBA Continues to Move Forward With Strategic Initiative Process

George Beattie, President & CEO, Nebraska Bankers Association

YOUR NBA STAFF IS PROACTIVELY WORKING THROUGH THE Action Plan developed last year by member bankers serving on the Strategic Initiative Committee. The Action Plan will be implemented from 2012 to 2014 and includes six goals:

- Strengthen advocacy
- Research profitable, viable education model options
- Enhance member communications
- Strengthen member relationships
- Address dues dependency and non-dues revenue
- Further develop leadership succession and long-term viability

Communication

Our first and major emphasis has been enhanced communication with our members. We rolled out the NBA's new interactive website at the end of 2011. The new website includes online registration and payment for education events; an education event calendar; online product ordering and payment; online job posting service; custom searches throughout the NBA Compliance Handbook and website; members-only functionality; web-based reporting tools; more information-rich content; real-time database integration; and secure individual registration and login.

In addition, the NBA has entered the world of social networking by establishing a presence on Facebook and YouTube in order to expand our avenues of member communication as well as enhance the image of the Nebraska banking industry.

The association also began using an email marketing program called Constant Contact that allows us to promote our campaigns not only through standard email but also via social media. The program helps us increase our reach by allowing our members to share our message with their networks.

Advocacy

Another area of improved efforts in the area of communication involves the goal of strengthening advocacy. With all of the regulatory and legislative challenges facing our member financial institutions, we are:

■ President's Message – continued on page 8

President's Message – continued

- Striving to increase banker/senator participation in our grassroots efforts;
- Seeking input from bankers at summer meetings to determine the best way to implement a program of "in bank" visits by state and federal representatives; and,
- Considering periodic webinars to review pending state and federal legislative issues with interested bankers.

Education

A new NBA Education Advisory Committee was formed as an outcome of our education goal within the strategic initiative. The development of the new committee will utilize a total of approximately 34 bankers plus the inclusion of a newly formed group of trainers and human resources specialists from each of the top 10 NBA education users.

Information Technology

With the approval of the 2012-2013 NBA budget, the NBA IT staff will begin the process of virtualization and the implementation of our disaster recovery plan. This will allow for the development of an Association Management System (AMS) during 2013.

Dues Structure

Members of the NBA Board of Directors who serve on both NBA Past Chairman Kendell Holthus' and NBA Chairman Clark Lehr's Executive Committees reviewed and approved the NBA's 2012-2013 Budget, Reserve Policy, and NBA Dues Structure. A new Reserve Policy was approved and the NBA dues formula was not changed. The dues formula has remained constant since May 1, 2003.

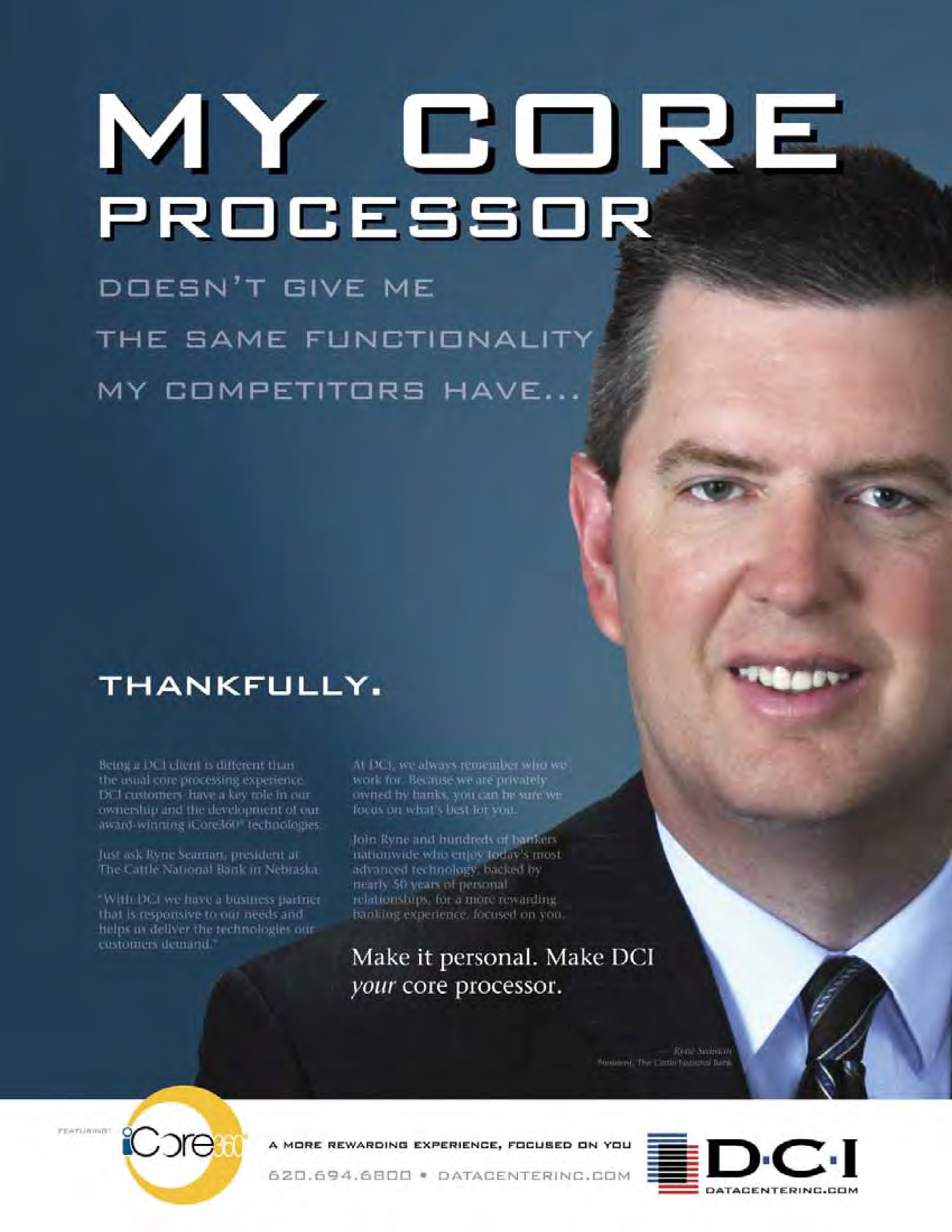
Partnerships

The NBA has invested in Compliance Alliance, which will assist all NBA members in managing their compliance issues and return an investment to the NBA. In addition, the NBA announced a new partnership with The Executive Development Group for personalized executive coaching for our members—a win-win example of meeting a membership need and returning an investment to the NBA.

Succession Planning

Just like our members, the NBA has a goal addressing leadership succession. The NBA's internal administrative group is in the final stages of drafting the Action Plan that will be presented to the NBA Executive Committee within the next several months.

In conclusion, the NBA staff appreciates the support and guidance by the bankers who served on the Strategic Initiative group and the NBA Board of Directors. We will continue to update you on our progress.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Washington Update

PowerTalk

Frank Keating, President & CEO, American Bankers Association

Where were you March 19-21? If you were in Washington, D.C., with your fellow Nebraska bankers attending the largest-ever ABA Government Relations Summit, thank you. There's no question that you made a difference.

IF YOU MISSED THE MEETING, YOU might want to put next year's dates on your calendar today. It's becoming the can't-miss event of the year—a unique gathering of the banking industry's current and emerging leaders who share a passion for industry advocacy.

A record 1,100 bankers came to Washington for this year's event. Our summit's theme was "Talk to Power," and bankers like you did just that, proudly articulating banks' role as the engines of economic growth and job creation in their communities. They also urged their members of Congress to clear away the regulatory underbrush and allow them to better serve their communities.

Banker delegations also focused on specific legislation, and got results. Case in point: Congress' enactment and the President's subsequent signing of the JOBS Act, which includes ABA- and NBA-backed provisions that increase the SEC registration threshold from 500 to 2,000 for financial institutions and also raise the deregistration threshold from 300 to 1,200 shareholders.

ABA first proposed raising the shareholder threshold seven years ago. It's been a long, difficult road. Working together, ABA, the state associations, and our grassroots bankers pushed this legislation across the goal line. Our conservative estimate is that the new shareholder provisions will immediately help at least 500 banks that have been affected by the outdated threshold and its associated regulatory burden.

The credit unions were also on Capitol Hill during our summit—outnumbering us 4 to 1. Even so, bankers continued to push back—loud and clear—against legislation that would give more bank-like powers to tax-avoiding credit unions.

Our summit bankers also continued to build support for the exam fairness bills (S. 2160 and H.R. 3461)—legislation that offers solutions to the many problems banks have been reporting about their examinations, from untimely reports to a lack of an effective appeals process. In fact, we gained 21 co-sponsors for the bills in the week following bankers' visits.

As I told the bankers at the summit, our industry needs to be front and center, aggressive and unapologetic, because we are both right on the issues and indispensible to America. Banking is the white-hat industry.

The bankers responded with energy and enthusiasm, and their commitment to advocacy provided a very clear example of what we can accomplish, and how we can make a difference, together.

The ABA Government Relations Summit represents the largest banking political advocacy event of the year. We not only speak to power, we exercise it.

Reach Frank Keating by email at fkeating@aba.com.

Does Our Credit Culture Need Cultivating?

Michael Wear, Faculty Member, Graduate School of Banking at the University of Wisconsin-Madison

FOLLOWING CHALLENGING TIMES, our industry has historically responded by reassessing loan underwriting and monitoring processes. Often as a result, loan policies are likewise modified to memorialize these frequently painful lessons learned. But questions haunt us still: How likely are we to repeat the mistakes of the past if we do not *fully* adopt the spirit and intent of these changes? How do we avoid this pitfall?

The answer lies deep within our bank's credit culture—in the glue inside the binding of loan policies and procedures, and the spirit and intent looking over our shoulder with each credit decision. Banking is built upon knowledge and behavior. Our behaviors are shaped by our knowledge and memories of "the good, the bad, and the ugly" decisions of the past. Even today, Benjamin Franklin's words ring true: "Creditors have better memories than debtors." A sound credit culture fosters open and frank consideration of different viewpoints, built upon the knowledge and memories from various backgrounds and experiences. When fully adopted, the decisions of the bank's loan committee are strengthened by respecting and encouraging independent judgment to resist the herd mentality and other small group dynamics.

Credit Culture Self-Assessment

An equilateral triangle illustrating the components and relationships behind credit culture serves as a backdrop for this self-assessment. The triangle's equal sides and segments remind us that each component and relationship is equally important for an effective, well-balanced credit culture.

The base of the triangle provides the daily reinforcement of credit culture and alignment with the guidance of the pinnacle segment: the bank's **mission and purpose**.

- How well do we know our mission and purpose? Are they still meaningful to our stated goals?
- Do they provide clear direction of what is expected of us and the rationale behind our policies and processes?

In a hectic work environment, we all need periodic reminders—from citing excerpts on all-employee emails or on network access portal pages, to recognizing tangible examples at staff meetings. *We need to find ways to effectively communicate and constantly support these tenets of credit quality*, if they still offer meaningful and valued ideals on which to build the bank.

Loan policy and processes (or procedures) provide the philosophical framework and tactical field guide for our daily work. These should provide a common-sense reality check given current market conditions.

- Do our processes include sufficient and *timely* early-warning indicators?
- Are processes in sync with policy and vice versa?
- Are short-term viewpoints aligned with our long-term strategies?

With more banks chasing too few commercial loans, there is a strong risk of compromising underwriting standards in pursuit of volume. We should be aware of how our loan policies and processes are affected and ask ourselves, "*When does a policy exception become the new norm?*"

All benefits from a well-written mission statement, loan policy, and procedures manual can be impaired quickly if not followed by corresponding behavior of lenders, operations staff, loan review, and audit.

- Do we have individual accountability and responsibility for actions and decisions?
- Are bank objectives weighed more than individual or profit center goals?

Although it is best to train new lenders from within the bank, this is not always an option. With mergers and acquisitions between banks and consolidation of duties within departments, there is a need to quickly and effectively train the bank's risk tolerances to those new to the bank or the lending function. Credit culture training can be limited to just handing the new hire the loan policy to read their first day on the job. *Do we truly take the time to instill our values from the bank's historical background and reasoning behind the mission and purpose, as well as our loan policy and processes?*

Training credit culture cannot come from a one-hour webinar or a one-day seminar. This is an investment in our people, to establish a firm bond between the bank's intrinsic values to those hired for their own intrinsic values. It requires a three-prong approach of on-the-job coaching, technical training, and leadership development. A consistent, disciplined credit culture is a durable line of defense against impulsive credit and pricing decisions. *Through training, we not only cultivate and strengthen our credit culture by developing our people, but also enhance overall credit quality and therefore our profitability.*

Michael Wear is a senior credit analyst at First National Bank of Omaha and a faculty member and loan portfolio management section leader at the Graduate School of Banking at the University of Wisconsin-Madison. You can reach him at (800) 755-6440 or mikewear@hotmail.com. **For 67 years, the Graduate School of Banking in Wisconsin has been an industry leader in providing advanced management education for financial professionals. Curriculum and program offerings are continually updated and uniquely tailored to meet the needs of today's banking leaders. For more information, visit www.GSB.org.**

Security, Not Compliance

Stephanie Chaumont, CISA, CISSP, Security+ and **Carl Cope**, CISA, CISSP, CoNetrix

I ATTENDED A CONFERENCE WHERE I had the privilege of hearing a state examiner speak about corporate account takeover. One idea he expressed has stuck with me the last few days: "We have to make this a security issue, not a compliance issue." How many of you have been struggling with the latest FFIEC supplement for Internet Banking? Are you feeling it's yet another compliance mandate? Is your biggest concern to please an examiner, or provide the best security for your customers?

When understanding this is a security—rather than compliance—issue, it's easy to see the importance of a risk assessment. Learning how attackers gain information from your customers and which types of customers are most vulnerable can help your organization understand what controls are needed. You may currently have the same controls for retail customers and commercial customers, but seeing the difference in risk levels for those types of accounts will help you make more informed decisions about multifactor authentication, out-of-band transaction authorizations, etc. A risk assessment is a valuable security tool rather than a compliance exercise.

The guidance also addresses customer education. So, have you provided yet another disclaimer in a tiny font for your customers? If so, you technically made those resources available to them but, if we're honest, whoever reads any of those? Your customers (even commercial customers) probably do not have the level of security awareness training you provide for your staff. They likely do not understand the need for information security. As a result, they may be the weakest security link against corporate account takeover. They need to know about the risks of online banking as well as the controls they could and should put in place. You, as their financial institution, serve as the best means for education. Just as it is for good teachers everywhere, it's up to you to make the information relevant and easy to retain.

The last area the supplement addresses is the notion of layered security. The supplement specifically states that, "financial institutions should not rely solely on any single control for authorizing high-risk transactions, but rather institute a system of layered security." With layers of security, if attackers get past one security control, there are other layers to thwart their attempts to access information or funds. Most banks have already embraced a layered security approach, recognizing its importance aside from being a compliance requirement. Prior to the release of this supplement, I have seen banks requiring out-of-band authorization for wires, tokens for commercial customers, etc.

It was nice to meet an examiner more concerned with real-world security than a compliance checklist. Acknowledging the security benefits of assessing risk, implementing layered security controls, and educating your customers will go a long way in providing better quality controls and education materials for your Internet banking customers. And if you are driven by the goal of security, you might not even notice you took care of your compliance as well.

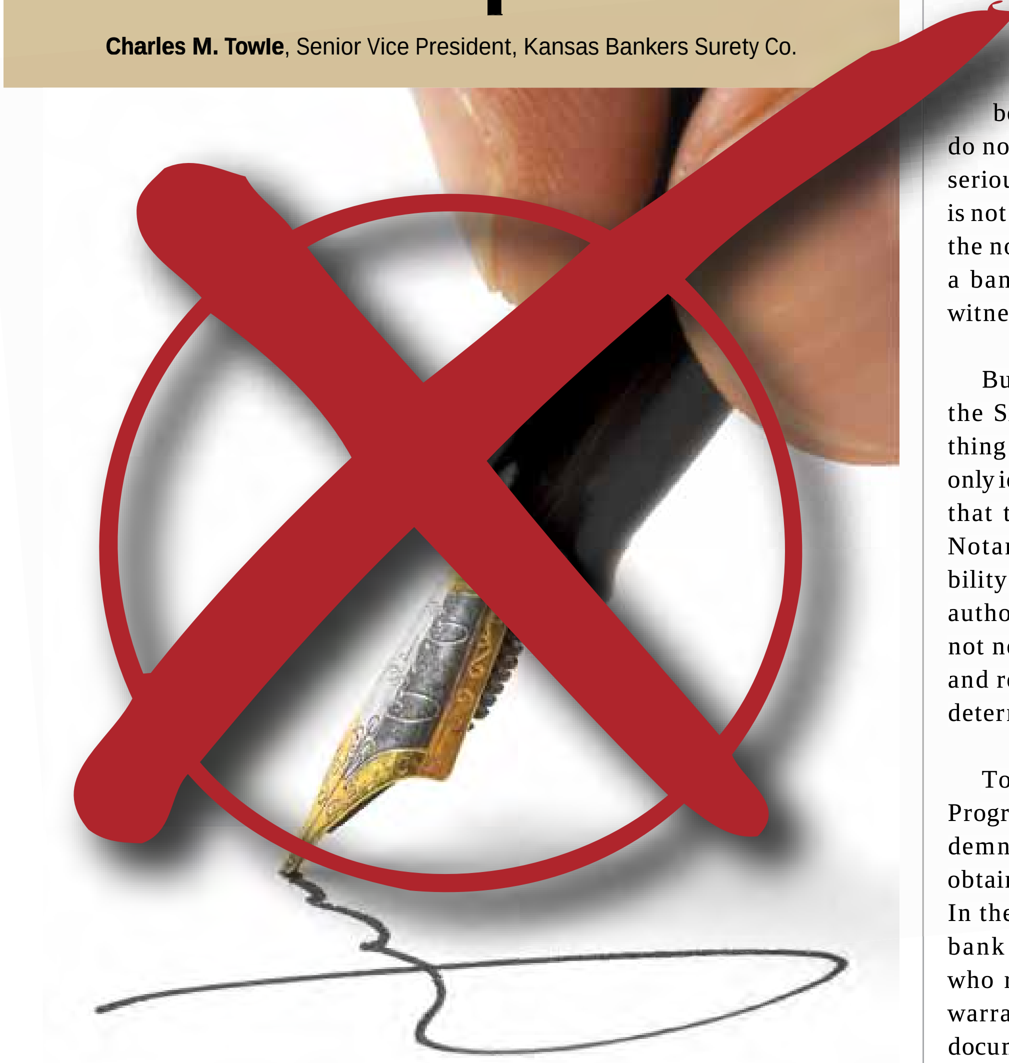
Stephanie Chaumont and Carl Cope are security and compliance consultants for CoNetrix. CoNetrix is a provider of information security consulting, IT/GLBA audits and security testing, and tandem, a security and compliance software suite designed to help financial institutions create and maintain their Information Security Program. Visit the CoNetrix website at www.conetrix.com.

SECURITY OFFICER'S BY-WORD

Signature Validation Program

Banks Should Not Participate!

Charles M. Towle, Senior Vice President, Kansas Bankers Surety Co.



A BANKER CALLED ME THE OTHER day asking about the Signature Validation Program. A customer of a bank was signing up to participate in the U.S. Savings Bond TreasuryDirect Program and needed his signature certified by a bank officer. The paperwork provided by TreasuryDirect indicated that a bank officer needed to certify the signature on the forms and include a bank stamp such as a Signature Validation Stamp.

I had never heard of the Signature Validation Stamp and I did not know the requirements of the TreasuryDirect Program, so I did some research.

First, I researched the Signature Validation Program. The program, started in 2008, appears to be administered by the same people who administer the STAMP Medallion Signature Guarantee Program. A STAMP Signature Guarantee is not allowed to be used on non-security documents. The new Signature Validation Stamp was designed to be used on non-security type documents.

The idea behind the Signature Validation Program appears to be that some parties have required a notary witness when documents are completed and submitted. However, a notary provides little benefit to someone who relies upon it because it takes so little to become a notary and some notaries do not always take their responsibility seriously. When relying on a notary, it is not possible to evaluate the quality of the notary. Many people would prefer a bank officer, rather than a notary, witness a document.

But further research showed that the Signature Validation is not anything like a notary signature. A notary only identifies the person and witnesses that the person signs the document. Notaries do not have any responsibility to determine if the signer has authority to sign a document. They do not need to understand the document and related facts in order to make any determination about authority to sign.

To join the Signature Validation Program, a bank must sign an SVP Indemnification Agreement before it can obtain a Signature Validation Stamp. In the SVP Indemnity Agreement, the bank agrees to indemnify everyone who relies on the stamp imprint and warrants that: (a) the signature on the document is genuine, (b) the signer was known by or otherwise satisfactorily identified, and (c) the signer had authority to sign the document.

This is a very broad indemnity agreement in which the bank willingly chooses to financially protect everyone who relies on the signature for their loss if it is later found that the signer exceeded his authority when he signed that document.

While a bank can know or identify a signer, warranting that a person has actual authority to sign a particular document is much more difficult. It requires the bank officer to completely understand the document being signed and requires the officer to obtain and retain documentation proving the person has authority to sign. A bank may be able to document a signer's status as a corporate officer or trustee. It is much harder to document whether a person has authority to sign a particular document. In many cases, it would be impossible for a bank officer to determine if a person had actual authority to sign a particular document. This is a completely new liability that a bank creates for itself by signing a contract. It is not a liability created by law.

Some brokers are apparently asking their customers to get a Signature Validation Stamp on brokerage account opening agreements. If the bank uses the Signature Validation Stamp, the bank is agreeing to be financially responsible to the broker for any loss if the person signing the brokerage account opening document did not have actual authority to sign that document. There is no maximum to the bank's potential liability.

If the person signing was a corporate officer who was opening an account in the name of a corporation, the officer might have exceeded his authority when opening the account. The officer may have authority to open an account for the benefit of the corporation, but would be exceeding his authority when he signed a document opening an account which he plans to use to funnel corporate money for his own benefit. The bank has agreed to indemnify the broker for whatever loss the broker incurs in reliance on the signature on that account opening document if the signer did not have authority to sign that document. Potentially, the bank could be liable for every dollar that went through the brokerage account for years.

If the person signing is John Smith, but he is opening the account by impersonating a different John Smith, he does not have authority to sign that account opening document. By using the Signature Validation Stamp on the document, the bank has agreed to be liable to the broker, possibly for every dollar which goes through the account.

Indemnity Agreements should always be viewed skeptically and should only be signed after much thought about their ramifications. This particular Indemnity Agreement is creating, by contract, a significant, possibly huge, new liability for banks. For security-type documents where a signature guarantee is required, a bank can determine the value of the security and use more caution when large dollars are involved. For non-security documents upon which the new Signature

■ Banks Should Not Participate!
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Banks Should Not Participate! – continued

Validation Stamp may be used, a bank cannot even guess the amount of the bank's exposure or know who the bank may later have to indemnify. A bank may be asked to put a Signature Validation Stamp on a type of document that the bank officer does not understand and could not possibly determine whether the signer had actual authority to sign that document.

You might be swayed into joining the program because, for a small fee, a bank can, or must, purchase a Surety Bond for the Signature Validation Program. The Surety Bond protects only the persons who rely upon your Signature Validation Stamp. The Surety Bond is not insurance to protect the bank. The bank agrees in the same SVP Indemnification Agreement to indemnify and hold harmless the surety company if anyone makes claim under the Surety Bond. The surety company's only risk is when someone makes claim under the Surety Bond and the bank is insolvent or otherwise cannot repay the surety company. There is no insurance to protect a bank for its loss that could result from the liability the bank agreed to take on by signing the SVP Indemnification Agreement.

> Banks should be very wary of allowing the Signature Validation Program to grow because it creates a substantial new risk to banks.

This Signature Validation Program is clearly a program that adds new liability for banks under the SVP Indemnity Agreement.

I also investigated the requirements relating to U.S. Savings Bonds to see if the government was requiring banks to join the Signature Validation Program. The government does not require any bank to join the SVP program.

Federal regulations regarding U.S. Savings Bonds, specifically, 31 CFR 353.55, require that signatures on certain documents be certified by a "certifying officer." Bank officers may act as certifying officers.

The regulations require the certifying officer to establish the identity of the signer in accordance with the "Treasury instructions and identification guidelines" and place a notation on the back of the document, or in a separate record, show how identification was established. So the first thing a banker will need to do before acting as a certifying officer is to learn and follow the "Treasury instructions and identification guidelines" and then properly record how identification was established.

The regulation also requires the certifying officer to "affix, as part of the certification, his or her official signature, title, seal, or issuing agent's stamp, address, and date of execution."

While a seal or stamp must be used, the regulation itself does not require anything called a "Signature Validation Stamp." The forms themselves only refer to a stamp or a corporate seal. Therefore, the bank's corporate seal can be used if the bank does not want to create a special stamp for the certifying officer to use for this purpose.

Clearly the bank is not required by TreasuryDirect to join the Signature Validation Program and use a special Signature Validation Stamp. If the bank uses the Signature Validation Stamp, the bank is subjecting itself to potential additional liability above the federal regulation requirements because of the liability it agrees to incur under the SVP Indemnity Agreement.

In my opinion, banks should not sign up for the Signature Validation Program. Banks that have already signed up for this program should terminate their participation in the program. Banks should be very wary of allowing the Signature Validation Program to grow because it creates a substantial new risk to banks.

If a bank does decide for whatever reason to participate in the Signature Validation Program, it should do so with extreme caution. The bank needs to evaluate each document on which the bank uses the Signature Validation Stamp to determine if the bank can document, and forever prove, that the person signing had actual authority to sign. The bank also should attempt to determine the amount of the bank's potential risk with regard to that document in order to evaluate if the small fee, or other benefit, that the bank may receive in exchange is worth the potential liability the bank may incur.

For more information, contact Kansas Bankers Surety Co. at (785) 228-0000.

COUNSELOR'S CORNER

Security Interests in IP – Part II

Collateralizing & Creating Security Interests in IP

Jeff Makovicka, Husch Blackwell LLP

As discussed in the first installment (Part I) of this series, companies spend significant resources to either directly develop and obtain intellectual property (IP)—trademarks, patents, and copyrights—assets or acquire assets developed by others. Companies may exploit their IP assets by using them as collateral to obtain financing.

THE CONCEPT OF THIS TYPE OF secured financing is simple: The lender provides financing to the borrower, and the borrower grants the lender a security interest in the IP assets as collateral for a loan. Effective security interests in IP or lack thereof are often discovered and disputed, if at all, in bankruptcy proceedings. Lenders not aware of the pitfalls surrounding the structuring and perfection of a security interest in IP assets may find themselves without an enforceable security interest, jeopardizing the value of the collateral. Lenders should not ignore the fundamental questions of collateralization, specifically, (a) the effect of using different types of IP assets as collateral in secured financing and how it impacts the rights of borrowers and lenders and (b) the structure of the collateralization.

This article, along with Part I, sets out general guidance relating to selected issues when dealing with IP as collateral. Lenders, however, are advised to consult with their counsel when collateralizing IP assets as fact-specific issues exist in every financing.

I. Background

As discussed in Part I, security interests in IP involve the application of two separate and distinct bodies of law: Federal IP law[1] and individual state uniform commercial codes (UCC). As a general principle, the UCC provides the rules for the creation, perfection, and priority of security interests in IP, unless preempted by federal law. Under the UCC, intellectual property will generally be classified as a "general intangible," although derivative rights to payment (such as the right of a licensor to receive royalties payable under a license of intellectual property) will be classified as accounts. While the UCC does not specifically recite patents, trademarks, and copyrights, the Official Comment uses the term "intellectual property" as an example of a general intangible.

II. The Collateralization Structure

A critical factor in attempting to define a security interest, which adds to the uncertainty surrounding IP security interests, is the distinction drawn between the term "assignment" and the term "security interest." The terms "assignment" and "security interest" are terms with distinctly different meanings. A security interest in IP is a device to secure debt. Conversely,

For trademarks, ownership duties are typically more onerous than for patents. As such, lenders are advised not to take an outright assignment of trademarks, as opposed to a security interest, as this may put ownership duties on the lender and may destroy the trademark.

an assignment of IP is an absolute transfer of all right, title, and interest to the IP.

The manner in which a lender structures a security interest in IP may impact the effectiveness and enforceability of the security interest and the viability of the IP collateral. Modern security interests are intended to be enforceable even if the lender fails to obtain title, and need not be structured as an absolute assignment. Lenders have good reasons to avoid becoming "absolute" assignees, including avoiding liability for IP infringement. Structuring the security instrument as an outright assignment or conditional assignment presents risks to lenders. If the collateral assignment is interpreted as a current assignment, the lender has ownership of the IP and has the associated duties of an owner.

a. Specific Structuring Issues for Patents

A security interest is not an assignment, grant, or conveyance of a patent. Patent law adheres to strict concepts of title, in order to protect the ownership of new inventions. See *Waterman v. Mackenzie*, 138 U.S. 252 (1891). Therefore, the law distinguishes "assignments" of patents from all other transfers. *Id.* at 260. An assignment is the outright transfer of all (or of an undivided portion) of the patentee's exclusive rights to make, use, and sell an invention. Any lesser transfer includes the grant of a security interest. *In re Transp. Design & Tech., Inc.*, 48 B.R. 635 (S.D. Cal. 1985).

In the past, many lenders required borrowers to execute separate collateral assignments of patents for recordation in the U.S. Patent and Trademark Office (PTO), which were typically "absolute" in form with a license back to the borrower. This structure represented an attempt to fit within the language of section 261 of the Patent Act (35 U.S.C. § 261) but, in recent years, this structure is less common. An absolute assignment transfers record title to the patent and could subject the lender to liability for patent infringement. For example, a borrower that has transferred title may have difficulty in showing ownership for bringing infringement actions and a lender that is a patent assignee may be an indispensable party in any patent infringement action. An additional risk is that a lender/assignee could become liable for maintenance, prosecution, and exploitation expenses relating to the patent. To mitigate this risk, the current customary practice is to record a counterpart of the security agreement with the PTO or, alternatively, an abbreviated agreement that restates the grant of the security interests, identifies the patent in compliance with PTO recording requirements, and cross-references the security agreement.

If a lender takes a security interest under the UCC, the security agreement should include an irrevocable power of attorney allowing the lender to execute and deliver an assignment of the patent on the borrower's behalf upon default. The collateral description can be "all general intangibles," or it can identify the patent specifically (and must, if the secured party is not otherwise claiming all general intangibles or all patents).[2] As discussed above, the lender should file with the PTO a short form document that restates the grant of the security interest, identifies the patent, and references the security agreement. With this filing, bona fide purchasers of patents are likely to acquire actual notice of the short form patent security agreement through a PTO search even if the filing does not constitute constructive notice. *Moldo v. Matsco* (In re Cybernetic Servs., Inc.), 252 F. 3d 1039 (9th Cir. 2001).

b. Specific Structuring Issues for Trademarks

Trademark law parallels patent law in distinguishing "assignments" from all other types of transfer. *SMI Indus. Can. Ltd. v. Caelter Indus.*, 586 F. Supp. 808, 822 (N.D.N.Y. 1984). An "assignment" is the transfer of all right, title, and interest to the trademark. *Li'l Red Barn, Inc. v. Red Barn Sys., Inc.*, 322 F. Supp. 98 (N.D. Ind. 1970). The grant of a security interest, however, is not an assignment as the borrower retains rights in the collateral. *Li'l Red Barn*, 322 F. Supp. at 107.

For trademarks, ownership duties are typically more onerous than for patents. As such, lenders are advised not to take an outright assignment of trademarks, as opposed to a security interest, as this may put ownership duties on the lender and may destroy the trademark. As with patents, a lender is faced with problems associated with a collateral

■ Security Interests – continued on page 22

■ Security Interests – continued

assignment, namely, the lender must use the trademark in order to maintain the rights in the trademark; if the lender licenses the trademark back to the borrower, the lender must actively monitor and control the borrower's use of the trademark, and the lender must receive the goodwill associated with the trademark or the assignment will be void as an assignment in gross. Most lenders do not want to nor are they in a position to be the owner of the mark during the life of the loan. This requires exercising quality control over its borrower/licensee and filing necessary documents.

If a trademark is valuable, in addition to a state-level filing of a financing statement, lenders are advised to record a trademark security agreement with the PTO notwithstanding that the Lanham Act does not preempt the UCC (see Part I of this series). As in the case of patents, if a PTO recording is not made, a purchaser for value of the trademark who does not otherwise have notice of the security interest may cut off the lender's rights. Further, *Clorox Co. v. Chem. Bank* provides that an absolute collateral assignment instead of a security agreement may risk invalidating the trademark. 40 U.S.P.Q2d 1098 (1996) (an absolute assignment of a trademark application given to a lender as security was invalidated because the assignment was not accompanied by a transfer of the rated goodwill of the assignor's business). If structured as an assignment, care must be taken to comply with the technical provisions regarding assignments, especially when the mark is in the "intent to use" stage. *See Clorox*, 40 U.S.P.Q2d 1098.

Upon default, the secured lender may sell the collateral only if it (a) owns the trademark, and (b) transfers the goodwill associated with the trademark along with the trademark itself. *See N.C.P. Mktg. Grp., Inc. v. Blanks*, 337 B.R. 230 (D. Nev. 2005) (trademark could not be assumed and assigned by borrower in possession without consent of licensor). Because of this, there are two important provisions in any security agreement covering a trademark. First, the agreement should include an irrevocable power of attorney allowing the lender to execute an assignment on behalf of the borrower upon default. Second, if the collateral description mentions trademarks in general or a specific trademark, the description should include "all goodwill associated therewith" or words to that effect.[3] Goodwill is a "general intangible." *Bank of Wash. v. Burgraff*, 687 P.2d 236 (Wash. App. 1984). If the collateral description includes "all general intangibles," a specific reference to the goodwill associated with the trademark(s) is not necessary.[4]

The best course to avert the voiding of a lender's security interest and to maintain the integrity of the borrower's trademark collateral is to limit or avoid the use of assignment language in the security agreement and to structure the agreement as a UCC security interest. Further, since a UCC security interest would not be considered an assignment, including "intent to use" trademark applications as part of the trademark collateral should not cause validity problems.[5]

c. Specific Structuring Issues for Copyrights

Copyright security interests present many of the same practical problems that exist with respect to patent and trademark security interests discussed above. As in the case of patents and trademarks, in the security agreement, lenders should list "general intangibles" and set out the known copyrights and registrations on schedules to the agreement.[6]

Lenders should include appropriate covenants and warranties in their copyright security agreement, such as requiring the borrower to promptly notify the lender when the borrower registers previously unregistered copyrights and be vigilant in enforcing such provisions. In addition, lenders should create internal programs and protocols, so that the lien is immediately recorded in the U.S. Copyright Office against each copyright that is registered.[7]

Because copyright laws are somewhat unique in permitting a nonexclusive license of a copyright, whether recorded or not, to be valid against a subsequent transferee under certain circumstances, a lender should require from the borrower a warranty in the security agreement regarding the existence (hopefully nonexistence) of nonexclusive licenses. Moreover, the security agreement should also (a) specifically identify the work to which it pertains so that any recording in the Copyright Office provides notice and (b) include an irrevocable power of attorney allowing the secured lender to execute a true assignment on behalf of the borrower upon default.

III. Other Collateralization Issues

a. Searches

In addition to regular lien searches, lenders are advised to run specific IP searches on the borrower, especially if valuable IP is part of the lender's collateral. A search will confirm the owner of the IP and show existing liens. Borrowers must have rights in the collateral in order to grant an enforceable security interest. Where the borrower is a corporation a lender must exercise caution. Only natural persons can be "inventors." *See* 35 U.S.C. §§ 115-118. An assignment document is required to be filed transferring ownership from the inventor to a corporation. Because of this, a check of the PTO assignment records is recommended to confirm the borrower has title to the patent collateral. If IP is important to the transaction, lenders should be aware of the timing gap issues discussed below and consider performing additional post-filing searches.

b. Disclosure Schedules

Accurate schedules listing the IP are important but often difficult to obtain. Provisions in the security agreement will determine what should be disclosed on the schedules. Lenders may want to limit the list to registered IP or material IP and should reconcile schedules with search results.

c. Timing Issues

Due to the grace periods for delayed filing provided in the various federal statutes and federal filing systems, it is possible that even a completely accurate search will fail to turn up documents that affect a lender's security interest and title as they have not yet been recorded and when subsequently recorded, may relate back to an earlier date for priority. To mitigate this risk, the lender should require representations from the borrower that no competing assignments have been granted. Searches post-closing should disclose the existence of any of these filings.

d. After-Acquired IP

An entire additional set of issues arises when a borrower creates new or derivative works, or upgrades existing IP, after the original grant of a security interest. To safeguard that its security interest continues to be perfected in such after-acquired IP, the lender must monitor the borrower's activity closely and make separate new federal recordings for new items of IP.[8] Lenders may find some protection by requiring in the security agreement periodic (for example, monthly or quarterly) reporting and registration/recordation of after-acquired IP interests (including a requirement to inform the lender as soon as an unregistered copyright becomes registered).

IV. Structuring Tips

IP presents different challenges to lenders than other collateral. To reduce the risks associated with utilizing IP as collateral, a lender is advised to, without limitation:

- Review the records of the PTO and Copyright Office to determine whether the borrower has actual ownership of the IP collateral and the scope of the collateral.
- Structure the security instrument as a UCC security interest. Avoid use of "assignment" language which could affect the validity of the IP collateral and cause potential lender liability.
- Make sure the collateral includes all "now existing and hereafter acquired or created" IP, as well as everything associated with the IP.
- Borrower should have an affirmative duty and obligation to promptly register any newly acquired or created IP, and borrower should be obligated to notify the secured lender of any such newly acquired or created IP, to permit the secured lender to properly perfect the security interest in the collateral.
- The security agreement should allow the lender to exercise its remedies upon default, i.e., the borrower's agreement to cooperate, and a power of attorney to permit the secured lender to assign and register the rights upon foreclosure.
- Borrower should agree to properly maintain the IP collateral and timely file and pay all maintenance fees for patents and renewal fees for trademarks, and should also agree that it will notify the secured creditor of any infringement litigation.
- Security agreement should include warranties as to the borrower having good and marketable title, no prior security interests, no previous assignments, and the validity and enforceability of the IP.
- Employ the "belt and suspenders" approach and file security interest both at the state UCC level and/or the PTO and Copyright Office (see Part I to this series).
- Monitor the borrower's IP portfolio or require the borrower to provide reasonable notice of newly acquired IP, so that additional security interest notice filings may be made at the PTO or Copyright Office for after-acquired property.
- Secure the rights to any necessary tangible business assets and any licenses which may be required for use of the IP collateral.
- Restrict the borrower's ability to transfer, abandon, or license the IP collateral. Any restrictions or requirements should be reasonably based to avoid impairing the borrower's ability to run its business.
- Require borrower to provide updates to the lender with respect to IP.

For more information, contact Jeff Makovicka at Husch Blackwell LLP at (402) 964-5000 or jeff.makovicka@huschblackwell.com. Makovicka is a member of Husch Blackwell LLP's Banking & Finance practice where he concentrates on banking matters.

[1] The Lantham Act (15 U.S.C. §1060), the Patent Act (35 U.S.C. §261), and the Copyright Act (17 U.S.C. §205).

[2] In the case of patents, lenders could also obtain a grant of a security interest in all inventions, issued patents, and patent applications which the borrower owns, in whatever rights the borrower may have had or may in the future have against third persons that use or infringe the rights it owns, and in whatever transferable rights the borrower may have to use corresponding rights owned by others.

[3] Any assignment of a trademark without its accompanying goodwill is an "assignment in gross" and destroys the trademark as a symbol of any value. *See Roman Cleanser Co. v. Nat'l Acceptance Co.*, 43 B.R. 940, 947 (E.D. Mich. 1984).

[4] The grant of a security interest in trademarks could also cover all trademarks, service marks, designs, logos, indicia, trade names, trade dress, trade styles, and/or other source, and/or business identifiers and applications pertaining thereto, along with all registrations pertaining to the foregoing list.

[5] An assignment of an intent to use trademark can lead to invalidation of the trademark. *See Clorox*, 40 U.S.P.Q2d 1098.

[6] In the case of copyrights, lenders could obtain a grant of a security interest in all rights under copyrights in various published and unpublished works of authorship including computer programs, computer databases, other computer software, layouts, trade dress, drawings, designs, writings, and formulas owned by borrower along with all copyright registrations issued to borrower and applications for copyright registration.

[7] Lenders could require that, in taking a copyright as security, the borrower be obligated to register all copyrighted material with the Copyright Office.

[8] By contrast, under the UCC, after-acquired property can be made subject to the lender's perfected security interest in advance by a simple reference to after-acquired property, without the need for subsequent UCC filings or further monitoring by the lender of the borrower's future acquisitions of property.

Bert Ely's FARM CREDIT WATCH®

Shedding Light on the Farm Credit System, America's Least Known GSE

FCS: Home of the Supersized Borrowers

THE FARM CREDIT SYSTEM (FCS) LOVES to talk about lending to young, beginning, and small (YBS) farmers and ranchers (many of whom in fact are hobby farmers or owners of country estates). In fact, the FCS has done such a great job of marketing this myth that USDA granted the FCS nearly $700,000 to "help" small farm customers find credit. However, the FCS is extremely quiet about the bulk of its lending—supersized loans to big farming operations and agribusinesses who hardly need cheap, taxpayer-subsidized credit. Fortunately, the FCS' Annual Information Statement (AIS), equivalent to a 10-K, provides interesting insights into FCS lending. You will find the AIS at www.farmcreditfunding.com/ffcb_live/financialInformation.html?tab=statements.

According to the 2011 AIS, FCS institutions had 165,605 YBS loans and loan commitments outstanding at the end of 2011, totaling $21.290 billion. However, some YBS borrowers have multiple loans, so the FCS had far fewer than 165,605 YBS borrowers at the end of 2011. At the other end of the scale, the FCS had 80 borrowers with loan balances of more than $100 million. Those outstanding loans totaled $14.190 billion at the end of 2011—an average of $177.4 million per borrower. While the FCS does not publish data on loans aggregated by borrower for borrowers with less than $100 million in loans, at the end of 2011 the FCS had 3,044 loans outstanding, each between $5 million and $100 million, totaling $33.803 billion, for an average loan size of $11.1 million. However, some of those loans undoubtedly were taken out by borrowers with multiple FCS loans. The FCS should present all of its loan data aggregated by borrower; it has the capability to do so.

The FCS does not have a formal loan limit, but it tries to hold its total credit exposure (including unfunded loan commitments) to any one borrower below $750 million—hardly what the typical family farmer borrows. At the end of 2011, the 10 largest FCS borrowers had $3.428 billion of outstanding loans—an average of $343 million per borrower. At the same time, 10 FCS credit exposures (including unfunded commitments) fell in the $563 million to $750 million range, compared to just five such credits at the end of 2010. In just one year, the FCS doubled the number of credit exposures pushing up against its self-imposed $750 million credit-exposure limit! Interestingly, one of its 10 largest credit exposures at year-end 2011 was classified as Other Assets Especially Mentioned.

CFTC Takes Care of FCS, Quite Mysteriously

The March edition of Farm Credit Watch reported that the FCS was again trying to obtain special regulatory treatment. In this case, the FCS was trying to sidestep a Dodd-Frank Act (DFA) requirement that it register as a swap dealer because two FCS institutions—CoBank and an FCS association—have entered into interest-rate swaps with borrowers. The FCS, through its trade association, the Farm Credit Council (FCC), argued that because DFA explicitly exempts insured depository institutions from the swap-dealer registration requirement, the FCS should be exempt because, like banks, the FCS makes loans. Specifically, the FCC asked the Commodity Futures Trading Commission (CFTC), the regulator of swap dealers, to expand the definition of "insured depository institution" to include FCS institutions.

On April 18, the CFTC adopted a final rule defining who it would regulate as a swap dealer. It appears the FCS has been exempted from having to register as a swap dealer, but not for the reason the FCC gave in pleading for the exemption—we will know more about a possible FCS exemption when the CFTC publishes its swap-dealer regulation in a few weeks. One reason the CFTC may have developed a new rationale for exempting the FCS derives from a March 29 letter the leadership of the House and Senate Agriculture Committees sent to CFTC Chairman Gary Gensler.

The letter noted that "Congress provided an exemption for credit institutions that offer swaps in connection with loans from designation as swap dealers." This phrasing overlooks the fact that DFA provides the exemption only for "insured depository institutions," which the FCS clearly is not. Then comes the most mysterious sentence in the letter: "This provision ensures that the flow of credit can continue between businesses and small to mid-size lenders and farm credit institutions," which presumably means the FCS. The CFTC clearly got the message, loud and clear, and found a way to exempt the FCS. Perhaps the CFTC will justify its reasoning when it publishes its final swap-dealer rule.

George Beattie to FCSA: Pay Your Fair Share of Taxes

George Beattie, president and CEO of the Nebraska Bankers Association, recently published an editorial taking Farm Credit Services of America (FCSA) to task for bragging about the huge dividends it pays to its borrowers while paying next to nothing in corporate income taxes. As Beattie noted, FCSA has been "running advertisements throughout [Nebraska] that make a big deal about the 'dividends' they are paying customers who borrow from them" while claiming that "they are the only lender who 'shares' with their customers." FCSA brags on its website that it paid $130 million in dividends for 2011 and "more than $555 million" since 2004.

Beattie correctly noted that FCSA "made $456.4 million in after-tax profits in 2011" after providing "for just $9.4 million in total federal and state taxes—just 2 percent of their pre-tax income!" Beattie also observed that according to FCSA's annual report it "would have paid as much as $163 million in federal income taxes alone in 2011 if they were taxed like banks." Even worse, in 2010 FCSA "paid just $308,000 in total taxes on income of $419 million." Now that FCS associations have published their 2011 annual report bankers everywhere should point out how much FCS institutions are paying in dividends (really interest rebates) to their borrowers while paying next to nothing in taxes.

Report FCS Lending Abuses

Bankers are continuing to send Farm Credit Watch reports of FCS lending abuses such as FCS loans for rural estates, weekend getaways, and hunting preserves. Email reports of similar lending abuses in your market to greenacres@ely-co.com. Please provide as much detail as possible about any loan that violates the spirit, if not the law, governing FCS lending.

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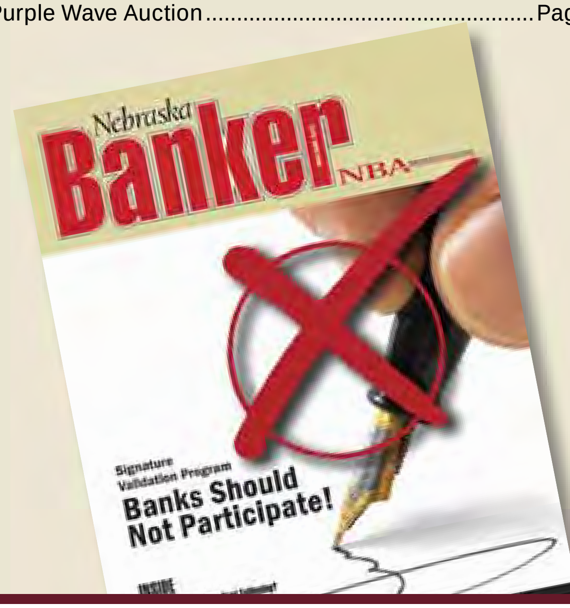

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