The financial sector's patent challenge

Although a series of recent conferences would seem to indicate that the financial services industry is becoming more patent-literate, worries remain that short-termism may see many in the sector taking their eyes off the ball

By **Phil Hargrove**

The financial services industry is slowly awakening to the implications of patents and other forms of intellectual property as both business risks and business opportunities. This growing awareness has spawned an increasing number of conferences on the topic during the past several months: Swiss Re, the second largest global reinsurance company, hosted an international meeting at its conference facility in suburban Zurich, Switzerland in July; in addition, two conferences were held in New York sponsored by the Institute for International Research in early May and the World Research Group in late July, and the topic was the focus of a session at the annual ACORD/LOMA insurance technology conference in Orlando, Florida, in late May.

This was the third conference on IP that Swiss Re has sponsored through the efforts of Dr Frank Cuypers, the head of intellectual property for the company. Cuypers, an actuary by training, is recognised as a leader in the field of IP in the financial services industry both in Europe and the US. He has actively promoted awareness of the topic through the auspices of Swiss Re and through presentations at several conferences and industry events.

Cuypers began the conference by reciting a fable about a kingdom whose livelihood and ultimate economic survival were threatened by the shroud of secrecy its farmers used to keep their agricultural techniques hidden from both outsiders and each other. The moral, of course, is that the kingdom only flourished once the farmers tossed aside that shroud and found the means both to share and to protect their best practices, which in turn accelerated innovation. And they all prospered and lived happily ever after.

Cuypers, like many others, believes that the ultimate value to society as a whole from IP, especially patents, is the growth in innovation that follows when inventors must publish their ideas in exchange for protection instead of keeping them closely guarded secrets. For an industry rarely synonymous with innovation, his view is that the real worth may be the stimulus to create new products and services without the fear of "me too" followers merely copying with impunity. So-called first-mover advantage is generally short-lived and more often a disadvantage that discourages the investment in innovation.

With the challenge to attendees to overcome any cultural bias against sharing, he opened the conference which epitomised the breadth and depth of interest in the topic of IP. Participants represented a wide variety of financial services institutions, including banks, insurance companies, brokerage firms, law firms and software vendors, as well as active and former leaders of patent offices from several countries.

Although entitled the Conference on Technology Transfer in the Financial Services Industry, the topics discussed ranged from the risks to the industry from patent trolls to the affect of open source as a counterpoint to proprietary innovation and patents. There were also several presentations on the current state of financial services patents in the major patent offices around the world. Each topic was the subject of much discussion and lively debate and while there was general acknowledgement of the impact of IP, especially patents, there was no clear consensus on the ultimate value and future importance to the industry.

The Pay as You Drive patent

A notable exception in the insurance industry is the Progressive Insurance Company's patent on a Pay as You Drive product. Using cellular and GPS technology, a driver's actual driving habits and routes are tracked and reported in real time to the insurance carrier, which adjusts the premium periodically based on this information. Progressive has not yet introduced the product in the US except in trials in selected markets, but the concept appears to be a real winner for Norwich Union in the UK. Norwich Union licensed the European rights from Progressive and has been working in partnership with IBM to introduce its version of the product.

Robert Ledger, head of Telematics for Norwich Union, reported that not only have the marketing trials gone extremely well, but word has spread and both current customers and prospects alike have expressed enthusiasm for the concept. In addition to the opportunity to determine premiums more accurately to the benefit of both the consumer and the insurance company, the technology offers the possibility to expand the company's offerings to include many value-added services to its customers. Ledger believes that acquiring a licence to Progressive's patent has given Norwich Union a decided competitive advantage in its markets. Progressive also has a patent pending in Europe to which Norwich Union will have rights as well under the terms of its licensing agreement, according to Ledger.

Business method debate

Q Todd Dickinson, the chief IP counsel for the General Electric Company and former Assistant Secretary of Commerce and head of the USPTO during the Clinton presidency, delivered the first of several presentations on financial services patents in the various patent offices. He not only offered his perspective on business method patents in the US, but also provided an update on efforts to improve the examination process at the USPTO.

Dickinson began by noting that despite the recent attention and debate resulting from the *State Street Bank* decision, patents on business methods have been issued in the US since the earliest days of the patent office and cited examples from the 18th and 19th centuries to underscore his point. In defence of the US position he noted that today: "Many of these sorts of patents focus on the harnessing of new powers of widespread computing to perform new business functions that were not previously possible."

In an information-based economy, business methods are the machinery that produce the goods and services and are potentially of no less value than the cotton gin was to an agricultural economy or than mechanical devices were to the industrial age. They are, in his view, not merely simplistic and obvious as the critics contend: "This confuses a concern about the quality of patents with the patentability of their subject matter and all types of patents can be both good and dangerous."

Dickinson also reported on efforts to improve the examination process and address many of the criticisms aimed at the USPTO for its handling of business method patents. The number of examiners has grown from a handful in 1999 to well over 100 in 2004, with more on the way. He believes that the second review process initiated during his tenure has improved the quality of patents issued, as the low allowance rate of less than 10% and recent court decisions attest.

Lastly, Dickinson noted that the USPTO has reached out to the private sector to provide training and insight into the standard processes within the financial services industry for its examiners. He also believes that the gold rush mentality of the late 1990s has greatly subsided and the quality of patent applications has greatly improved as patent attorneys and agents have themselves become more knowledgeable and sophisticated about business methods.

Gaston Williere of the European Patent Office presented the current status of financial services patents in Europe. While it is generally understood that business method patents, *per se*, are not allowed, patents are issued on processes that demonstrate a "technical effect" and that may be a key element of a business process. Interestingly, the allowance rate is around 10%, similar to the US. There is, however, a significantly higher attrition rate as applications are withdrawn or denied during the period of initial scrutiny by the EPO, a step that occurs much sooner than in the US.

Tadashi Inoue of the Japanese Patent Office presented the last in the series on patent offices and provided an overview of financial services patents in Japan. He gave several examples of patents that affect the financial services industry, such as a patent on a transfer processing system for banks and another on a database for tracking the path and energy of a typhoon. Just as elsewhere, the *State Street Bank* decision unleashed a torrent of applications but in numbers far surpassing the combined totals of both the Europe and the US during the same time period. A seeming hybrid of the two other major patent systems, Japan allows business

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method patents, but the ultimate litmus test requires the "creation of technical ideas utilising a law of nature, and a claimed invention must be concrete enough to accomplish a certain purpose". And, of course, the allowance rate is below 10%. Who says there isn't harmony in the patent world?

Open source challenges

The focus at the Swiss Re conference shifted temporarily from patents to Open Source as the subject of a panel discussion among the heads of IP for IBM, Microsoft and Cisco Systems. Dan McCurdy, the president of ThinkFire, moderated the discussion among a panel that included Robert Barr, chief IP counsel for Cisco, Marshall Phelps, vice president intellectual property & deputy general counsel for Microsoft, and Jim Stallings, vice president of intellectual property and standards for IBM. McCurdy provided an overview of open source focusing on the most controversial licence, the General Public License promulgated by Richard Stallman and the Free Software Foundation.

As an introduction to the presentations of the panellists, McCurdy cautioned: "There is no evidence that software patents have in any way inhibited either open source or proprietary source code development or use. If it ain't broke, don't fix it. This is not – should not be – a religious war." There were no bullets, only barbs exchanged among the panellists and there was agreement that open source is here to stay, although each company held a different perspective on how to deal with it.

IBM has built a substantial consulting business assisting companies in the implementation of Linux and provides major support for its continuing development through contributions of software code to the Open Source Development Lab. At the same time as it continues to maintain and grow its own patent portfolio, it actively supports open standards driven by industry or customer groups.

Cisco learned the hard way what happens when the two worlds collide following its US$500 million acquisition of Linksys and the subsequent public rancour over rights to the open source software embedded in its most popular router. According to Robert Barr, the lesson learned is the importance of training, tracking and disclosure within the organisation to avoid a nasty and costly surprise.

Marshall Phelps reported that Microsoft is exploring ways to co-exist, although he declined to respond to Jim Stallings' challenge that Microsoft should follow IBM's lead and waive any of it patent rights that might be infringed within Linux. As Phelps noted, IBM has not volunteered to waive any of its rights on the remaining thousands of patents in its portfolio.

A key point was that both open source and patents are a fact of life and companies are better served learning ways to deal with both than ignoring the reality of either. Any company that ignores the widespread use of open source software and believes it is creating purely proprietary applications is very much fooling itself. In the absence of any policy on the controlled use of open source, programmers are highly likely, and often encouraged, to make use of free open source code to meet deadlines and requirements. While many of the open source licences are benign, others, like the GPL with its viral effect, present a real danger to companies that rely on proprietary systems to gain competitive advantage and may inadvertently jeopardise their ability to protect their core business processes.

Trolls, tech transfer and pendency times

Rick Borden, assistant general counsel for The Hartford, discussed the ever unpopular patent trolls, those predatory practitioners of patent infringement who rarely practise the arts covered by their patents. Most, as he noted, are "predators, extortionists, terrorists or just really nasty people", with recognisable names and faces who lurk in the shadows to prey upon the innocent and unsuspecting. The growth of companies whose sole business model is to acquire and enforce patents represents a new form of trolling and traditional tactics of cross-licensing are a useless defence when attacked by a troll. He has discovered, however, that some are less fearsome and may present legitimate business opportunities and The Hartford is currently exploring them.

The conference theme of technology transfer was the subject of presentations by John Squires of Goldman Sachs and Michael Springs of Bank of America. Both companies have successfully commercialised their IP, Goldman Sachs through a joint venture with several other companies in which it retains a 25% equity position, and Bank of America through licensing its mini-card.

The WRG conference in New York covered much of the same ground as the others. There were more presentations of a technical nature than at the Swiss Re conference and the topics ranged from tips on constructing patent claims to advice on the steps to take if served with a notice of infringement. Although attendance was up from the inaugural conference in July of 2004, there were many of the usual suspects in attendance, mostly patent attorneys, which raises a concern about preaching to the converted.

In addition to the usual debate over the merits of business method patents at both conferences, there is a great deal of uncertainty for companies based, or doing business, in the US concerning the pendency rate at the USPTO. It was reported that the examination process can now take up to nine years and the low allowance rate serves only to compound the problem.

John Love, the head of the business method patent division at the USPTO, addressed the pendency issue at the July WRG conference in New York. He reported that efforts to increase the number of examiners are well underway with a goal of 500 examiners in his unit to handle the caseload. In the next year, alone, 150 additional examiners will be added, although he also noted that, over the short term, the increase in his staff will exacerbate the backlog as experienced examiners are redirected from their normal duties to help train and supervise the new hires. He also strongly recommended the use of the "petition to make special" process, when applicable, as a valid and viable means to accelerate the examination process.

Growing concern

The financial services industry has a very short history in the world of patents. Concern is growing among those charged with managing their company's IP portfolios that support from senior management may wane as the timeframes continue to lengthen. In addition, many companies were motivated by the prospect of untold riches from commercialising their patents, yet to date there are no IBMs in the financial services industry. Efforts to build revenue from licensing have proved elusive for most and, in the absence of a real patent portfolio, it has been extremely difficult for many to meet expectations.

In businesses most often driven by quarterly and annual results, waiting years for a patent to issue or licensing revenue to flow in is untenable for most leaders. One participant at a recent conference noted that patents and licensing are the ultimate test of management's patience. As expressed publicly and privately, for many the fear is that patience is quickly wearing thin.

For some segments of the financial service industry, most notably insurance, the concerns over patents sound like the dire warnings of Chicken Little. With the notable exception of The Hartford's US$80 million patent infringement judgment against it, the sky does not appear to be falling. For others, however, ignoring the growing numbers of patents on core business processes, not just in the US but worldwide, and despite the pendency problem at the USPTO, is simply a matter of playing chicken with an oncoming bus filled with plaintiff attorneys. Short term thinking, as many fear, may lead to disastrous long-term results.

Will the financial services industry continue to awaken and will there continue to be support for conferences such as those hosted by Swiss Re, WRG, IIR and others? Or will short-term thinking prevail due to the pendency problems in the US, unrealistic expectations of profits from licensing programmes or challenges elsewhere? Only time will tell. ■

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