

Mr Nestor A Espenilla, Jr: Private cryptocurrencies and lessons from a red paperclip

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Shareholders' Association of the Philippines (SharePHIL) General Membership Meeting and Cryptocurrency "The Truth & The Myth Forum", Makati City, 12 March 2018.

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Officers and members of the Shareholders' Association of the Philippines, guests from the public and private sectors, ladies and gentlemen, good afternoon!

It is my pleasure to share the Bangko Sentral's insights and initiatives on privately-issued cryptocurrencies. I am hopeful that in doing so, we will, as your theme suggests, be able to cut through the "truths and myths" surrounding this fairly novel medium of exchange. Notice though that I make a key distinction as there's such a thing as central bank-issued digital currency. I'm not going there today as that's a different conversation all together even as the underlying technology may be similar.

But there it is. Cryptocurrencies are a medium of exchange. The Bangko Sentral ng Pilipinas (BSP) recognizes this. We have defined crypto or virtual currency as any "form of digitally stored value created by an agreement within the community of virtual currency users." As far back as 2014, the BSP advised the public of the features, benefits and attendant risks in dealing with cryptocurrency.

We have adopted a regulatory approach to privately-issued cryptocurrency that is balanced, open and flexible. This is to allow the market to promote financial innovation and for the industry to take advantage of all its benefits and efficiencies – with prudence.

We have issued (and will be ready to issue more) responsive regulations. Last February 2017, we issued Circular No. 944. We now require businesses engaged in the exchange of privately-issued cryptocurrency for equivalent fiat money, to register with the BSP as remittance and transfer companies. Moreover, we strongly cautioned the public against unscrupulous individuals or groups who offer virtual currency pyramid schemes disguised as initial coin offerings or investment products. The advisory likewise provided tips on securing virtual currency accounts (I think this thrust is something SharePHIL would appreciate given its mission with respect to consumer education and protecting investors' rights.)

To be clear, we do not endorse privately-issued cryptocurrencies as a medium of exchange. Moreover, given their highly speculative and volatile nature, we do not endorse them as investment vehicles either.

Rather, our objective as a central bank is to address any risks that they may pose to the public even as they exist as a fact of life. This is consistent with our goal of increasing consumer protection. It is also in keeping with our advocacy against money laundering, terrorist financing and other crimes (As you know, given cryptocurrency's reliance on the full anonymity of those who transact in them, there is a propensity for this mode of payment to be used for illegal purposes).

In keeping with our mandate to promote financial stability, we also aim to address any risks posed by cryptocurrency to the financial system. These risks are not imagined. They arise as cryptocurrency necessarily interplays with the non-digital world – the regular economy – when they are exchanged into pesos or other traditional currency.

It is important to note that privately-issued cryptocurrency is not legal tender. Unlike fiat money,

such cryptocurrencies are not backed or guaranteed by any central monetary authority. Only the BSP has the sole power and authority to issue currency within the Philippines. Under the law, no other person or entity, public or private, may put into circulation, notes, coins or any other object or document which might circulate as currency. Our notes and coins are fully guaranteed by the Government and are legal tender in the Philippines for all public and private debts.

While privately-issued cryptocurrencies do not enjoy legal tender status, they are, however, as a matter of practice, used as a medium of exchange and a store of value. But aren't so many other things?

The red paperclip story

This brings to mind a story about a red paperclip that went viral. Some of you may be familiar with it. In 2005, a Canadian blogger – Kyle MacDonald began a series of transactions which he posted on-line. He began with a red paperclip as a medium of exchange. He exchanged this for an interesting looking fish-shaped pen, which he traded for an odd-looking doorknob...then a camp stove...so on and so forth. By his thirteenth barter – in a little over a year — MacDonald was in possession of a movie role (a chance to act in a movie), which was finally traded for a two-story farmhouse in a small Canadian town! And it all started with a red paperclip! (It's an interesting story. You can google it!)

This red paperclip story has uncomplicated elements that differ starkly from cryptocurrency's high-tech world of blockchains, miners and cryptography. I introduce it not just to keep your attention or to refresh you with its simplicity but because there are powerful and common lessons to be learned from it and from the phenomenon of cryptocurrencies.

These are: **First**, additional participants in a transaction exponentially increase value which is defined, measured and transferred through consent. **Second**, there is power in leveraging on digital technology as a connector of people. **Finally**, people always count.

Using these points, allow me to share not only more insights on cryptocurrency, but also some initiatives in the BSP's exciting financial reform agenda – initiatives which (unlike cryptocurrencies) we fully endorse.

Exponential increase in value through wide consent

The first lesson from both the red paperclip story and the phenomenal use of privately-issued cryptocurrencies is that additional participants in a transaction exponentially increase value. This value is defined, measured and transferred through consent.

The success of the red paperclip project comes from the fact that its transactors defined and determined what they deemed to be valuable. On the other hand, while privately-issued cryptocurrencies are fast gaining global popularity, we deem their acceptance as still limited.

We believe privately-issued cryptocurrencies cannot completely fulfill the roles of money as a store of value and as an independent unit of account. Until such time that such cryptocurrencies are able to fully demonstrate stability, the prospect that they will replace today's fiat currencies appears to be far-off. They are simply still too volatile.

Power of technology to connect people

The second lesson is that there is power in leveraging on digital technology as a connector of people. In the red paperclip story, it cannot be denied that the values that were traded were not just in the objects themselves (They were, especially in the beginning, only ordinary objects and might even be considered junk by many).

Rather, the psychic value came from the opportunity to be on-line personalities, from viral exposure as all trades were posted on MacDonald's blog that had gained quite a following. As with cryptocurrencies, the great socio-experiment could also not have been possible without dynamic computer-to-computer connections.

In this regard, the BSP acknowledges the huge potential of digital technology, that includes cryptocurrencies, to transform financial service delivery, specifically in the area of payments and remittance. High-speed digital networks allow funds to move across the globe at a much faster, cheaper and convenient way compared to traditional models. Their use is game-changing for the unbanked, given their affordability and wider reach.

As far as the BSP is concerned, this is worth looking into as it is consistent with its financial inclusion advocacy. For this reason, we continue to closely engage with various stakeholders, including fintech players, to better understand varying business models, processes and systems.

Our priority is to develop a digital financial ecosystem that supports the diverse needs of all users in a manner that is secure, sustainable, convenient and affordable. For the service providers – whether new or incumbent, this ecosystem enables them to tap into a wider client base, diversify revenue sources and secure new growth opportunities. To us, this line of pursuing financial inclusion is more in keeping with our financial stability objectives.

The pillars of such an ecosystem that leverages on technology would include: an efficient retail payment system that facilitates delivery of digital products, especially for small value transactors; an expansive network of low cost touch points to on-board new clients and facilitate the digitizing and disbursing of cash and other financial transactions; and democratized access to a transaction account, wherein every person – regardless of economic and social stature – is able to open an account and use digital finance products.

Overall, this inclusive digital finance ecosystem will support the diverse needs of all users in a safe, convenient and affordable manner. It would have the right mix and range of service providers (banks and non-banks alike) and digital platforms to facilitate the sustainable delivery of fit-for-purpose and affordable financial services, especially designed for the low income market.

People always count

The final lesson in all this is that, “people always count.” This is what drives us in the BSP as we pursue game changing financial reforms to deepen financial markets, foster financial inclusion, increase consumer protection and to basically improve the quality of life of all Filipinos.

That being said, I must say that this new frontier of cryptocurrency brings up legitimate concerns that affect people... that affect the public. These issues are being looked into by the BSP and other financial regulators globally.

One issue is private cryptocurrency as an investment option. Its value is volatile for starters. Thus, we earnestly caution the public that before speculating or investing their hard-earned money in cryptocurrencies — as with any other type of investment — prospective investors should first know and fully understand the risks involved.

Because people matter, we at the BSP, like SharePHIL, value investor education. We have (together with the Department of Finance, Securities and Exchange Commission, Insurance Commission and the Anti-Money Laundering Council) made plans to embark on a nationwide public information campaign on cryptocurrency. The purpose is to inform and educate the public on what cryptocurrencies are, their uses and risks, related policies and regulations in the Philippines, and possible pitfalls.

Another serious concern is cryptocurrencies' attractiveness to, and use by, money launderers and terrorist financiers. This attractiveness stems from the anonymous and encrypted identities of transactors in private cryptocurrency. It is this very anonymity that cryptocurrency users value most. It enables them to transact in the so-called "dark web."

Allow us at the BSP to offer a contrary idea: There is power in identification. We believe that to significantly catalyze a digital ecosystem, there must be a reliable national digital identification system. This system will address persistent customer on-boarding issues due to lack of acceptable IDs and the highly inefficient paper-based KYC processes which make serving small value transactors unattractive.

The BSP therefore strongly supports the passage of the Philippine ID System bill which was identified by the Legislative Executive Development Council (LEDAC) in its August 2017 meeting as an urgent measure. The Lower House has already approved its version on third reading. At the Senate, its version is tentatively scheduled for sponsorship today, Monday, March 12 even as we speak. Truly exciting!

The envisioned national ID system will be designed to ensure universal coverage, data integrity and security, and optimum utility. It will serve as an enabling platform for the efficient delivery of a whole range of government and private sector services for all Filipinos – especially the currently unserved. Establishing a readily- verifiable digital identity will enable our people to open accounts and use financial services more efficiently.

Closing thoughts

This message obviously comes from a Central Bank Governor wary of currencies that do not qualify as legal tender and which are not backed by any monetary authority.

But it is a message that comes too from a Central Bank Governor who has been labelled as a "disruptor" – one that leads an institution that is ready to embrace the challenges of a rapidly changing financial and economic landscape.

This message is shared with this audience, a staunch advocate of investor rights and investors' need for information. It is a good match.

As I close, to align this message better with your theme... let me summarize the truths and myths of cryptocurrency from the BSP's viewpoint:

Myth: Privately-issued cryptocurrencies are legal tender and shall soon replace fiat currency. **Truth:** Cryptocurrencies, not backed by any central authority are not legal tender. Moreover, until they fully demonstrate stability, wide acceptability and other economic attributes, they will not replace fiat currency any time soon.

Myth: Cryptocurrencies are bad and are only used for illicit activities. **Truth:** Cryptocurrencies, like fiat currencies, are neither good nor bad. They are neutral. But, no doubt, BSP is mindful of their wide use in illicit activities because of the anonymity of its transactors and is taking action in this regard.

Myth: The BSP endorses the use of and/or investment in privately-issued cryptocurrencies. **Truth:** The BSP allows the market to develop but it has also issued responsive regulations to uphold consumer protection and to maintain financial stability. The BSP does not endorse or promote privately-issued cryptocurrencies but aims to address its risks as it intersects with the financial system.

Rest assured, the BSP maintains a forward-looking approach to ensure that regulatory and supervisory frameworks are in tune with emerging trends and developments. Through constant

surveillance and monitoring of the market environment, the BSP stands ready to adapt to future challenges and opportunities ahead.

I hope I have delivered on the terms of reference for this forum. You have been a wonderful audience. Thank you for your attention.

Maraming salamat sa inyong lahat.