**Banking on Intellectual Property**

**BY ADRIAN WONG**

In 1997, legendary English musician David Bowie created an unexpected milestone in the financial world by issuing 10-year bonds out of future revenues from the 25 albums in his back catalogue. This innovative approach to obtaining financing resulting in intellectual property (IP), or IP securitisation, netted Bowie a handsome US$55 million by issuing US$1 billion by issuing bonds backed by the royalties from his catalogue.

One would think that the success of these corporations would have sparked more interest from the private sector, but those stories have turned out to be the exception rather than the rule.

According to the World Intellectual Property Organisation (WIPO), the practice of using IP as collateral in lending is a "recent phenomenon even in developed countries". WIPO defines IP as "creations of the mind", that is, inventions, literary and artistic works, designs, names, and images that are used in commerce.

The Intellectual Property Corporation of Malaysia (MyIPO) regulates and promotes IP in the country. It has the distinction of being one of the first Asian IP bodies to introduce the "IP Valuation" initiative.

This initiative was launched in 2010 with the aim of creating a better understanding of monetizing IP rights through IP valuation, IP financing and the creation of an IP marketplace.

Malaysia Debit Ventures Bhd (MDBV), meanwhile, provides financing for companies in exchange for IP assets as collateral. MDBV’s RM300 million Intellectual Property Financing Scheme (IPFS) was introduced by the government in 2013 to assist the tech sector in its attempts to secure funding from financial institutions. The scheme has disbursed RM40 million to 11 companies since its inception.

IPFS’s ‘INSECURE’ NATURE
IPFS is broadly divided into four categories - trademarks, copyrights, industrial design and patents. Each category is governed by its own law, in its own country, and offers different rights to the IP holder. The companies involved are all these types of IP, however, are insecure. This "insecurity" makes it less attractive to the collateral market for banks, according to Lee Tatt Boon, a senior consultant at Baker Tmainwindow.

"A landed property is very secure because the moment you own it, it cannot be changed," he says. "Whereas in the case of IP, the title may be revocable. For example, all these inventions may be new to you, but when you do a worldwide search, it may already be done before that, and that's where people come and challenge it and knock off your asset.

Also, a patent can be invalidated and trademarks can be challenged, or even sometimes diluted in value. These are some of the reasons why IP is not so interest in it!"

To illustrate the concept of dilution, one can see the example of the Mandarin Oriental chain of hotels, where another hotel may already exist using the name same but without belonging to the international hotel group.

"So, because of the many possibilities, the value of the Mandarin name has gone down simply because of the existence of other hotels with the same name. This could be another reason banks are not so keen on using IP as collateral," he says.

Another worry is that in the event

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**MDV’s Intellectual Property Financing Scheme**

Malaysia Debit Ventures Bhd’s (MDBV) Intellectual Property Financing Scheme (IPFS) has been up and running since 2011, and has promised RM40 million in financing to tech companies with a focus on innovative and cutting-edge technologies. The IPFS was introduced by the government in 2013 to assist the tech sector in its attempts to secure funding from financial institutions. The scheme has disbursed RM40 million to 11 companies since its inception.

**Unsecured Loans**

Unsecured loans given on a one-to-one basis, and are considered to be the most flexible type of finance available.

**Collateralised Loans**

Collateralised loans require the borrower to provide collateral, such as intellectual property, as security for the loan.

**Securitised Loans**

Securitised loans are typically given to companies in the tech sector, with a focus on innovative and cutting-edge technologies.

**What is the typical collateral for IPFS loans?**

The typical collateral for IPFS loans is intellectual property, such as patents, trademarks, copyrights, and industrial designs.

**Does MDBV accept all types of IP?**

Yes, MDBV accepts a wide range of IP, including patents, trademarks, and copyrights.

**What is the maximum amount of IPFS loans?**

The maximum amount of IPFS loans is RM40 million.
of a default, a bank might struggle to find a buyer for a "foreclosed" IP asset. Unlike real estate, IP could be harder to sell on the secondary market and may require specialized knowledge-how to operate.

**LEGISLATIVE HURDLES**

According to Kuek Pei Wei, a partner at Skrine, legislation is also a hurdle for IP securitization. "The Patents Act 1983 explicitly states that there is a notice on trusts that are not to be registered," she says. "This means that a charge cannot be created on patents for a collateral agreement."

When you use property as collateral, a trant is created on the asset to signify that the asset is pledged to the lender as collateral. In the case of a patent (based on the present Act), it appears that this cannot be done. "First of all, you need to go in and take out provisions that prevent the registration of a charge," she says. "Secondly, you need to expressly put in provisions to allow the registration." This has been done for the Industrial Designs Act 1996, but the amendments have been passed."

Other Acts (namely, the Patents Act 1983, the Trade Marks Act 1980 and the Copyright Act 1990) have been discussed, but things are still undecided. According to Kuek, there is no similar provision that says a charge cannot be created in the other Acts. But neither does it say that a charge can be created. This ambiguity adds to the current state of confusion, which could yet be another hurdle financiers consider too cumbersome to explore."

**NO FRAMEWORK AND THE VALUATION CONUNDRUM**

Another major stumbling block to accepting IP as collateral is the valuation process. Not many financial institutions are equipped with the expertise of valuing intangible assets such as IP, which can produce a wide range of values. This makes it difficult to settle on a value that is acceptable to all the parties involved. "Valuation itself is a very subjective, what more an intangible asset," says Pirvathachandra Coopers Capital associate director Adeline Kho Soet Ling. "When one looks at a valuation, many questions come to mind. Which is the best methodology to apply? What are the appropriate cash flows generated by the asset? How long can the asset be used? Which discount rate is appropriate?"

Some valuation methods, such as the market approach, which uses comparable past transactions as a benchmark for valuation, cannot be wholly relied upon as they do not distinguish between certain factors, Khoo points out. "What we always find challenging as valuers is finding an asset that is truly identical to another," she says. "For instance, the value of a 3G spectrum licence in India could be different from the value of a 3G spectrum licence in Malaysia. The unique characteristics of regulations, competition and demographics make valuation a complex exercise. This is possibly why the market approach is used in this case."

**LAYING THE GROUNDWORK**

However, even though these concerns are valid, alternatives have already been suggested to mitigate them, according to MyPO's IP valuation and marketplace consultant Samirah Muazzafar. "From a business standpoint, MyPO is not pushing for IP to be a standalone collateral (to the agreement), but rather as part of a traditional collateralised asset. This reduces the risk that banks can take on because they are holding on to other assets besides IP," she says. "Even for IPO, it takes a determination over a company's other assets as well as a corporate guarantee on top of the IP asset."

MyPO has developed a rational IP valuation model that is " Malaysian in nature to suit lenders and financiers in the country. According to MyPO's director general Shamah Kamaruddin, this specifically targeted model is the first of its kind in the region. "The IP valuation model provides a minimum for lenders and financiers to start valuing IP rights," she says. "It utilises the income approach, specifically the valuation on a royalty-free royalty-basis and is generally consistent with the recommendations of internationally accepted standards such as the International Financial Reporting Standards, International Valuation Standards and International Organisation for Standardisation."

In addition to the model, MyPO has begun training its IP brokers, which are certified by the World Trade Institute, an interdisciplinary centre of the University of Bern in Switzerland. "We have engaged valuators from the US, the UK, Australia and Singapore to conduct IP valuation under the IPPA, where their valuation reports will be used in the training of local IP valuators," Samirah says. "This is also to ensure that our valuers have a benchmark with foreign transactions and whatever valuation approach taken, it should not differ too much from previous cases."

The training of local valuers is aimed at providing Malaysian banks a cheaper alternative as foreign valuators can be costly. According to Samirah, banks could begin by looking at loans of shorter durations to minimise risk. Typically for IP financing, the tenure is relatively short because of the risk that technology can be obsolete. If an IP right can last for, say, 20 years, a bank can lend for three to five years and still sell the IP if the borrower defaults. "The government will continue to make provisions to stimulate IP development in Malaysia and this ongoing IP valuation initiative, which is the first in the region, reinforces MyPO's commitment to driving growth in the IP landscape. It is now up to the private sector players, namely the lenders, to take steps to make this initiative a success that Malaysians can be proud of."