HM Treasury

Consultation on the first Financial Market Infrastructure Sandbox

The Digital Securities Sandbox

July 2023

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Chapter 1
Introduction

Digital asset technology in financial markets

1.1 The UK is ranked as one of the most fintech-friendly countries globally.[1] Both the UK government and regulators have shown a strong commitment to supporting innovation and competition in financial services – with initiatives such as the Financial Conduct Authority's Regulatory Sandbox and Innovation Hub, Open Banking framework, and the Bank of England's Real-Time Gross Settlement (RTGS) renewal programme. Appropriate policy and regulation, accompanied by a clear allocation of supervisory responsibilities, can promote innovation. It gives innovators in companies of all sizes a clear framework within which to operate, setting high standards for business practice and giving consumers the confidence to try new services and providers.

1.2 The adoption of digital assets will be no different. The use of digital assets has the potential to be genuinely transformative for financial markets. This could include improving existing processes by making markets more efficient, transparent and resilient, but also by changing the way markets operate in potentially radical ways. It is important that markets are able to realise the benefits in a safe manner, preserving existing regulatory outcomes.

1.3 The term 'digital assets' encompasses a range of technologies and a variety of possible use cases. 'Cryptoasset' is the term that is often used in relation to digital assets, and generally refers to any cryptographically secured digital representation of value or contractual right. Subcategories of cryptoasset include new forms of asset, such as exchange tokens, utility tokens and asset backed tokens, as well as digital representations of existing assets, such as security tokens. Cryptoassets may be supported by an underlying asset, or unsupported by any asset and therefore 'unbacked'.Another term in this space is 'Distributed ledger technology' or 'DLT', which is frequently used to describe the technology underpinning digital assets and tends to refer to the recording, processing and storage of data in a distributed way (using a network of synchronised ledgers).

1.4 It is difficult to predict exactly what a future financial ecosystem based on digital assets would look like, but it seems clear that financial

[1] Why is the UK so successful in fintech? - FTAdviser

market infrastructures (FMIs) will play a crucial role.[2] Digital assets could be used by incumbent FMIs to enable greater efficiency, cost effectiveness and resilience without distributing control. It could also be used by new entrants to build infrastructures that have no central control, disintermediating existing FMIs and creating markets without central intermediaries. Another possibility is a compromise between these two scenarios, whereby some functions are decentralised, but other functions remain under central control (particularly where necessary to ensure that an infrastructure meets regulatory outcomes).

1.5 New FMIs using innovative digital asset technology could have different functionalities- some may resemble existing markets, with similar operating hours and settlement cycles, or they could deviate substantially from existing practice, such as by enabling 24/7 operation or T+0 settlement. They may have different customers: some infrastructures may cater for retail investors, and for less liquid assets, or they could be adopted for large, wholesale markets where the most liquid, systemically important assets are traded. In some cases, they may cater for both markets at the same time.

1.6 In future there may be a small number of large, digital asset infrastructures serving entire markets. Alternatively, there may be a larger number of digital asset infrastructures, potentially with multiple infrastructures across particular markets (the latter case would strongly imply the need for interoperability between FMIs to avoid fragmentation of liquidity).

1.7 The broad term 'digital asset technology' is adopted in this consultation as a catch-all term for the variety of technologies in this space, as well as the different practices use of these technologies could entail. We have used the more specific term of 'digital securities' to refer to where digital asset technology is used in relation to existing classes of security.

1.8 The use of these terms is an attempt to avoid inadvertently excluding certain use cases (for example, only using the term 'DLT' could inadvertently exclude the use of digital ledgers with a centralised function). We still refer to specific terms, such as DLT, where this is appropriate. We expect that these terms will continue to evolve as more use cases appear, and as implementation happens at greater scale.

FMI Sandboxes and the Digital Securities Sandbox

1.9 The use of digital asset technology implies potentially significant changes to financial services legislation and regulation, which will continue be essential for ensuring that markets function effectively. In 2021, HM Treasury conducted a Call for Evidence to examine the application of DLT to FMIs, with the government's response published

[2] In this consultation and for the purposes of the Digital Securities Sandbox the term 'Financial Market Infrastructure' refers collectively to central securities depositories and multilateral/organised trading facilities . It does not include central counterparties which are outside the scope of the DSS.

in April 2022.[3] A key issue identified in responses to the Call for Evidence was that the UK legislative framework has not been built to support the use of DLT in FMIs, and that changes would be needed to enable the use of DLT and realise its potential benefits.

1.10 The uncertainty regarding what the future financial market ecosystem will look like, and what the nature of the risks will be, means it is difficult to ascertain up front all the legislative and regulatory changes required. It is important that this does not lead to inertia in the legislative and regulatory space, but to acknowledge instead that the job of re-working financial services legislation and regulation will be an ongoing process that may take many years.

1.11 To enable this process, responses to the Call for Evidence identified a need to experiment with the use of DLT in markets, facilitated by temporary modifications to existing legislation. This would help HM Treasury, regulators, and industry to better understand the impacts of emerging technologies, like DLT, to ensure that regulatory objectives can still be met, and in particular to understand what changes should be made to the FMI legislative framework to support their effective and safe adoption.

1.12 Sandboxes were highlighted by respondents as a key method for achieving this. Sandboxes have been used in different ways, both in and outside of financial services, as a safe space in which to experiment, learn, and in some circumstances test new technology. In 2016, the Financial Conduct Authority (the FCA) launched its "Regulatory Sandbox", which allows businesses to test new technologies and products in financial markets, in a controlled manner and with close regulatory oversight, within existing legislative frameworks. In addition to helping firms navigate the authorisations process, the FCA provides firms in the sandbox with informal steers to help them understand the potential regulatory implications of their business model.

1.13 After the Call for Evidence closed, the government announced in April 2021 that HM Treasury in conjunction with the Bank of England (the Bank) and the FCA would develop an FMI sandbox. This will test whether and how FMIs can use new technology or practices to perform specific activities, and to test modifications to the legislative framework aimed at enabling this technology to be used in an effective, efficient, and safe way. Subsequent to this, the government committed to implementing the first FMI Sandbox in 2023.

1.14 In July 2023, the Financial Services and Markets Act 2023 (FSMA 2023) received Royal Assent after passage through Parliament.[4] The Act provides HM Treasury with powers to set up FMI sandboxes via statutory instrument (SI). Each SI laid before Parliament would provide the legal basis for each sandbox and for temporarily disapplying or

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[3] https://www.gov.uk/government/consultations/uk-regulatory-approach-to-cryptoassets-and-stablecoins-consultation-and-call-for-evidence

[4] https://bills.parliament.uk/bills/3326/publications

modifying relevant legislation for participants. It will also set out the wider framework for that sandbox (including who can participate and what restrictions there will be on activities).

1.15 The powers in FSMA 2023 are intended to be sufficiently flexible to enable different FMI sandboxes to be established, in order for different technologies and practices to be tested by different entities. Each future sandbox would be set up via an SI laid before Parliament.

1.16 A key aspect of the powers is the ability to make permanent changes to legislation on the basis of what is learnt. In order to change legislation, HM Treasury will report to Parliament on the operation of a particular sandbox, setting out why and how it intends to change UK legislation on a permanent basis. The permanent changes themselves would be enabled by HM Treasury laying a further SI before Parliament.

1.17 HM Treasury can exercise these powers before the end of a sandbox, to ensure there is no gap between that sandbox ending and the UK legislative framework being permanently modified (thereby avoiding a 'cliff edge' for participating entities). The regulators will also be able to update rulebooks and standards in response to what is learned from a sandbox.

1.18 **This consultation concerns the first FMI Sandbox (herein referred to as the 'Digital Securities Sandbox' or 'DSS') to be set up under the powers granted under FSMA 2023. The DSS will enable firms to set up and operate FMIs using innovative digital asset technology, performing the activities of a central securities depository (specifically notary, settlement and maintenance), and operating a trading venue, under a legislative and regulatory framework that has been temporarily modified to accommodate digital asset technology.**

1.19 **These activities will be performed in relation to existing security classes (which could either be digitally native issuances or digital representations of existing securities). Limits will be put in place for participating entities, which can be increased as progress is made. These limits will reflect the ability of a participating entity to meet requirements and manage risks.**

1.20 **These will be real-world market activities and assets. The intention is that any digital securities issued, traded, settled and maintained via entities in the DSS will be able to interact with wider financial market activities (e.g. for collateral posting or repos), where this can be done in compliance with existing legislative and regulatory frameworks.**

1.21 The rest of this document sets out in more detail how we expect the DSS to function, in order to enable industry to provide feedback. It also sets out some broader policy and legal issues to consider, as well as inviting respondents to express their interest in applying.

Other digital asset initiatives

1.22 There are a number of current initiatives that will have interdependencies with the DSS. In the UK, a consultation was published on 1st February 2023 regarding a future financial services regulatory regime for cryptoassets.[5] The focus of that consultation is largely on regulating cryptoassets that have evolved outside the regulatory perimeter. For the DSS, the focus will be on assets that are already classified as an existing category of security, albeit that they are underpinned by a new technology (these financial instruments are referred to in the above consultation as 'security tokens').

1.23 Separately, HM Treasury and the Bank judge that a UK central bank digital currency (CBDC), the digital pound, is likely to be needed in the future. However, a final decision on its introduction has not yet been made and will be informed by the public consultation and future work. HM Treasury and the Bank are now moving into the 'design' phase, that will enable us to respond to developments in the payments landscape and materially reduce the lead time if there is a decision to introduce a digital pound in the future. It will involve investment in the Bank's technology capabilities, and an ambitious approach to the technology roadmap and collaboration with the private sector. One of the aims of the design phase is to support the development of the broader UK digital currency technology industry through experimentation and proofs of concept.

1.24 Alongside the response to the Call for Evidence on the application of DLT to FMIs, HM Treasury also published a response to the consultation on the UK regulatory approach to stablecoins in April 2022.[6] FSMA 2023 gives HM Treasury powers to introduce a regime that will allow for the regulation of fiat-backed stablecoins which are used for payments, similar to that for other payments methods, given that these stablecoins have the potential to become widely used as a form of payment. The Act brings Digital Settlement Assets[7] into the Bank of England's regulatory perimeter for systemic payment systems. It also brings service providers into the Payment Systems Regulator's regulatory perimeter for regulated payment systems. Further details on the government's approach to fiat-backed stablecoins will be set out in due course.

1.25 Alongside explicitly CBDC-focused experiments, the Bank of England is setting up a DLT experimentation function. As well as

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[5] https://www.gov.uk/government/consultations/future-financial-services-regulatory-regime-for-cryptoassets

[6] https://www.gov.uk/government/consultations/uk-regulatory-approach-to-cryptoassets-and-stablecoins-consultation-and-call-for-evidence

[7] The definition of a digital settlement asset is "a digital representation of value or rights, whether or not cryptographically secured that a) can be used for the settlement of payment obligations, b) can be transferred, stored or traded electronically, and c) uses technology supporting the recording or storage of data (including DLT)". A "digital settlement asset" comprises only those cryptoassets that can be used for the settlement of payments (and in fact covers assets other than cryptoassets that can be used for the settlement of payments too). See clause 22(2), Financial Services and Markets Bill, Bill 181 2022-23 (as amended in Public Bill Committee)

ensuring that DLT is appropriately considered in the digital pound design phase, this function aims to incubate UK private sector digital currency technology, while also deepening DLT expertise within the Bank in support of its broader mission.

1.26 Experimentation with digital asset technology is underway internationally, particularly with the London-based Bank of International Settlements Innovation Hub taking forward projects looking at CBDC, next generation financial market infrastructures, and supervisory technology. Regulatory work is concurrently taking place in international fora - for instance, the Basel Committee has published a set of standards covering prudential treatment of banks' exposures to cryptoassets (including tokenised traditional assets, stablecoins and unbacked cryptoassets).[8]

1.27 The use of emerging technologies such as digital assets can give rise to novel legal issues. Several recent initiatives have demonstrated the strength of English and Welsh common law in responding flexibly to innovation in this area. In February 2023, the UK Jurisdiction Taskforce (UKJT)[9] published its legal statement on the issuance and transfer of digital securities using a system deploying DLT under English private law,[10] which considered how general legal principles apply to potentially novel and distinctive parts of digital securities. In June 2023, the Law Commission of England and Wales ("the Law Commission") published its final report on Digital Assets,[11] which concluded that the common law of England and Wales is well-placed to provide a coherent and globally relevant regime for existing and new types of digital assets and made recommendations aimed at further solidifying the legal foundation for digital assets. The Government is carefully considering the Law Commission's recommendations. This work is considered further towards the end of this consultation.

1.28 The financial sector is also undertaking work to assess the benefits of digital assets and clarify the process for adoption. Recent industry publications include the Global Financial Markets Association (GFMA) assessment of the 'Impact of Distributed Ledger Technology in Global Capital Markets'.[12] UK Finance and Oliver Wyman have also recently published a joint report on securities tokenisation.[13]

1.29 In the EU, the DLT Pilot Regime has been set up to enable the testing of DLT in FMIs, while Markets in Crypto Assets (MiCA) legislation

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8 https://www.bis.org/bcbs/publ/d545.pdf

9 The UKJT is an industry-led initiative tasked with promoting the use of English law and the UK's jurisdictions for technology and digital innovation: https://lawtechuk.io/ukjt

10 https://lawtechuk.io/insights/ukjt-digital-securities

11 https://www.lawcom.gov.uk/project/digital-assets/

12 https://www.gfma.org/policies-resources/gfma-publishes-report-on-impact-of-dlt-in-global-capital-markets/

13 https://www.ukfinance.org.uk/policy-and-guidance/reports-and-publications/unlocking-power-securities-tokenisation

has been created to provide a regulatory framework for crypto assets.[14][15] A number of EU Member States have also put in place national frameworks to facilitate the issuance and transfer of digital assets. Switzerland has created a framework for digital assets and for DLT FMIs.[16] Singapore has put in place a DLT framework, and completed a number of practical experiments, particularly through the Project Guardian initiative set up by Monetary Authority of Singapore.[17][18] A number of live digital asset issuances have also been taken forward, particularly by the European Investment Bank in partnership with both public and private sector organisations.

1.30 This summary is far from exhaustive, and reflects the diversity of work going on to facilitate the use of digital assets in financial markets. The government will continue to keep abreast of wider work being taken forward both in the UK and globally, by both public and private sector organisations, in the digital assets space.

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14 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32022R0858

15 https://data.consilium.europa.eu/doc/document/PE-54-2022-INIT/en/pdf

16 https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-84035.html

17 https://www.mas.gov.sg/development/fintech/technologies---blockchain-and-dlt

18 https://www.mas.gov.sg/schemes-and-initiatives/project-guardian

Chapter 2

Digital Securities Sandbox: Key Features

Summary of the Key Features of the Digital Securities Sandbox ('DSS')

1. **Modified legislation and rules:** entities operating an FMI in the DSS will be subject to temporarily modified legislation that removes barriers to the performance of notary, trading, settlement and maintenance in relation to digital securities, while maintaining the principle of "same risk, same regulatory outcome".
2. **A range of digital securities in scope:** HM Treasury intends for a range of securities, both systemic and non-systemic, to be in scope. At a minimum we expect this to include a subset of "financial instruments" as defined in the Regulated Activities Order (RAO) and include digital bonds and equities, as well as digital versions of assets such as money market instruments. We will consider other asset classes highlighted in responses.
3. **Regulator-set limits on participating entities:** entities operating an FMI in the DSS will be subject to limits, particularly on the amount of digital securities in scope. HM Treasury does not currently intend to set quantitative limits in legislation. Instead, the regulators will be empowered to set the capacity of the DSS (where deemed necessary for specific asset classes) in line with their objectives, and to allocate specific limits to participating entities. A key factor in determining limits, as well as increasing them, will be the extent to which regulatory requirements are being met and how well risks are being managed.
4. **Eligibility to participate:** We intend for both existing authorised firms and new entrants to apply to operate an FMI in the DSS. Firms applying would have to set out the regulatory barriers standing in the way of their proposed business model and use of technology.
5. **Proportionate regulation:** Entities operating an FMI in the DSS will be subject to risk-based supervision, undertaken by either the Bank or the FCA, or both, depending on the activities being performed. Requirements can be phased in depending on the risks posed by a particular entity, and the amount of activity it is undertaking.
6. **Interdependence with non-DSS activity:** Our intention is that activity in the DSS can be interdependent with activity outside. Digital securities in scope of the DSS can be utilised outside, and other non-Sandbox activities can be performed provided this is compatible with existing regulatory or legal frameworks (for example, we intend that DSS securities could be used for collateral posting or repos).
7. **Agile and efficient approach to permanently changing legislation:** Having assessed the operation of modified legislation/regulation in the DSS and reported to Parliament, HM Treasury can make permanent changes to legislation to facilitate digital assets via statutory instrument.
8. **Route for exiting and operating outside the DSS:** We intend that successful entities should be able to move to performing unrestricted activity outside the DSS, without any regulatory cliff-edges.

See Annex A for a summary diagram showing how the DSS process is intended to operate for participating firms.

Aims and regulatory outcomes

2.1 The DSS is a regulatory construct and not a technology system. It will allow participating entities operating an FMI that uses digital asset technology to have access to a modified regulatory framework that will enable them to test and scale their activities. It will also give the regulators ability to set requirements in a flexible way, evolving as the participating entity's experience and business model matures, and as appropriate risk management becomes embedded. The regulators will set limits on the amount of digital securities that can be utilised on FMIs in the DSS.

2.2 The DSS will operate on a 'same risk, same regulatory outcome' basis. This means that while modifications to legislation will be made for participating entities, those participating entities would need to adhere to the same regulatory principles as firms outside the DSS, and will be supervised by the regulators according to their objectives in order to meet the same regulatory outcomes. Where legislation is unchanged, participating entities will need to meet the same regulatory requirements as currently in place.

2.3 There are three general aims of the DSS:

1. **Testing how existing UK legislation needs to change to accommodate digital asset technology and the new practices associated with it.** This would be done through temporary legislative modifications made within DSS, which participating entities would be subject to. These changes would be assessed through discussion and analysis of outcomes between participants and regulators. The regulation may be subject to further modification during the period of the DSS depending on these assessments. HMT can then make permanent changes to UK legislation based on the outcome of testing.
2. **Enabling the financial sector to test and adopt digital asset technology in FMIs**. This would be done in a phased way, with activity initially restricted but increasing as entities progress through the DSS and regulation being applied which is proportionate to the risk.
3. **Testing the use of FMI sandboxes as a policymaking concept**. While the existing FCA Regulatory Sandbox has been up and running for several years, the DSS differs in that it is specifically targeted at FMIs, and will allow UK legislation to be modified and permanently changed. The DSS could be followed by further FMI sandboxes if this concept is successful.

2.4 The DSS can be used where the proposed design of a digital FMI is not compatible with existing UK legislation. If a proposed FMI is able to use digital asset technology in a way that is compatible with existing legislation, then it would be expected to operate under existing legislation rather than through the DSS.

2.5 The Bank, PRA and FCA have gained additional secondary objectives under FSMA 2023. The PRA and FCA have been given a new

secondary objective to facilitate the international competitiveness of the UK economy and its growth in the medium to long term. The Bank of England, in its regulation of CCPs and CSDs, has also been given a new secondary objective to facilitate innovation in the provision of clearing and settlement services, with a view to improving their quality, efficiency and economy. These new secondary objectives and existing primary objectives will apply to the regulation of the DSS once the relevant legislation comes into force.

2.6 While key UK legislation will be temporarily modified for the purpose of the DSS, these changes will continue to be in line with the CPMI-IOSCO Principles on Financial Market Infrastructures (PFMIs), which will remain the international standard for all FMIs and their regulators. The PFMIs will continue to evolve under the auspices of the CPMI and will remain a key reference point for the duration of the DSS.[19]

Assets in scope

2.7 It is the government's intention that the asset classes in scope of the DSS will be digital representations (either tokenised or digitally native) of a subset of financial instruments that are defined in the Regulated Activities Order (RAO), referred to generally in this consultation as 'digital securities'. At minimum we expect this to include debt and equity instruments, and other assets such as money market instruments. We will also consider other financial instruments in scope of the RAO after further analysis and feedback from the consultation, for example tokenised units in funds (e.g. UCITS).

2.8 The government does not intend to limit the DSS to non-systemic and less liquid securities. It will also consider instruments that could be systemic and have higher levels of liquidity. Where necessary, regulators will have the ability to limit activity in order to meet their regulatory objectives – this approach is outlined in more detail in a later section.

2.9 However, the DSS is expected to **exclude** the following asset types:

- **Unbacked cryptoassets**– while this asset type (which includes exchange tokens) is closely interlinked with the advancement of novel technologies such as DLT, the regulatory landscape, both in the UK and as a globally coordinated response, is still evolving. Until there is more certainty in these frameworks, we are intending to utilise existing regulatory initiatives to develop policy and regulation for this asset class.
- **Derivatives** – the focus of the DSS is on the regulation of activities (including settlement) directly relating to securities. The government does not intend to modify the legislative framework for derivative transactions in the underlying assets, nor phase in any requirements in this area, as part of the DSS. However, we are

[19] https://www.bis.org/cpmi/publ/d101a.pdf

considering whether it is possible to utilise assets issued via DSS FMIs as the basis for derivatives outside the DSS (provided this is consistent with existing legal frameworks, particularly UK EMIR).

2.10 We welcome feedback on the approach above, and on specific use cases that respondents feel should be in scope. The regulators will set out their detailed approach to digital securities in the DSS and activities after the conclusion of this consultation.

Box 2.A Questions for respondents

1. Do you agree with the broad approach set out above to digital securities in scope of the DSS? Please outline any comments or concerns as part of your answer.
2. What specific kinds of digital securities/asset classes should be considered for inclusion in the DSS?
3. Do you have any novel use cases or use cases for non-systemic asset classes that you wish to discuss with regulators? Have you identified any regulatory adjustments required to support these use cases?

Activities, designations and authorisations

2.11 The government intends that the following activities will be able to be performed in the DSS under modified legislation:

- Notary - the initial recording of a security in a securities settlement system.
- Settlement - the operation of a securities settlement system.
- Maintenance - providing and maintaining securities accounts at the top tier level.
- Operating a trading venue - in particular a multilateral trading facility ('MTF') or organised trading facility ('OTF').

2.12 **The DSS will allow participants to, subject to the appropriate existing and modified legislation/regulation, undertake both primary issuance and secondary trading of digital securities that are in scope.**

2.13 The regulatory frameworks for these activities were cited by the financial services sector, in response to the previous call for evidence on use of DLT in financial markets, as most in need of modification in order to facilitate the use of digital assets. This was particularly the case for the first three activities, which together are the activities currently performed by Central Securities Depositories (CSDs), and therefore subject to legislation such as the UK Central Securities Depositories Regulation (CSDR).

2.14 Where legislation is not modified in the DSS, firms will be required to comply with existing legislation.

2.15 **The ability to perform these activities live in the DSS will depend on the designations and authorisations an entity seeks (and receives) as part of its application:**

1. **Designation as a Sandbox Entrant:** On entry into the DSS, the entity intending to operate an FMI will become designated as a Sandbox Entrant. This gives it access to the temporarily modified legislation set out in the statutory instrument enacting the DSS. The Sandbox Entrant will then engage in extensive dialogue with the regulators and initial testing of systems, ahead of gaining further designations as a Digital Securities Depository (see below) and/or authorisation as an MTF/OTF (if not already authorised).

   Sandbox Entrants will need to demonstrate that they meet all the rules/conditions that regulators require ahead of live activity taking place (and ensure that any live activity will be carried out in a way that safeguards the regulators ability to meet their objectives, particularly in relation to financial stability). We do not intend to set any minimum time spent in this stage, meaning progression to live transactions could be quick, though this will depend on the ability of the Sandbox Entrant to demonstrate to regulators their readiness to move to undertaking live transactions.

2. **Designation as a Digital Securities Depository:** To perform one, or a combination, of the activities of a CSD (notary, settlement, maintenance) in the DSS, a designated Sandbox Entrant would also require further designation as a 'Digital Securities Depository', or 'DSD'. An entity designated as a DSD would be subject to a temporarily modified legislative and regulatory framework, with requirements set that are proportionate to its risks. In addition, it would be subject to the remaining unmodified CSD legislation (a summary of HM Treasury's broad approach to modifications is provided below). The Bank will provide guidance following the closing of this consultation on their approach to DSD requirements. Full authorisation as either a CSD, DSD or a new category of entity would take place when an entity leaves the DSS (the terminology will depend on how HM Treasury permanently modifies the existing CSD legislative framework outside the DSS after activity has taken place).

3. **Authorisation as an investment firm operating an MTF or OTF:** For operating a trading venue, an entity can either use its pre-existing authorisation or exemption as a Recognised Investment Exchange (RIE), or apply as part of its DSS application to become authorised as an investment firm operating an MTF/OTF under Part 4A of FSMA. We are not currently intending to create a new category of trading venue for the DSS, given that the framework for MTFs/OTFs (particularly UK MiFIR) does not itself appear to

need much amendment to accommodate digital securities. As such, we intend to keep the existing MTF/OTF terminology, and utilise existing authorisation processes. The existing MTF/OTF process is flexible, and includes being able to impose requirements and vary permissions depending on how effectively requirements are being met, creating a similar flexibility as set out for DSDs in the DSS. Any temporary legislative modifications made in relation to the framework for MTFs/OTFs as part of the DSS will be triggered and applied to an MTF/OTF if it is designated as a Sandbox Entrant.

2.16 **It will be possible in the DSS to obtain all three designations/authorisations, and combine the roles of CSD and MTF in one FMI.**

2.17 Ultimately, an entity in the DSS could potentially perform different combinations of the above activities. For example, an entity could choose to only undertake notary, settlement and maintenance, which are the activities of existing CSDs. Alternatively, it could choose to undertake notary, settlement, maintenance *and* operate a trading venue, combining the activities of a CSD with that of a trading venue. An entity could also choose to operate an MTF/OTF in the DSS without undertaking any CSD activities, though given we have found limited need to modify the legislative frameworks for MTFs/OTFs, there may not be much value in using the DSS for this purpose.

2.18 Although some functions may be distributed differently across FMIs in the DSS when compared to more traditional models, the entity operating the FMI in the DSS will carry the regulatory responsibilities for any permissions it is granted as a DSD or MTF/OTF operator.

2.19 Annex A sets out the process for progressing through the DSS, including the points at which the above designations and authorisations will be obtained.

2.20 **The conditions under which DSS activities will take place will be set out via the Sandbox Approval Notice (SAN) issued to each Sandbox Entrant.** The SAN will act as a 'visa' detailing the permitted activities being performed and the restrictions in place, including what limits have been allocated to that entity (see below for a section on limits). The SAN will be updated as an FMI progresses through the DSS, with the limits allocated to that FMI amended as it meets the appropriate regulatory requirements.

2.21 Entities in the DSS will be expected to provide all necessary information to the regulators and have systems in place to assist the regulators in their supervision. The SAN may be amended following regulators' reviews to reflect this. Restrictions and/or conditions are likely to be reduced as progress is made against rules and requirements and supervisors are confident that risks are being managed appropriately. On the other hand, entities consistently failing to meet regulatory requirements may have additional restrictions added and be given time to remedy concerns. If the issues are not remediated, regulators may ultimately revoke the SAN entirely, meaning that entity

is no longer approved to do DSS activities and if necessary will be required to invoke its wind-down plan.

Box 2.B Questions for respondents

4. Do you agree with the broad approach to activities, designations and authorisations in the DSS as outlined above? Please explain your answer.
5. Do you have any comments or concerns with the process outlined in Annex A?

Non-DSS activities

2.22 To enable the entire lifecycle of a DSS asset to remain as similar as possible to assets outside the DSS, and to maintain market function, our intention is that 'non-DSS activities' will also be permitted in relation to DSS entities and assets. Some of these activities could be carried out directly by DSS participants themselves, subject to the relevant regulatory approvals. For example, any primary market activity required for models involving digitally native assets would need to meet all appliable rules (e.g. in the listings and prospectus regimes).

2.23 However, entities in the DSS may be prevented from directly carrying out some activities with DSS assets, for example under UK EMIR the services and activities which a Central Counterparty (CCP) is authorised to provide or perform are limited to activities linked to clearing.

2.24 **For 'non-DSS activities', the main principle that we intend for entities participating in the DSS to follow is that any activity will be permissible provided it is performed according to existing regulatory or industry frameworks, unless it is explicitly prohibited within the DSS, and provided appropriate regulatory notification procedures are in place.**

2.25 Examples of non-DSS activities being performed in relation to DSS assets (where existing legislation would apply, or may be subject to existing market frameworks) could include (*but is not necessarily limited to*):

- Custody
- Primary market activity
- Transfer
- Payments
- Repurchase and reverse repurchase agreements ('Repo')
- Lifecycle management (for example, corporate actions)
- Securities financing and lending arrangements

- Clearing of transactions relating to sandbox assets
- Use of assets as collateral

2.26 Note that some of these activities are required to be performed separately according to existing regulation. Unless legislation has been explicitly modified, then requirements relating to segregation of activities would continue to apply in relation to relevant activities and assets.

2.27 Given the parts of the legislative framework not being amended will remain in force, including for those participating in the DSS, the effect of FSMA and RAO would mean only authorised firms with Part 4A permissions under FSMA, or exempt persons, would be able to do regulated non-Sandbox activities.

Box 2.C Question for respondents

6. Do you agree with the approach to non-DSS activities outlined above? Please explain your answer.

Limits on DSS assets and activity

2.28 The DSS is intended to facilitate the testing of new technology in a controlled manner against a temporarily modified legislative and regulatory framework. Therefore, limits will be in place to ensure that operating a trading venue, or performing notary, settlement and maintenance functions in relation to digital securities, is consistent with regulatory objectives, particularly in relation to financial stability. As noted above, the SAN issued to each entity will be updated as it progresses, with the limits allocated being amended as it meets the appropriate regulatory requirements.

2.29 HM Treasury does not intend to legislate for quantitative limits on specific asset classes in the scope of the DSS. Instead, HMT intends to grant the regulators the ability to limit the amount of assets in scope of the Sandbox in a way that is consistent with their objectives. The Bank will set:

1. The overall 'capacity' for particular asset classes within the DSS, where this is necessary.
2. Limits for each individual entity participating in the DSS.

2.30 Capacity and individual limits will be set in a way that is consistent with regulatory objectives. This approach is intended to be flexible, with different capacity ranges set for different asset classes that are in scope of the Sandbox.

2.31 When setting the capacity ranges, the Bank will consider the potential impact to financial stability based on a number of risk factors. Capacity and limits may be based on the amount of activity in that asset class, or on the face value of the assets in the DSS, either through

native issuance or tokenisation of an immobilised asset. It is likely that regulatory capacity and limits will be set in sterling, as the majority of settlement at UK-regulated CSDs is in GBP-denominated securities.

2.32 The regulators intend to allocate limits to individual FMIs in the DSS in accordance with the following principles:

1. That limits are apportioned in a fair way, ensuring that certain FMIs are not disproportionately allocated overall capacity.
2. Some capacity will be retained for later entrants to the Sandbox, to ensure that this is not used up by earlier entrants.
3. The limits allocated to entities in the DSS will be reviewed as they progress, evolving as the entity's experience and business model matures, and entities are able to meet more stringent requirements and risk management standards, via amendments to the SAN.
4. Operate on the basis that limits should be calibrated based on the performance of particular entities, and that entities which are able to effectively meet requirements should not be held up by other entities that are unable.

2.33 Once a Sandbox Entrant is designated as a DSD and/or authorised as an MTF or OTF, it will enter a scaling phase, whereby greater limits can be allocated depending on how effectively risks are being managed and regulatory requirements are being met. When an entity is able to meet the requirements that would be necessary to operate in an unrestricted way outside the DSS, it will enter a 'completion' phase, ahead of moving outside into what may be a permanently amended legislative/regulatory regime. The process will be slightly different for DSDs than MTFs/OTFs- this is explained further below.

2.34 The Bank, working with the FCA, will set out its approach to limits and allocating capacity in the DSS in due course.

Box 2.D Questions for respondents

7. Do you agree with the broad approach to capacity and limits in the DSS described above? Please explain your answer.
8. What size of activity does an FMI in the DSS need to reach in order to be commercially viable? Please note if there is any sensitivity in sharing information here.

Eligibility to participate in the DSS

2.35 Firms should only apply to the DSS if there are clear regulatory barriers standing in the way of their proposed business model. If they are able to perform activities in line with legislation and regulation as it

currently stands, they should apply for authorisation under existing regulatory frameworks.

2.36 The eligibility criteria for the DSS is intended to be broad. We anticipate that applications will be accepted from both existing firms (incumbents) as well as new market entrants. We do not anticipate the scale of entities at the application stage being an important factor preventing them from applying to participate (in other words, participation is not limited to large firms). We will, however, only accept applications from entities established in the UK.

2.37 Applicants will need to have a legal entity at the point of application– this can be a new legal entity created specifically for the DSS or an existing legal entity. Applicants may have existing permissions to undertake DSS activities and/or non-DSS activities such as the provision of banking services. Applicants will be required to demarcate clearly their DSS activity from activities for which they have existing permissions. This could be done by creating a separate legal entity for the DSS. Alternatively, applicants will be required to demonstrate clearly how they will maintain the separation between DSS activities and activities for which they have existing permissions.

2.38 We are also considering whether it would be possible to accept applications from groups of entities that, together, make up a trading and/or CSD arrangement. Given the potential legal and governance complexities with such an arrangement, such decisions are likely to be made on a case-by-case basis and will need to evidence robust governance standards that meet regulatory requirements. In such cases, a lead entity may need to be designated as a central point of contact that would manage the application process, and if the application is accepted, be responsible for liaising with the regulators on an ongoing basis.

Box 2.E Questions for respondents

9. Do respondents agree with the approach to eligibility outlined above? Please explain your answer.
10. Will participating entities be comfortable demarcating Sandbox from non-Sandbox business?

Applying to participate in the DSS

2.39 The Bank and FCA will set out in detail the application forms, as well as the process for accepting applications in advance of the DSS opening. Together they will consider and assess completed applications that fall under their respective regulatory remits. Both the Bank and FCA will coordinate to avoid duplicative processes as far as possible for those applicants intending to perform the activities of both CSD and MTF/OTF, and to understand any interdependencies.

2.40 The application forms may vary depending on the relevant activities, but are likely to request information such as:

2.41 Scope

- The core activities that the applicant is looking to undertake and any existing authorisations for related activities
- Any ancillary activities that the applicant wishes to undertake in order to support their core activities
- The assets for the purposes of the proposed activities
- The types of users that are expected to participate in the proposed activities and information about arrangements in case of participants' default

2.42 Regulatory barriers

- Regulatory barriers that in the applicant's view prevent them from undertaking their activities outside of the DSS
- Temporary modifications sought by the applicant to regulatory requirements in order to participate in the DSS, the required duration of such modifications and plans for full compliance with regulation over the course of participation in the DSS

2.43 Preparedness

- Evidence of financial resources sufficient to perform the proposed activities
- The business plan, including proposed timelines, showing the projected growth of the business – both in terms of the volumes and values of assets, the technology development as well as the business more broadly – over the course of participation in the DSS

2.44 Organisation

- Basic information such as company name, address, directors, and current regulatory status.
- The governance arrangements for sandbox activities, including shareholders (if relevant), key staff (and their backgrounds), any overlaps with governance arrangements for activity outside of the DSS and how these will be managed and demarcated where appropriate
- Any key elements of the business that will be outsourced, including details of third-party providers
- Any proposed links to other financial market infrastructures and/or credit institutions in order to support DSS activity

2.45 Other information

- An outline of the technology that the applicant proposes to use, the differences between this technology and existing technology used to undertake the proposed activities. Details of if/how the new technology will interoperate with existing technology used to perform proposed activities.
- The proposed means of settling transactions for proposed activities, whether authorisations to undertake such settlement already exist, whether these authorisations sit with a partner entity or whether the applicant intends to apply separately for such authorisations
- The proposed arrangements for winding down sandbox activities, including transitioning assets out of DSS if required
- Other information that regulators will require in support of the application, which will be set out ahead of the DSS application opening. Regulators will also have flexibility to request additional information from the applicant over the duration of the application process.
- The arrangements for the payments leg on the FMI in the DSS, and what settlement asset will be used.

2.46 Regulators will in due course set out guidance around the application process, including on the application forms, when the DSS will be open to applications, how long application windows will be open for and how long the application process will be expected to take.

Box 2.F Questions for respondents

11. Do you agree with the approach to applications outlined above? Please explain in detail any issues or concerns.
12. Do you have a preference on the timeframes within which applications can be made?

Legislative modifications

2.47 The main benefits of participating in the DSS is the ability of firms to be subject to 1) a temporarily modified legislative and regulatory framework that accommodates digital assets, and 2) flexible management of legislative/regulatory requirements, which can be phased in or potentially disapplied for participating entities, given the controlled environment of the DSS.

2.48 FSMA 2023 provides HMT with the power to create FMI sandboxes that temporarily modify and disapply legislation to remove

existing regulatory barriers and to provide regulatory flexibility. The legislation in scope of the DSS will be:

- Financial Services and Markets Act 2000 (FSMA)
- Companies Act 2006
- Financial Markets Insolvency (Settlement Finality) Regulations 1999 (SFRs)
- Uncertificated Securities Regulations 2001 (USRs)
- Financial Collateral Arrangements (No 2) Regulations 2003 (FCARs)
- UK Central Securities Depositories Regulation 2014 (CSDR)
- UK Markets in Financial Instruments Regulation 2014 (MiFIR)
- UK Commission Delegated Regulation 2017/565 (MiFID Org Regulation)

2.49 Note that the government also has the ability to bring further pieces of legislation into scope of the sandbox through the powers in FSMA 2023.

2.50 The approach taken to modifying and disapplying provisions in legislation as part of the DSS will vary. Where legislation is not modified/disapplied, existing provisions will be retained as drafted and will automatically apply. For provisions that need to be modified we are intending to take the following approaches:

1. Some provisions will be modified upfront to remove known regulatory barriers to innovation.
2. Some provisions will be converted into regulator rules. This will allow regulators to revise rules as they learn from the DSS *en route* to making final changes to legislation. Rules could be applied to entities in the DSS in a more proportionate way.
3. Exemptions from some regulator rules may also be offered on a case-by-case basis reflecting individual business models and risks

2.51 **We expect that the focus of most legislative and regulatory modifications will be in relation to CSD activities (notary, settlement, maintenance), rather than operating a trading venue.**

2.52 For regulatory rulemaking in the DSS, we intend to create a rulemaking process that is more flexible for regulators and firms than the existing rulemaking process under FSMA outside the DSS. This could include being able to apply rules in different ways for different types of entity, or as noted above to enable the regulators to more easily provide exemptions from the rules. Existing requirements around consultation when making rules may also be altered within the DSS to enable a more flexible process, though the regulators will be expected

to remain transparent around the way they make rules in the DSS. Any rules made by regulators will be in line with their objectives.

2.53 This will not impact the rulemaking process and any existing rulebooks outside the DSS (though as with legislation, in future these could be modified based on the outcome of activity in the DSS). In order to leave the DSS, a participating entity will need to show it complies with all regulator rules and legislation and seek full authorisation as necessary.

2.54 FSMA 2023 repeals retained EU law relating to financial services in order to deliver a Smarter Regulatory Framework tailored to the UK. HM Treasury will consider how best to repeal the relevant EU law provisions identified below at the appropriate point in a way that does not disrupt the operation of the DSS.

2.55 The rest of this section broadly sets out the regulatory barriers across specific pieces of legislation that could be modified for the purpose of the DSS. The specific approach to dealing with any modifications to legislation (and the precise use of the three methods identified above) will be set out after the consultation has closed:

UK Central Securities Depositories Regulation 2014 (CSDR):

2.56 The approach in the DSS will be to enable participating entities to obtain designation as a DSD to do CSD activities, to enable securities issued via a DSD to be admitted to regulated trading venues, and to ensure the requirements the DSD has to meet are consistent with the new technology it is utilising. It should also enable use of tokenised forms of payments, which can be in commercial bank money form (see below).

2.57 CSDR sets out the requirements regarding the organisation and conduct of CSDs, and generally for the settlement of financial instruments. Parts of CSDR do not clearly accommodate the use of digital assets for settlement, new business models which may include the combination of settlement with operating a trading venue within a single entity, or the unbundling of activities involved in securities settlement.

2.58 We have identified the following regulatory barriers in CSDR:

- Definitions (Article 2): some of the definitions and concepts set out do not accommodate digital asset technology/DLT, particularly use of tokenised cash and securities, and digital wallets.
- Book entry (Articles 3-4): requirements to record transactions on book-entry systems do not accommodate DLT.
- Effect of authorisation (Article 18): prevents hybrid business models that combine CSD/MTF activities.

- Integrity of issue (Articles 36-37): reconciliation requirements only reflect existing technology and do not account for a single shared record of issuance and transfers of a digitally native security on a DLT-based system

- Requirement for designation of a securities settlement system under the SFRs (Article 39): full designation may not be appropriate for the DSS.

- Cash settlement (Article 40): tokenised forms of payment are not explicitly accommodated.

- Freedom to issue on a CSD and access between CSDs (Articles 49, 50-53): it may not be proportionate to maintain these rights for all stages of the Sandbox.

- Record-keeping and reporting: existing requirements across CSDR do not account for reporting and record-keeping on DLT, including via regulatory nodes.

2.59 The precise drafting approach to modifying provisions in CSDR will depend on the feedback to this consultation.

2.60 A number of other requirements in the CSDR may be challenging to meet for firms in the early stages of development. These should not, however, be confused with regulatory barriers preventing the use of DLT technology and/or new business models. In cases where requirements are challenging to meet, regulators will have the powers to modify and provide temporary exemptions from certain rules and requirements, depending on the scale of activity. These changes to requirements would be expected to be removed over the course of the DSS as participants scale-up their activity. This is broadly in line with the existing risk-based supervisory approaches taken by regulators.

2.61 HM Treasury will consider in due course the extent of the temporary modifications that will be made directly to the DSS CSDR in advance of opening in order to address the obvious regulatory barriers. Some of the modifications may be made by regulators using their rule-making powers.

Financial Markets Insolvency (Settlement Finality) Regulations 1999 (SFRs):

2.62 The purpose of the SFRs is to mitigate the potential systemic impact of a participant in a system becoming insolvent. This is achieved by 'designation' of the relevant system under the SFRs, which protects the designated system and its participants against the adverse operation of certain provisions of UK insolvency law. Article 18.2 of CSDR requires that securities settlement systems are operated only by authorised CSDs, and Article 39 CSDR requires that the securities settlement systems operated by authorised CSDs are designated under the SFRs (and that certain provisions for the moments of entry &

irrevocability of transfer orders are defined in accordance with the SFRs).

2.63 We are considering our approach to settlement finality designations in the DSS. One option is to facilitate 'temporary designation' under the SFRs, with proportionate requirements. An alternative approach is to offer an exemption from SFR requirements to entities while they are in the DSS. However, entities in the DSS will ultimately be required to obtain full designation under the SFRs in the usual way on exiting the Sandbox if they wish to operate a securities settlement system.

Uncertificated Securities Regulations 2001 (USRs):

2.64 The USRs enables title in a security to be evidenced without a certificate and for securities to be transferred without a written instrument. The regulations set out the procedure for recording and transferring the title of securities. Under the USRs, operating a 'relevant system' requires HM Treasury approval, as well as compliance with the regulations' operational and governance requirements.[20] The USRs also disapply certain formalities under the Law of Property Act 1925 that would otherwise apply to the disposition and assignment of property, and which would otherwise impede the transfer of property under these regulations.

2.65 In the DSS, we are considering disapplying the procedure requiring HMT approval, and allowing participating entities to operate a 'relevant system' as part of their designation as a DSD. Among other changes that may be required to the USRs, targeted modifications to the definitions of "Relevant systems", "Operators", "Instructions" and "Rules" may be required to accommodate DLT and non-traditional business models. Further issues identified include:

- Introduction: no explicit mention of entities using digital assets being classed as operators under the USRs.
- Purposes and basic definition (Regulation 2(1)): no provisions to enable the transfer of securities using distributed systems.
- Interpretation (Regulation 3): no explicit provisions for the use of digital assets.
- Rectification of register of securities (Regulation 25): does not reflect securities issued on distributed ledgers.

[20] Relevant system is defined in the USRs as 'a computer-based system, and procedures, which enable title to units of a security to be evidenced and transferred without a written instrument, and which facilitate supplementary and incidental matters' The Uncertificated Securities Regulations 2001 (legislation.gov.uk)

- Properly authenticated dematerialised instructions (Regulation 35): no provisions for different types of activity on a DLT system or for corrective measure that may be used on a DLT system.

Companies Act 2006:

2.66 The Companies Act is a key piece of legislation setting out company law in the UK. Some modifications may be necessary to enable digital securities to be notarised, traded, settled and maintained. We have identified the following potential issues:

- The section covering formalities of registers of members (Section 113) may need to be clarified to ensure that references to a "register" include digital or electronic form.

- Section 770, which covers instruments of transfer may need to be modified to ensure that any transfers via an FMI in the DSS can be regarded as consisting of a proper instrument of transfer.

- References to securities (particularly in Section 783) may need to be clarified to ensure they includes securities issued/traded/settled/maintained inside the DSS.

- The section relating to company records (Section 1134) may require modification to treat "kept by a company" as including those stored and maintained in digital or electronic form on a decentralised ledger within a DSS FMI.

- We are also considering whether to modify Section 755 to facilitate exemptions to the prohibition on public offers.

Financial Collateral Arrangements (No 2) Regulations 2003 (FCARs):

2.67 We are considering amendments to the FCARs to ensure that provisions operate DLT/digital assets context, particularly in relation to security arrangements constituted in a register or account-based system. This includes carefully considering the recommendations in respect of the FCARs made by the Law Commission in their report on Digital Assets (published 28 June 2023).[21]

UK Markets in Financial Instruments Regulation 2014 (MiFIR):

2.68 We have not identified many areas of MiFIR that may need to be directly modified to accommodate digital securities, though some alleviation from existing requirements may be necessary in the early stages of participation in the DSS (such as the requirement to provide open access). The main issue flagged by industry previously has been the ability of trading venues to perform notary, settlement and maintenance activities (i.e. the activities of a CSD). Our intention is that

[21] https://www.lawcom.gov.uk/new-recommendations-for-reform-and-development-of-the-law-on-digital-assets-to-secure-uks-position-as-global-crypto-hub/

a DSS entity would be able to undertake these activities through its designation as a DSD. Industry should consider what other changes made be needed, for instance to enable the primary issuance of digitally native assets on an MTF. MiFIR reporting requirements have previously been raised by industry as in need of consideration- this is covered further below.

Box 2.G Questions for respondents

13. Do you agree with the approach to legislative modifications and regulator rules outlined?
14. What other specific regulatory barriers have you identified to the use of digital securities within markets, either in relation to the legislation above or generally?
15. Are there any pieces of legislation in addition to the above that should be brought into scope of the DSS (either listed in the FSMA 2023 as "relevant enactments" or outside of this)?

Duration

2.69 **The current expectation is that the DSS will last up to five years, with the possibility of extension by HM Treasury.**

2.70 This will give all participating entities the chance to trial new technological approaches, using a framework of temporarily modified legislation, and ensure that applications do not have to be submitted right at the beginning of the DSS. Participating entities will not need to stay in the DSS for the full duration if they are able to demonstrate compliance with permanent regulations (existing or modified by HM Treasury in response to the DSS). For example, if a firm is fully compliant with a regulation in its temporarily modified form in the DSS, and this regulation is subsequently permanently amended and becomes general law, then that entity would be able to exit the DSS and operate without those restrictions.

2.71 Given that successful entities may be able to exit early, and HM Treasury can permanently amend legislation before the end of the DSS, the DSS itself can have a five-year duration. This is desirable to provide time (if needed) to implement the technology and to meet regulatory requirements necessary to enable the entity to progress outside, including through seeking full authorisation in the case of CSD activities. We do not intend to impose a limit on how long the DSS can be extended by.

Box 2.H Questions for respondents

16. How long are participating entities likely to need in the DSS?
17. Is five years an appropriate timeline? Should it be longer or shorter if not? (note that we anticipate entities exiting the DSS before the overall timeline expires)

Exiting the DSS

2.72 Participating entities will exit the DSS in one of two ways: 1) continuing to operate but under a permanently amended UK legislative framework or 2) by winding down their activities in the DSS.

2.73 Regarding exit route 1), once regulators have determined that an entity is meeting requirements that are sufficient for operating outside the DSS, the entity will arrive at a 'completion' stage. At this stage, it is ready to apply for unrestricted activity and where necessary seek full authorisation outside of the DSS.

2.74 HM Treasury (working with the regulators) will need to assess what permanent legislative amendments will be put in place, informed by the activity conducted in the DSS. We will need to ensure that any such amendments will continue to enable the regulators to meet their objectives. HM Treasury will report to Parliament on the activity that has taken place and the permanent amendments to legislation it intends to make, before laying a statutory instrument making the required changes. It is also possible that HMT could utilise powers gained under the Smarter Regulatory Framework to make other necessary legislative amendments.

2.75 HM Treasury will need to ensure that, if permanent legislative amendments are desirable, this amended regime will be in place before the end of the DSS, with no "legislative" gap for successful entities between the DSS ending and a new amended framework of legislation coming into effect beyond the DSS. It is possible that HM Treasury could make permanent changes via SI more than once for the DSS, so that entities that have reached their completion phase before others are not held back from progressing outside by other entities still in the scaling phase within.

2.76 We envision that the process for leaving the DSS would be slightly different for DSDs than MTFs/OTFs:

- For a DSD this would involve authorisation outside the DSS, either as a CSD (with the legislative framework having been permanently modified), DSD (if we set this up as a new category of FMI permanently in legislation), or as another, new category of FMI that HM Treasury can legislate for in response to activity in the DSS.

- MTFs/OTFs will have already obtained authorisation under Part 4A FSMA at the beginning of the DSS, though any restrictions placed on their activities within the DSS could be lifted at this point. These processes are outlined at Annex A.

2.77 Where an entity in the DSS is both an authorised MTF/OTF and designated as a DSD, these processes will need to be managed jointly to ensure that exit occurs in tandem.

2.78 On the DSD side, given that DSS participants will have been working closely with regulators on meeting requirements whilst inside, we expect any evidence and experience gained as part of the DSS process to be carried forward into the full authorisation process outside the DSS. Firms will not be required to re-start the authorisation process from scratch – any relevant evidence and materials provided as part of DSS activity will be used as part of the full authorisation process.

2.79 **Broadly, the Bank and FCA will endeavour to make the transition away from the DSS as smooth as possible, and to ensure that participation in the DSS will not be a bridge to nowhere.**

2.80 Entities that are not ready for full authorisation once the new permanent regime is in place or are waiting for full authorisation will remain in the DSS. In cases where insufficient progress towards full authorisation is being made and there is no realistic path to doing so, participants may have their permissions revoked and be required to wind-down their activity in the DSS in an orderly way. A wind down could also be triggered for other reasons, including through being commercially unviable, or failing to meet requirements set by the regulators.

2.81 As part of the application process, an entity seeking to participate in the DSS will need to set out an exit strategy in the event that it does not progress to full authorisation. This will need to evidence clearly how impacts on users of the FMI it operates would be mitigated, and how assets would transition to other FMIs or cease to exist (the approach will differ depending on the activity and assets: for example short term bonds may be easier to wind down than equities, given the former could simply be allowed to mature).

2.82 Note that the above is also subject to the wider work to be undertaken to implement the Smarter Regulatory Framework.

Box 2.I Question for respondents

18. Do you agree with the approaches to exiting the DSS outlined above?

Supervision and enforcement

2.83 The FCA will be the appropriate regulator for participating entities operating a trading venue, and the Bank will be the appropriate regulator for entities undertaking the activities of notary, settlement and maintenance. Participating entities will need to be open and transparent with the regulators to enable effective supervision of their activities and updates to their SAN. Arrangements for dual regulation of firms intending to be both designated as a DSD and operate a trading venue in the DSS will be set out by regulators in due course.

2.84 Regulators will be able to enforce the permissions and conditions set out in the SAN and will have the ability to modify, suspend or terminate permissions as appropriate. Participants consistently failing to meet regulatory standards may have additional restrictions added to their SAN and be given time to rectify concerns. If concerns are not rectified within a reasonable period, regulators may amend the SAN (along with DSD recognition and/or MTF authorisation) such that the entity can no longer conduct DSS activities and would be required to implement its wind-down plans, or in some circumstances to revoke the SAN entirely.

2.85 Other powers specific to the DSS will be conferred on regulators, such as the power to direct an entity to engage or cease engaging in a specified action, and to require participants to provide regulators with certain information or documentation.

2.86 The regulators will have access to all the existing enforcement powers they have at present in relation to CSDs, MTFs and OTFs, as well as investment firms, as part of the DSS. This includes the FCA and the Bank's powers under FSMA, including information gathering and investigation powers, powers of direction, powers to impose penalties, powers to issue censure and powers to apply for injunctions or impose restitution. The regulators' enforcement powers under FSMA are referable to the Tribunal. FSMA also allows firms to refer decisions that refuse, vary or revoke permission or recognition orders to the Tribunal. These protections are expected to be extended to DSS applicants and participating entities.

2.87 Participating entities will need to be fully open and transparent with supervisors around the technology being used in the DSS, and how it is performing. Some information may also need to be shared with the government to enable legislation to be changed in an informed way. The government may also need information to be able to effectively report to Parliament on the functioning of the DSS. We are considering what requests would be consistent with existing disclosure requirements, and expect that the details of specific entities and the FMIs they operate would either be anonymised or not made public.

Box 2.J Questions for respondents

19. Do you agree with the approach to supervision and enforcement outlined above? Please explain your answer.
20. Is there any information that will be sensitive to share with the government regarding the operation of a DSS FMI?

Digital cash/payment leg

2.88 An entity in the DSS that seeks to perform securities settlement will need a mechanism for settling the payment leg of each transaction. There are several options for money settlement, ranging from the continued use of traditional central bank payment rails – RTGS – to settle the cash leg of transactions, to the use of new DLT-based settlement assets. More innovative payment solutions that are directly compatible with digital asset ledgers could unlock increased functionality. To support innovation, the DSS will be flexible and pragmatic with regards to the payment leg.

2.89 International standards for financial market infrastructure (Principle 9 of the Principles for Financial Market Infrastructure) and CSDR Article 40 require that money settlements should be conducted in central bank money, "where practical and available".[22] This is because central bank money has no credit or liquidity risk. Where settlement in central bank money is not used, international standards require that an FMI should conduct its money settlements using a settlement asset that is regulated to mitigate the inherent credit and liquidity risks associated with private money.

2.90 **Given that currently in the UK there are no central bank money options available that would be directly compatible with FMIs using digital asset technology, there will be flexibility within the DSS to use alternative settlement assets. Initially, the regulators are expected to allow tokenised commercial bank deposits to be used for settlement.**

2.91 Over time, there may be new forms of privately-issued money that are neither central bank money nor commercial bank money, such as stablecoins. Any settlement asset that is used in the DSS must be authorised under a live regulatory regime, and must meet the standard required for FMI money settlement, as set out in the CPMI-IOSCO principles for FMIs.

22 Principles for Financial Market Infrastructures (bis.org)

2.92 New ways of settling the cash leg in central bank money may also become available during the lifetime of the DSS. This may include, for example:

- RTGS synchronisation functionality under the roadmap for RTGS beyond 2024. This would allow third party firms (synchronisation operators) to connect to RTGS and ensure conditional DvP settlement between RTGS and other ledgers, including those based on DLT.

- Omnibus account facilities, which would allow an operator of a payment system to fund their participants' balances with central bank money.

2.93 As the payment landscape evolves, regulators will continue to monitor new developments and associated risks. Where new forms of money become regulated outside of the DSS, regulators may permit these for use in the DSS if they are judged to meet the required standards for FMI money settlement.

Box 2.K Question for respondents

21. What features do industry require from a money settlement asset in the DSS and why?

Chapter 3
Further Policy Issues

Technology considerations

3.1 There are a range of different digital assets-based models and design choices which vary depending on the proposed use cases. At its core, digital asset technology, and in particular DLT, may make use of distributed data, decentralisation of control of the ledger, cryptography, and smart contracts (which facilitate increased automation, and new functionalities such as tokenisation). A public permissionless system may offer fully decentralised governance, whilst private permissioned systems more closely mirror the centralised approach of existing FMIs, which rely on a central actor responsible for ensuring systems operate smoothly, dealing with outages, ensuring regulatory requirements are met, setting the rules of that system, and engaging with the regulators. Between these two extremes there are a variety of different designs, such as consortium networks or public permissioned systems.

3.2 It is the expectation that entities participating in the DSS will be able to meet the required regulatory and legislative standards, and that these will ultimately be equal to that in general financial services law when the entity exits the DSS. The temporarily modified legislation under the DSS will be consistent with the existing Principles for Financial Market Infrastructure (PFMIs), and DLT based settlement systems will need to be able to demonstrate that they can be compliant with these standards.

3.3 It is unclear whether the use of public permissionless DLT could deliver the necessary level of assurance for activities that are integral to the stability of the financial system, including with regards to, for example, settlement finality, governance, anti-money laundering/know-your-customer requirements, or use of crypto-assets. In the absence of mitigations, it remains very uncertain whether use of public permissionless DLT solutions in the market today would be consistent with the PFMIs and other regulatory obligations.

3.4 We welcome views from industry on possible mitigations that might enable a public permissionless system to meet the necessary level of assurance, namely equal to that in traditional finance. Further, we would welcome views from industry on the types of DLT that firms might use, and the trade-offs associated with different models of this technology.

Box 3.A Questions for respondents

22. What type of DLT system are you planning to use (permissioned or permissionless), and what trade-offs have you considered in your decision?

23. How can settlement systems based on permissionless DLT be designed in a manner that would meet the PFMIs?

Prudential treatment of digital assets

3.5 The Basel Committee for Banking Supervision (BCBS) in December 2022 set out standards regarding the prudential treatment of cryptoasset exposures.[23] Tokenised traditional assets, which meet in full a set of classification conditions (set out in the BCBS paper as Group 1a), would be subject to capital requirements based on the risk weights of underlying exposures as set out in the existing Basel Framework. The paper also covers leverage ratio, liquidity coverage ratio, and net stable funding ratio requirements in relation to cryptoasset exposures.

3.6 In 2023, the Prudential Regulation Authority (PRA) will start work on changes to their rules to implement these standards, and will be consulting on an implementation after Basel 3.1 rules have been finalised. Generally, supervisory authorities take a technology-neutral approach to regulation, but are also aware that risks may relate to the use of specific technologies, including where the underlying technological infrastructure poses additional risks. The BCBS approach to infrastructure risk is that any add-ons to capital requirements will initially be set at zero, and will only be increased by the authorities based on any observed weakness in the infrastructure used by those tokenised traditional assets.

3.7 This work is being taken forward by the PRA and is separate from the DSS.

Reporting

3.8 In future, digital asset technology could enable streamlined and automated regulatory reporting, with the regulators potentially able to receive transaction reporting directly from a distributed ledger, easing burdens and improving efficiency.

3.9 Key to the usefulness of regulatory reporting, however, is consistency and the ability for regulators to amalgamate data from different sources. Coupled with the costs and complexities of any changes to regulatory reporting regimes, we therefore do not currently propose to make any changes in the DSS in this area. This should not

[23] https://www.bis.org/bcbs/publ/d545.htm

prevent firms considering how the use of innovative technologies might help them to meet existing reporting requirements.

Box 3.B Questions for respondents

24. What benefits could entities using digital asset technology offer when meeting regulatory reporting requirements?
25. Are there any aspects of the existing regime that would prevent effective reporting in the context of digital securities?

Custody

3.10 DSS entities that hold and control client money or safeguard custody assets as part of their business will need to follow rules set out in the FCA's Client Assets Sourcebook (CASS), as well as other FCA rules that are relevant to custody (e.g., prudential, operational resilience, redress) set out in Article 40 of the RAO. Industry should flag where there are issues regarding rules functioning well in the context of new DLT-based business models that introduce features such as tokenised assets and omnibus wallets.

Box 3.C Questions for respondents

26. How do potential DSS entities intend to carry out custody functions in relation to activities in the DSS?
27. Are there any changes to the existing custody regulatory framework (including FCA rules, Article 40 of the RAO and CASS) that would facilitate the safe operation of these functions?

Retail users

3.11 We would expect that all existing consumer protections would be safeguarded within the Sandbox, including requirements relating to client protection, client categorisation, product governance and disclosure. We do not envisage any change to the circumstances in which retail clients are able to access trading venues.

Box 3.D Questions for respondents

28. If you envisage retail investors interacting with investments traded on DSS entities, how would this differ from more traditional models?
29. Do you see any UK rules or requirements as obstacles to this model?

Operational resilience and outsourcing

3.12 Entities participating in the DSS would be expected to comply with operational resilience and outsourcing rules and policies published by the regulators, alongside existing outsourcing and business continuity requirements in existing legislation. The aim of these policies is to ensure that financial infrastructure firms can absorb and adapt to shocks and disruptions, rather than contributing to them. Like other financial firms, DSS entities would be expected to have robust plans in place to deliver essential services, no matter what the cause of the disruption, as a condition of participating in the DSS. This includes man-made threats such as physical and cyber attacks, IT system outages, and third-party supplier failure.

Regulator fees

3.13 The regulators will consider their approach to fees in the DSS. Furthermore, as is currently the case with existing FMIs, ongoing fees commensurate to the resources necessary to supervise a specific participant in the DSS and the policy activity required to support this may also be imposed. The regulators will set out their approach to fees in due course.

Taxation

3.14 We expect that all relevant tax obligations that would ordinarily apply in relation to digital securities will continue to apply in the DSS. This means that for assets issued/traded/settled/maintained in the DSS, all relevant taxes such as Stamp Taxes on Shares (STS) should continue to be processed. For example, we would expect that STS would continue to be collected in relation to equities settled on an FMI in the DSS, as it would be collected for existing equities admitted to UK markets. Industry should flag if the application of existing tax procedures is likely to be problematic, where possible setting out possible remedies that might be put in place.

3.15 In the context of the cryptoassets work, it is worth noting that HMRC has extended the Investment Manager Exemption to include designated cryptoassets, and the government has recently published a

consultation document on the tax treatment of decentralised finance involving the lending and staking of crypto.

Box 3.E Questions for respondents

30. How would an entity operating an FMI in the DSS ensure that the tax obligations of its users are being fulfilled?
31. What issues could be created by the application of existing tax procedures to assets settled via FMIs in the DSS?

Cross-industry collaboration

3.16 Different entities may employ different technologies and practices, which may have various implications for policymaking across the sector. The ability of the wider market to understand what is happening in the DSS will be important, particularly to enable wider market coordination on the adoption of digital technology.

3.17 This is likely to include the building of common standards, which may be particularly important in the context of facilitating interoperability, given that without action the appearance of multiple FMIs using digital asset technology could fragment liquidity. Interoperability may be needed not only between new FMIs, but also between new FMIs and legacy systems. It seems likely that some form coordination will be needed to mitigate these issues.

3.18 The need to develop common approaches to collective issues may necessitate a high degree of transparency regarding the performance of FMIs set up in the DSS, not only to government and the regulators but also across the wider financial services sector.

3.19 We would appreciate views from industry on what information is likely to be sensitive, commercially or otherwise, and on the extent to which entities participating in the DSS would be prepared to share details of their operations and their progression inside the DSS (including detail of what requirements are being applied to them).

3.20 We are also considering whether an industry committee or working group should be formed to consider jointly the experience and outcomes of participating in the DSS and provide cross-industry recommendations. Members of such a body could include entities directly participating in the DSS, trade associations, law firms, academics, the regulators and HMT (and potentially other government departments). This body could also link in with other workstreams and working groups underway in the UK, such as the UK Jurisdiction Taskforce.

Box 3.F Questions for respondents

32. How should information regarding DSS activity be shared with the wider financial services sector?
33. What information will be sensitive for a DSS entity to share with others across the FS sector?
34. Would a cross-industry body, set up to scrutinise DSS activity and provide policy recommendations, be appropriate? If so, how should this be set up, and who should participate?

International coordination

3.21 The regulation of digital assets and technologies is a developing issue across multiple jurisdictions. Eventually the UK framework will need to be globally consistent and based on global standards to sufficiently mitigate risks and support the competitiveness of the UK. The UK works closely with other jurisdictions to use existing global frameworks to create compatible standards and facilitate cross border use of digital assets. This includes through standard setting boards such as the Bank for International Settlements (BIS) and its Committee for Payments and Market Infrastructures (CPMI), the International Organization of Securities Commissions (IOSCO), and the Financial Stability Board (FSB).

Box 3.G Question for respondents

35. What frictions might hinder the use of digital assets on a cross-border basis?

Chapter 4
Legal Considerations

English and Welsh law

4.1 The law of England and Wales consists of three parts:

1. **Judge-made law.** This is comprised of two forms:
    a. The common law, which derives its authority from the legal decisions of judges settling disputes. This is known as judicial precedent and provides that the decision of a superior court binds an inferior court (it may even bind another superior court).
    b. The interpretation of legislation when the meaning is either ambiguous or disputed
2. **Legislation enacted by Parliament.** In the event of a conflict between judge-made law and legislation enacted by Parliament, the latter prevails under the doctrine of Parliamentary sovereignty.
3. **International law.** The UK's international obligations include international conventions and treaties and included European Union law up until December 2020. European law in force up to that date formed part of UK domestic law, then becoming what is known as "retained EU law" created under an Act of Parliament. In the event of conflict between international law obligations and legislation enacted by Parliament, the latter, in principle prevails.

4.2 We recognise that property, including securities, is governed by a combination of legislation and judge-made law. The DSS seeks to remove legislative barriers when using digital asset technology to perform the activities of notary, operating a trading venue, settlement and maintenance. **HM Treasury is not intending to codify common law into statute using the DSS.**

4.3 DSS entities will need to consider both (i) how to comply with legislation enacted by Parliament (which will be temporarily modified for the purposes of the DSS) and (ii) the decisions of the court concerning DLT and the treatment of digital assets. The speed and extent to which decisions of the court can contribute to this area of law will depend upon the types of cases and whether they are referred to a superior court.

4.4 This results in judge-made law being made piecemeal and sometimes at a slower pace. It does, however, as explained by the UK

Jurisdiction Taskforce of LawtechUK (UKJT), provide for inherent flexibility, which allows the law to adapt and evolve to a changing environment, often without the need for legislative intervention. **The Law Commission, in its Final Report has recommended that most private law principles should be modified as appropriate by common law, as opposed to statutory means, given that the result will be more flexible, responsive to changing technologies and likely quicker.**[24]

4.5 In February 2023, the UKJT issued a legal statement concerning the issuance and transfer of digital securities on DLT-based systems under English and Welsh private law.[25] The UKJT legal analysis is confined to private law and not public law principles. It therefore did not address the wider legislative landscape that is within scope of the DSS, including the Financial Services and Markets Act 2000 and the Companies Act 2006.

4.6 **The statement concludes that English and Welsh law has inherent flexibility to recognise new digital asset classes, and that in most use-cases, digital securities (particularly those involving permissioned, centrally managed DLT-based systems) are consistent with English and Welsh private law, and unlikely to give rise to novel legal issues.** The statement also highlights a number of specific issues that would need to be addressed through the design and legal construct of digital securities. We welcome the efforts of the UKJT to provide a robust analysis of the treatment of digital assets under English law.

4.7 There has also been discussion about the legal status of smart contracts, such as whether contractual terms and conditions of DLT securities can be fully coded into the token. It does not seem necessary to provide further clarity on the enforceability of smart legal contracts beyond what has been addressed by the Law Commission, whose 2021 report found the current legal framework in England and Wales is clearly able to accommodate smart legal contracts.[26]

Box 4.A Questions for respondents

36. Following the conclusions of the UKJT statement, what further action (either public or private sector led) needs to be taken to provide clarity regarding use of digital securities, as well as digital assets more generally?

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[24] https://www.lawcom.gov.uk/project/digital-assets/

[25] https://lawtechuk.io/ukjt-digital-securities

[26] https://www.lawcom.gov.uk/project/smart-contracts/

Typology of digital securities

4.8 For the purposes of the DSS, we consider that digital securities will fall into two broad categories:

1. **Digitally native securities,** whereby securities that are being issued for the first time on DLT-based system do not reference an underlying asset immobilised in traditional infrastructure. This could include, for example, new corporate debt or equities issued directly onto a blockchain. The digital record would represent the top-tier register of ownership, therefore the entity with legal responsibility for managing the ledger would perform a function comparable to a CSD.

2. **Digital representations of traditional securities held at a CSD,** whereby the original issuance of the security is maintained at a CSD, with a digital representation (such as a token) created on behalf of the registered owner of that security. A token, for example, would confer ownership rights to that underlying asset and the ledger record would reflect the beneficial ownership of the asset. The underlying asset would need to be immobilised at the top tier to allow the digital representation to be traded, and we believe the security would be traded under the same identifier as the immobilised asset, given it is an identical representation. The Global Financial Markets Association (GFMA) refer to this as "true tokenisation" in their recent Report on the Impact of DLT in Global Capital Markets, and consider these 'true tokens' to qualify as specified investments.[27]

4.9 We would appreciate any views on whether the above categorisation is correct, particularly whether there are any assets that are not likely to fall into either of the two categories above.

Box 4.B Questions for respondents

37. Do you agree with the categories above?

38. Into which category will your proposed use-case sit?

Jurisdiction /choice of law

4.10 There may be uncertainty regarding the governing law of an FMI in the DSS if one or more nodes associated with the operation of a DLT-based system are located outside the UK. This may also create conflicts of law issues if certain nodes are operating from or deemed to be

[27] https://www.gfma.org/policies-resources/gfma-publishes-report-on-impact-of-dlt-in-global-capital-markets/

connected to a different jurisdiction. The position of HM Treasury is that each DSS FMI (or the nodes controlling that FMI) should be controlled and operated by a UK-based entity and should expressly commit to be being governed by English and Welsh law as a condition of joining the DSS. This would not rule out such an FMI having users based in foreign jurisdictions, but would dictate the choice of governing law. HM Treasury would also expect that each entity operating an FMI in the DSS expressly agree that the choice of jurisdiction for the purpose of arbitration or litigation be courts or arbitral bodies based in England and Wales.

Box 4.C Questions for respondents

39. What conflicts of law issues are likely to arise in the DSS? How should these be mitigated?

40. We intend that applicants to the DSS should be required to confirm English and Welsh law as the choice of law. Applicants should also agree that England and Wales will be the choice of jurisdiction in the event of a dispute. Do you agree? If you disagree, please explain why

Chapter 5

Expressions of Interest and Next Steps

5.1 It is important that conversations between regulators and potential applicants begin as early as possible to understand what is likely to be tested in the DSS.

5.2 We are therefore including this expression of interest chapter to enable respondents to highlight whether they are interested in utilising the DSS, and if so, what activities they intend to perform and what assets they would like to be in scope.

5.3 **Respondents are not obliged to complete this section. We acknowledge that proposals will take time to develop: if respondents wish to submit a response to this section after the expiry of the consultation deadline, they will still be welcome, but early responses will be more useful in guiding engagement.**

5.4 As with the wider responses to this consultation, the information provided in response to this chapter will be shared with the Bank and FCA. Respondents should indicate clearly where they are not content for information to passed on the to the regulators.

Box 5.A Questions for respondents

41. Are you, or a firm you represent, interested in applying to operate an FMI using digital asset technology as part of the DSS?
42. If so, what activities are you, or the firms you represent, interested in undertaking as part of the DSS, and what assets would be in scope?
43. What non-DSS activities (i.e. activities beyond notary, settlement, maintenance and operating a trading venue) are likely to be performed (with sandbox and/or non-sandbox assets)?
44. Do you have an indicative development timeline that you wish to share? How soon do you intend to apply?
45. Please include any further details you think relevant for informing HMT, the Bank of England and FCA about your use of the DSS.

Next steps

5.5 Please send responses to digitalsecuritiessandbox@hmtreasury.gov.uk.

5.6 Following the consultation, the government will respond in the normal manner. HMT intends to lay a statutory instrument before Parliament later this year, which will set up the legal framework for the Sandbox. In parallel, the Bank and FCA will publish further guidance, consult on rule changes, and set out the application process. The government will carefully consider responses, which will be important for informing policy development here.

Processing of personal data

5.7 This section sets out how we will use your personal data and explains your relevant rights under the UK General Data Protection Regulation (UK GDPR). For the purposes of the UK GDPR, HM Treasury is the data controller for any personal data you provide in response to this consultation.

Data subjects

The personal data we will collect relates to individuals responding to this consultation. These responses will come from a wide group of stakeholders with knowledge of a particular issue.

The personal data we collect

The personal data will be collected through email submissions and are likely to include respondents' names, email addresses, their job titles, and employers as well as their opinions.

How we will use the personal data

This personal data will only be processed for the purpose of obtaining opinions about government policies, proposals, or an issue of public interest.

Processing of this personal data is necessary to help us understand who has responded to this consultation and, in some cases, contact certain respondents to discuss their response.

HM Treasury will not include any personal data when publishing its response to this consultation.

Lawful basis for processing the personal data

The lawful basis we are relying on to process the personal data is Article 6(1)(e) of the UK GDPR; the processing is necessary for the performance of a task we are carrying out in the public interest. This task is consulting on the development of departmental policies or proposals to help us to develop good effective policies.

Who will have access to the personal data

The personal data will only be made available to those with a legitimate need to see it as part of consultation process.

We sometimes conduct consultations in partnership with other agencies and government departments and, when we do this, it will be apparent from the consultation itself. For these joint consultations, personal data received in responses will be shared with these partner organisations in order for them to also understand who responded to the consultation.

For this consultation, responses will by default be forwarded on to the Bank and the FCA, given they will be running and supervising firms in the DSS, and are working closely with HM Treasury on the design of the policy. Responses should clearly indicate where they do not wish for responses to be forwarded on to the Bank and FCA, or if they wish for their response to be anonymised.

As the personal data is stored on our IT infrastructure, it will be accessible to our IT service providers. They will only process this personal data for our purposes and in fulfilment with the contractual obligations they have with us.

How long we hold the personal data for

We will retain the personal data until the consultation process has been completed and the policy is implemented. After this, we will only retain personal data if it is embedded in a response, but we will not use it for any unrelated purposes.

Your data protection rights

You have the right to:

- request information about how we process your personal data and request a copy of it
- object to the processing of your personal data
- request that any inaccuracies in your personal data are rectified without delay
- request that your personal data are erased if there is no longer a justification for them to be processed
- complain to the Information Commissioner's Office if you are unhappy with the way in which we have processed your personal data

How to submit a data subject access request (DSAR)

To request access to your personal data that HM Treasury holds, contact:

The Information Rights Unit
HM Treasury
1 Horse Guards Road
London

SW1A 2HQ

dsar@hmtreasury.gov.uk

Complaints

If you have concerns about our use of your personal data, please contact the Treasury's Data Protection Officer (DPO) in the first instance at privacy@hmtreasury.gov.uk

5.8 If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner at casework@ico.org.uk or via this website: https://ico.org.uk/make-a-complaint.

Annex A Summary of DSS

Application Process

A firm applies to set up an FMI platform in the DSS, seeking the following:

1. *Designation as Sandbox Entrant (SE)*- signifies entry into the DSS, enables access to modified legislation, facilitates intensive dialogue with regulators and testing ahead of live activity.
2. *Designation as a Digital Securities Depository (DSD)*- enables a platform to perform the activities of notary, settlement and maintenance in a live environment with real assets under modified CSD legislation.
3. *Authorisation as an MTF/OTF*- enables platforms to operate a trading venue. Applicants use existing authorisation as an MTF/OTF, or apply for authorisation as an MTF/OTF as part of their application. The MTF/OTF will need to be designated as an SE to access any modified legislation.

Firms do not have to apply for all three (though they will need to apply to be an SE and at least one of the other two), for example a firm could apply to become an SE and DSD without operating an MTF/OTF within the DSS.

Application process is run jointly by Bank and FCA. Designations and authorisations listed above would be applied for at the same time. Information likely to be requested may include:

- Scope (core and ancillary activities, assets in scope of proposal, users of platform)
- Regulatory barriers (barriers preventing activity outside Sandbox, easements sought, plans for compliance)
- Preparedness (evidence of resources, business plans)
- Organisation (governance arrangements, details of outsourcing, proposed links to other entities to support sandbox activity)
- Other information (outline of technology, proposed means of settlement, arrangements for winding down sandbox activities)

The regulators will set out their approach to applications once the consultation has closed.

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Regulator process to assess applications

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Accepted and designated as SE, issued with Sandbox Approval Notice (SAN)

SAN sets out designations/authorisations, the requirements being met, asset limits allocated to the platform, and any other relevant information. This is a live document that will be continually updated by the regulators working jointly.

Without designation as a DSD or authorisation as an MTF/OTF, the SAN will contain relatively little detail, given the platform cannot yet perform live regulated activity.

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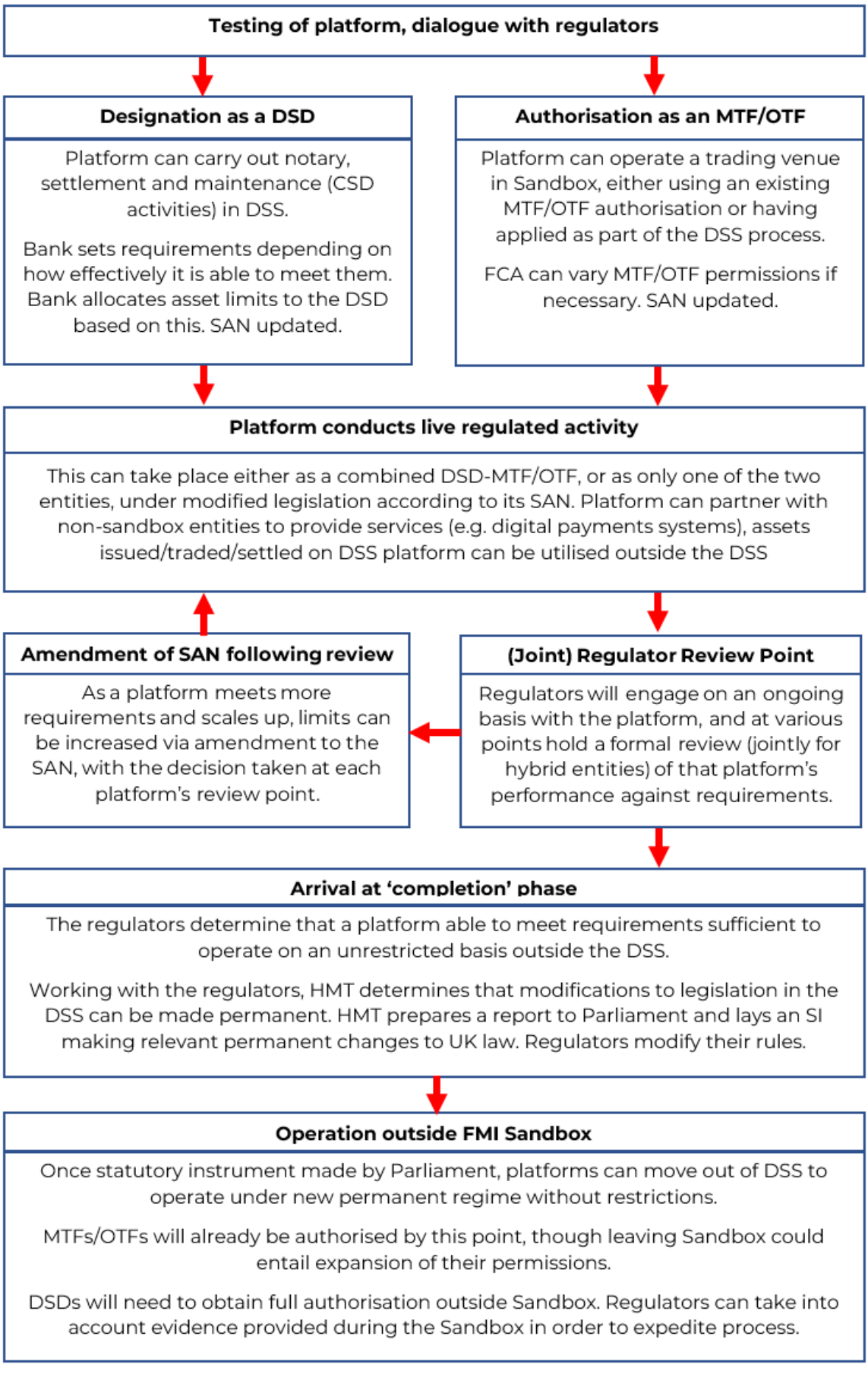
Testing of platform, dialogue with regulators
Designation as a DSD
Platform can carry out notary, settlement and maintenance (CSD activities) in DSS.
Bank sets requirements depending on how effectively it is able to meet them. Bank allocates asset limits to the DSD based on this. SAN updated.
Authorisation as an MTF/OTF
Platform can operate a trading venue in Sandbox, either using an existing MTF/OTF authorisation or having applied as part of the DSS process.
FCA can vary MTF/OTF permissions if necessary. SAN updated.
Platform conducts live regulated activity
This can take place either as a combined DSD-MTF/OTF, or as only one of the two entities, under modified legislation according to its SAN. Platform can partner with non-sandbox entities to provide services (e.g. digital payments systems), assets issued/traded/settled on DSS platform can be utilised outside the DSS
Amendment of SAN following review
As a platform meets more requirements and scales up, limits can be increased via amendment to the SAN, with the decision taken at each platform's review point.
(Joint) Regulator Review Point
Regulators will engage on an ongoing basis with the platform, and at various points hold a formal review (jointly for hybrid entities) of that platform's performance against requirements.
Arrival at 'completion' phase
The regulators determine that a platform able to meet requirements sufficient to operate on an unrestricted basis outside the DSS.
Working with the regulators, HMT determines that modifications to legislation in the DSS can be made permanent. HMT prepares a report to Parliament and lays an SI making relevant permanent changes to UK law. Regulators modify their rules.
Operation outside FMI Sandbox
Once statutory instrument made by Parliament, platforms can move out of DSS to operate under new permanent regime without restrictions.
MTFs/OTFs will already be authorised by this point, though leaving Sandbox could entail expansion of their permissions.
DSDs will need to obtain full authorisation outside Sandbox. Regulators can take into account evidence provided during the Sandbox in order to expedite process.

HM Treasury contacts

This document can be downloaded from www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk