

Felipe M Medalla: Virtual assets and evolving approaches to regulation

Speech by Mr Felipe M Medalla, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the 38th Bangko Sentral ng Pilipinas Environmental Scanning Exercise, Manila, 26 May 2023.

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Members of the Monetary Board, resource speakers, colleagues, ladies, and gentlemen, *magandang tanghali po*. Welcome to the 38th BSP [Bangko Sentral ng Pilipinas] Environmental Scanning Exercise (ESE). Today's topic is "Virtual Assets in the Philippines."

It is worth noting that although we are talking about virtual assets (VAs) in the Philippines, clearly, the value of VAs in the Philippines will be determined globally.

Looking to lessons from government-initiated bans and non-monetary currencies

Indeed, [during] the conference in Cebu that the BSP hosted with the IMF [International Monetary Fund], a representative from India asked a very difficult question: "If these VAs are primarily designed to avoid and elude government, what should be the government's attitudes toward it?" The logical answer is "panic," right?

But, at the same time, the experience of banning-let us say, in the case of alcohol-if we look at the history of the prohibition, [it] actually backfires. The [act of] banning itself turns the commodity under the control of the very people you do not like-criminals.

The conclusion was [that] the regulation of VAs must follow a certain global standard. Countries all over the world must agree on how to deal with it.

Note that we keep using [the term] "virtual assets," not "virtual currencies," because currency, they are not. They are so volatile that when prices are rising, nobody wants to use them [since people are holding them in anticipation of future gains]. On the other hand, when it [the price] is falling, nobody wants to accept it [as a medium of exchange].

I guess, for old graduate students like [Monetary Board Member (MBM)] Eli [Remolona] and me, it is nice to go back to the evolution of currencies without government. The usual reference point is the evolution of cigarettes as currency in prisoner-of-war camps. There are many lessons to be learned there. Why cigarettes, not milk or fruits? The answer is, it is hard to hold so many fruits in your pocket. Also, fruits and milk are not standardized. What happened was that cigarettes emerged as the currency of choice in the camps.

But then, many problems came out later. A smoker knows a bad cigarette from a good one. So, he will keep the good cigarettes and trade the bad ones.

So, we expect that all these problems will happen as well to virtual currency. There are many competing ones, and even the ones that survive will have problems because of all these issues.

The limits of decentralization: when should regulation step in?

If the goal is to use them as stablecoins, clearly, that is banking. Because then, you are taking money-taking deposits and guaranteeing deposits to support the currency. Therefore, you should be treated like a bank and regulated like one.

If you are issuing a stablecoin, maybe the requirement should be at least 50 percent of the assets that back it up should be very liquid assets. Maybe you should have a reserve requirement. Maybe you should have a liquidity coverage ratio, and so on and so forth.

Therefore, this avoids the very purpose of why these currencies were created to begin with. For them to be useful and safe, they have to be regulated. I think that this is the story of FTX [failed cryptocurrency exchange].

Encouraging responsible and cautious innovation

Nonetheless, we should be open to new developments, especially [in] a country [like ours] that is dependent on remittances. Therefore, we have to have an open mind.

At the same time, as [MBM] Eli [Remolona] said, regulation should be a cautious one. We do not want to regulate without asking what the private players think and the role that they envision for virtual currencies. Are they for remittances? Are they for speculation?

We are clearly, more likely to give [virtual asset service provider (VASP)] licenses to banks that already exist if, at all, there will be trading; if they will be allowed to trade in these virtual currencies.

By the way, if virtual currencies were to replace gold-if you believe Google-the overall supply of gold is US\$7.5 trillion globally. If this can displace just 13 percent of gold, then, at the very least, the value of VAs is US\$1.0 trillion. Exactly which VA will be worth US\$1.0 trillion, we actually do not know.

The other question is one of consumer protection-the extent to which the government and the central bank must educate the public and say, "We are allowing this to happen, but these are very risky assets. You should not put in money that you really need for many important things."

Ongoing dialogue between regulators and market players

In this ESE, we would like to be updated on the adoption and usage of VAs in the Philippines. What exactly is happening on the ground? What are they being used for? To what extent should regulation apply?

Right now, our view is [that] the moment VAs meet fiat currency or deposits, clearly, you have to be regulated. Exactly what the form of regulation will be is, of course, evolving.

Our view is one of caution. When did we freeze the issuance of VASPs? About six months ago. Our view is a cautious one, but regulation should be open to potentially good uses. Therefore, if you ban it, then you are not in a position to move in that direction.

We hope that we can gain some insights from our speakers. I hope that we can have a fruitful, balanced, and productive discussion ahead. As I already said, the central bank is open to it but very, very cautious. The more we learn, the more we can handle it better.

Thank you very much, and I hope that it will be a very good afternoon and [an] interesting discussion.