Digital Securities Sandbox joint Bank of England and FCA consultation paper

This consultation paper sets out the Financial Conduct Authority and the Bank of England's ('the regulators') proposals to implement and operate the Digital Securities Sandbox.

Supporting innovation

We are enabling the application of new technology to the trading and settlement of securities.

Providing a glidepath

We are providing a glidepath to a potential new technology friendly regime.

Protecting financial stability and market integrity

The use of limits will facilitate safe scaling of business that mitigates risks to financial stability without undermining innovation.

Published on 03 April 2024

Bank of England

FCA FINANCIAL CONDUCT AUTHORITY

What is the Digital Securities Sandbox (DSS)?

The DSS is a regime that will allow firms to use developing technology, such as distributed ledger technology (DLT), in the issuance, trading and settlement of securities such as shares and bonds. Firms that successfully apply for the DSS will be able to operate under a set of rules and regulations that has been modified to facilitate this. The DSS lasts for five years and will help regulators design a permanent technology friendly regime for the securities market.

It will be possible for firms that successfully apply to the DSS to undertake the activities traditionally associated with central securities depositories, namely the issuance, maintenance and settlement of financial securities. It will also be possible to combine these activities with that of a trading venue, creating new business models.

The Bank of England (the Bank) and Financial Conduct Authority (FCA) will work together to operate the DSS. In doing so, the Bank and FCA will pursue three overarching aims:

1. Facilitating innovation to promote a safe, sustainable and efficient financial system.
2. Protecting financial stability.
3. Protecting market integrity and cleanliness.

The following financial instruments are examples of what could be issued and traded in the DSS:

- equities;
- corporate and government bonds;
- money market instruments such as commercial paper and certificates of deposits;
- units in collective investment undertakings (fund units); and
- emissions allowances.

The trading and settlement of derivative contracts and of 'unbacked cryptocurrencies' such as Bitcoin are not in the scope of the DSS.

The intention of the Bank and the FCA is that financial market participants, such as companies that use capital markets to raise finance, or participants in financial markets who trade securities, should be able to interact with the firms inside the DSS as normal while benefitting from the new technology.

Similarly, unless otherwise specified by the regulators, all financial market participants will be able to use the securities issued in the DSS as they normally would any other security, including in securities financing transactions, or as collateral. They can also write derivative contracts based on those securities. Those activities would still need to comply with the regulations that govern them.

In order to protect financial stability, the Bank will impose limits on the value of securities that can be issued in the DSS. This reflects the fact that the new technologies are untested in important financial markets at significant scale.

The DSS is composed of different stages of permitted activity, reflecting the Bank's approach to managing financial stability risks. There will be a series of gates for sandbox entrants to move through to progress from one stage to the next, with the amount of permitted activity increasing with each stage. This glidepath will enable firms eventually to graduate from the DSS to a possible new regime if they meet the relevant standards.

The DSS will allow regulators to determine how the existing regime for the issuance, trading and settlement of securities would need to be permanently amended to support the use of new technologies.

How might the DSS benefit the wider financial system?

The application of new technology such as distributed ledgers could materially improve the efficiency of 'post-trade' processes that take place after a trade is executed. By making these processes faster and cheaper, the adoption of these technologies could, if successfully implemented, lead to material savings across financial market participants, such as pension funds, investment firms and banks.

DSS Objectives

- Facilitate innovation
- Protect financial stability
- Protect market integrity

DSS timeline

November 2023	January 2024	April 2024	April-May 2024	Summer 2024	Autumn 2024+
HMT response to DSS consultation	DSS Regulations in effect	DSS consultation paper (CP) published	DSS Consultation Period	Joint Bank/FCA response to firms' CP feedback and DSS open to applications	First cohort of DSS applicants becoming sandbox entrants

What digital securities are in scope of the DSS?

In scope

- Transferable securities (eg, equities, soverign and corporate debt).
- Units in collective investment schemes (fund units).
- Money market instruments (eg, commercial paper and certificates of deposit).
- Emissions allowances.

Out of scope

- Derivative contract settlement (derivative contracts referring to DSS assets are permitted if settlement is outside the DSS).
- Unbacked cryptoassets (eg, Bitcoin and Ether).

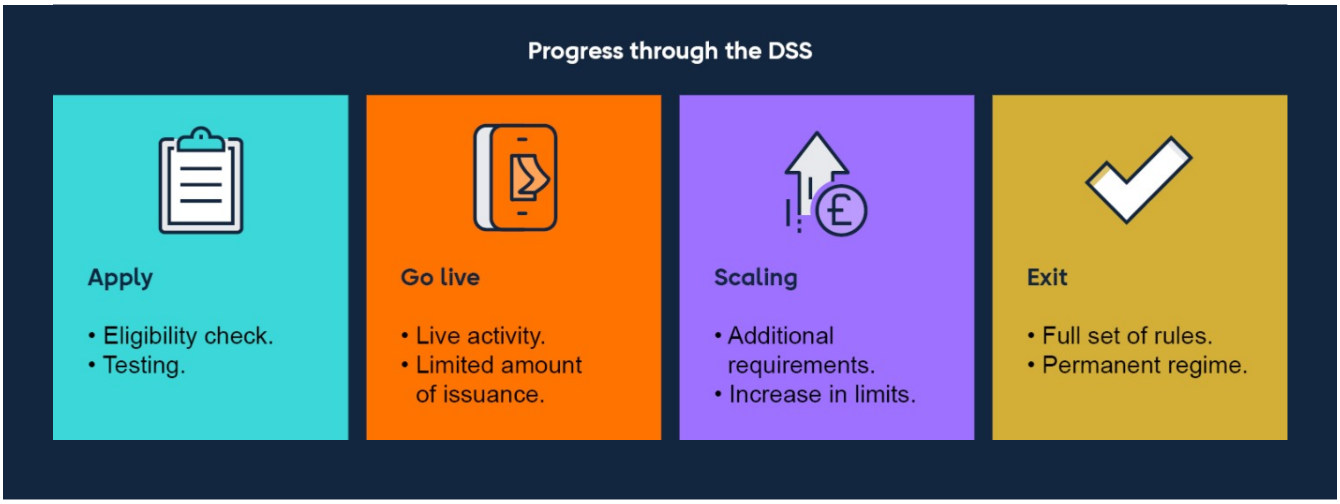
Eligibility criteria

A UK established entity.

Intending to undertake trading and/or notary, settlement and maintenance activities.

Proposing to issue, trade, settle or maintain in-scope assets.

Highlighting clear regulatory barriers or obstacles preventing the activity outside the DSS.



Why consult?

The Bank and FCA want to operate the DSS in a way that meets their overarching aims (above), while giving fair consideration to the impact of their policy on key stakeholders. As such, the regulators have produced a consultation document that includes:

1. An outline of the proposed approach to the operation of the DSS, including the Bank's rules and fee regime.
2. A draft guidance document for potential applicants.

The regulators welcome responses to the specific questions posed as part of the consultation documents as well as general feedback on the draft guidance document.

Who should engage with the consultation paper?

The primary audience for the publication is prospective providers of financial market infrastructure looking to apply to the DSS to operate a trading venue and/or settlement services using new technology such as DLT.

It may also be of interest to firms who wish to engage with those FMIs such as their prospective members or a firm seeking to offer custody services for the digital securities that are recorded, traded or settled in the DSS. Law firms and industry bodies acting on behalf of potential applicants will likely also find the publication of interest.

Timeline responses

The closing date for responses to the consultation paper is 29 May 2024. The eight-week consultation period reflects the fact that the DSS is not a permanent regime and that the DSS rules can be amended during its lifetime as firms and regulators learn about the application of new technology in practice.

Where to send responses

Please send responses to:

✉ **DSSCPResponses@bankofengland.co.uk** or ✉ **cp24-5@fca.org.uk**

Given that this is a joint consultation, please be aware that all responses received will be seen and considered by both the Bank of England and the FCA.

What are the next steps and when will the DSS be launched?

After a review period, the Bank and FCA will issue a formal response to the views submitted as part of the consultation process. Following this, the final guidance and rules will be published and the DSS will open for applications over the summer of 2024.

Content

Privacy statement

By responding to this consultation, you provide personal data to the Bank of England (the Bank) and the Financial Conduct Authority (FCA), jointly 'the regulators'. This may include your name, contact details (including, if provided, details of the organisation you work for), and opinions or details offered in the response itself.

The response will be assessed to inform our work as regulators and central bank, both in the public interest and in the exercise of our official authority. We may use your details to contact you to clarify any aspects of your response.

This is a joint consultation paper (CP) by the Bank and the FCA. Both regulators will therefore review the responses and may also contact you to clarify aspects of your response. The regulators will retain all responses for the period that is relevant to supporting ongoing regulatory policy developments and reviews. However, all personal data will be redacted from the responses within five years of receipt. To find out more about how the Bank deals with your personal data, your rights or to get in touch please visit **Privacy and the Bank of England**. Please see further information on how and why the FCA uses your personal data (**Privacy notice|FCA**).

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure to other parties in accordance with access to information regimes including under the Freedom of Information Act 2000 or data protection legislation, or as otherwise required by law or in discharge of the Bank, the Prudential Regulation Authority (PRA), or the FCA's functions.

Please indicate if you regard all, or some, of the information you provide as confidential. If the Bank receives a request for disclosure of this information, we will take your indication(s) into account but cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system on emails will not, of itself, be regarded as binding on the Bank. The FCA makes all responses to formal consultation available for public inspection unless the respondent requests otherwise. The FCA will not regard a standard confidentiality statement in an email message as a request for non-disclosure. Despite this, the FCA may be asked to disclose a confidential response under the Freedom of Information Act 2000. The FCA may consult respondents if it receives such a request. Any decision the FCA makes not to disclose the responses is reviewable by the Information Commissioner and the Information Rights Tribunal.

Responses are requested by 29 May 2024.

Please address any comments or enquiries by email to:

✉ **DSSCPResponses@bankofengland.co.uk** or ✉ **cp24-5@fca.org.uk**

Alternatively, please address any comments or enquiries to:

Post-Trade Innovation Policy Team
Bank of England
20 Moorgate
London EC2R 6DA

or

Market Conduct and Post-Trade Policy Team
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Consent to publication

The Bank and FCA publishes a list of respondents to its consultations, where respondents have consented to such publication.

When you respond to this CP, please tell us in your response if you agree to the publication of your name, or the name of the organisation you are responding on behalf of, in the Bank and FCA's feedback response to this consultation.

Please make it clear if you are responding as an individual or on behalf of an organisation.

Where your name comprises 'personal data' within the meaning of data protection law, please see the Bank and FCA's Privacy Notice above, about how your personal data will be processed.

Please note that you do not have to give your consent to the publication of your name. If you do not give consent to your name being published in the feedback response to this consultation, please make this clear in your response.

If you do not give consent, the Bank and FCA may still collect, record and store it in accordance with the information provided above.

You have the right to withdraw, amend or revoke your consent at any time. If you would like to do this, please contact the Bank using the contact details set out above.

1: Overview

This CP[1] sets out the proposals of the FCA and the Bank (together 'the regulators') to implement and operate the Digital Securities Sandbox (DSS). These proposals comprise the regulators' joint approach to:

1. The implementation and operation of the DSS.
2. The application process to enter the DSS.
3. The use of rule-making powers.
4. Approach to managing financial stability and market integrity risks in the DSS.
5. Supervision and enforcement.

These proposals also comprise the Bank's approach to:

1. Fees levied by the Bank.
2. Managing the limits on DSD activity within the DSS.

This CP follows His Majesty's Treasury's (HMT's) **response to its consultation on the DSS**, which was published in November 2023. In its response, HMT confirmed the scope of the DSS, which will allow for the use of developing technology, such as distributed ledger technology (DLT), in the undertaking of financial market infrastructure (FMI) activities, specifically those traditionally performed by a central securities depository (CSD) (notary, settlement and maintenance of securities) and the operation of a trading venue.[2] In acknowledgment that the current framework for the operation of a CSD was not designed with the use of developing technology in mind, a new category of firm was created for the purpose of the DSS. To perform one, or a combination, of the activities of a CSD in the DSS, a firm will apply to be a Digital Securities Depository (DSD).[3] HMT provided for this through the DSS Regulations by creating a temporarily modified legislative and regulatory framework (modified framework). Since the Bank supervises CSDs, while the FCA supervises the operation of trading venues, the DSS and sandbox entrants will be jointly overseen by both regulators.

This CP will affect, and should be read by, firms intending to apply to enter the DSS and be approved as a sandbox entrant. It will also be of interest to firms who wish to engage with a sandbox entrant but not become one themselves, such as the prospective members of a DSD in the DSS, or a firm seeking to offer custody services for the digital securities that are recorded, traded or settled on those FMIs.

There will be no obligation for firms to participate in the DSS. Firms wishing to undertake the activities of a CSD outside the DSS would need to comply with existing regulatory requirements.

However, if firms wish to operate an FMI under the modified framework, they will first need to apply to the regulators to become a sandbox entrant. Firms that do not require the modified framework to operate their business models should do so outside the DSS.

A draft guidance document is also included in Appendix A and should be read alongside this CP. This sets out how the DSS will operate and what firms looking to apply to the DSS can expect. **We welcome feedback on the contents of this guidance document, including areas where additional guidance is required.**

Question:

1. Do you have any comments on the draft Guidance on the Operation of the Digital Securities Sandbox (Appendix A)?

Responses and next steps

This consultation closes on 29 May 2024. The eight-week consultation period reflects the fact that the DSS rules do not represent a permanent regime and that the rules can be amended during the lifetime of the DSS as firms and regulators learn about the application of new technology in practice. This will allow regulators to support firms wishing to innovate by promptly updating rules and guidance. The regulators invite feedback on the proposals set out in this consultation. The regulators also invite stakeholders to bring to our attention any relevant issues that are not addressed in the proposals set out in this CP. Please address any comments or enquiries to ✉ **DSSCPResponses@bankofengland.co.uk** or ✉ **cp24-5@fca.org.uk**.

Please indicate in your response if you believe any of the proposals in this CP are likely to impact persons who share protected characteristics under the Equality Act 2010, and if so, please explain which groups and what the impact on such groups might be.

Table A below shows key terms used in the rest of this document. **A glossary is also included at the bottom of this webpage** for a full list of defined terms.

Table A: Key terms used in the CP

Term	Definition
Digital securities	The financial instruments in scope of the DSS are specified in Regulation 3(7) of the **DSS Regulations** and defined as 'FMI sandbox instruments'. For the purposes of this CP, such financial instruments are referred to as 'digital securities'.
Sandbox entrant	This 'catch all' term is used to refer to a firm which has been approved to enter the DSS, irrespective of that firm's business model or the stage they have reached in the DSS.
Digital Securities Depository (DSD)	This term is used to refer to a sandbox entrant which has been permitted to undertake the activities traditionally performed by a CSD, which results in it being a 'DSD'. References to a DSD include a firm which undertakes other regulated activity alongside its DSD operations, both inside and/or outside the DSS.
Hybrid entity	This term is used to refer to a sandbox entrant which combines the roles of a trading venue and the activities traditionally performed by a CSD into one FMI. Such a firm would be both a DSD and have authorisation to operate a trading venue. This business model is explained in further detail below.

Note: a reference to a DSD includes any firm in the DSS that has permission to undertake the activities of a CSD, whether as a standalone entity or one that also has permission to operate a trading venue as a hybrid entity.

2: Introduction

In the evolving landscape of global finance, the intersection of traditional financial systems with digital innovations presents both opportunities and new challenges. The use of new and innovative technologies in global finance can create a more efficient, competitive, and robust financial system that helps facilitate economic growth.

The adoption of new technologies has a long history of transforming financial markets in the UK. The transformation from paper-based exchanges to digital trading platforms revolutionised how securities are traded. Today, investors have a growing choice of trading venues, many of which employ innovative technology to streamline their services and therefore increase the efficiency and integrity of these markets.

Despite these advancements, the post-trade environment remains encumbered by sequential, often manual processes that are time-consuming, costly and operationally risky. The current system, while efficient in execution (ie, entering or agreeing a trade), can lead to a build-up of credit risk due to settlement periods, the involvement of multiple intermediaries and operationally cumbersome processes. These pose financial and operational challenges for financial market participants – including financial intermediaries such as banks and end-investors such as pension funds – and impose a cost to them in utilising these markets. The introduction of securities on distributed ledgers – digital securities – offers the potential to consolidate trade and post-trade functions and reduce settlement times. This could significantly reduce the number of intermediaries, streamline processes, and diminish systemic risks, thereby enhancing the overall resilience of financial markets.[4] Furthermore, the deployment of smart contracts on DLT introduces the possibility of new programmability and functionality in financial transactions, offering a more efficient, cost-effective, and transparent trading ecosystem.

These technologies need to be introduced in a way that protects the FMI that is at the heart of the financial system. Therefore, HMT, under the **Financial Services and Markets Act 2023 (FSMA 2023)**, has been given the power to make provision for FMI sandboxes via statutory instruments. FMI sandboxes allow firms to experiment with new or different practices and developing technology in the key functions of FMI in a safe regulatory environment under temporarily modified legislation.

Recognising the potential of digital securities, the DSS is the first of these sandboxes in the UK. It focuses on the use of developing technology, such as DLT, in the undertaking of financial market activities traditionally performed by a CSD (notary, settlement and maintenance of securities) and the operation of a trading venue. In facilitating the application of developing technology to these activities, the DSS will offer greater efficiencies in the trading and settlement of securities to users of these financial markets. However, recognising that some of these developing technologies could increase risks, the Government and regulators have decided to explore this in the DSS first.

The three primary aims of the DSS outlined by HMT in its consultation[5] in July 2023 were:

1. Testing how existing UK legislation needs to change to accommodate digital asset technology and the new practices associated with it.
2. Enabling the financial sector to test and adopt digital asset technology in FMIs.
3. Testing the use of FMI sandboxes as a policymaking concept.

Following its consultation response in November 2023, HMT laid the **Financial Services and Markets Act 2023 (Digital Securities Sandbox) Regulations 2023** (DSS Regulations), which commenced on 8 January 2024. The DSS Regulations created the temporary framework under which sandbox entrants will operate and through which the regulators will implement and operate the DSS. This includes giving the regulators the powers to:

- establish an application process;
- maintain arrangements for the joint supervision of the DSS by the regulators, which includes the oversight of sandbox entrants;
- make, modify and disapply rules for sandbox entrants;
- modify and disapply existing technical standards; and
- put in place limits on overall activity in the DSS.

The outcome we are seeking to achieve

In implementing and operating the DSS, the regulators have three overarching aims in line with their statutory objectives:

- **Facilitating innovation to promote a safe, sustainable and efficient financial system:** the DSS facilitates the use of developing technology, such as DLT, for firms undertaking the activities of a CSD and operating a trading venue by removing potential barriers and obstacles.
- **Protecting financial stability:** the use of developing technology, such as DLT, has the potential to change settlement by offering increased speed and efficiency, while potentially removing the need for intermediaries. However, it remains untested at scale in traditional FMIs and opportunities to test it in systemically important financial activities have often not been permitted. It is therefore important to use the DSS to explore if and how to mitigate the potential risks to financial stability arising from the use of developing technology and/or the modified framework under which firms will operate in the DSS.
- **Protecting market integrity and cleanliness:** UK wholesale markets benefit from a regime that ensures market integrity and cleanliness. While making the changes necessary to enable the adoption of developing technologies, such as DLT, the proposed approach continues to

provide for the integrity and cleanliness of our markets.

Some of the proposed key design features of the DSS to deliver on these aims are:

- The DSS should be proportionate and flexible to accommodate a variety of business models.
- In order to protect financial stability, the activities in the DSS normally undertaken by a CSD should be subject to limits.
- There should be a glidepath for sandbox entrants to move from operating within the DSS to operating outside of it under a possible new permanent regime, mitigating the risk of a regulatory cliff edge.
- Activity undertaken in the DSS will be 'live' and the financial system should be able to interact with sandbox entrants and digital securities in broadly the same way it does with conventional FMIs, subject to existing requirements where activities are not in the scope of the DSS.

While the DSS will allow for live activity in financial markets, it is by its nature an exploratory environment. As HMT stated in its consultation response, the Government has the tools to put in place permanent changes reasonably quickly. However, the specific nature of such changes is uncertain and will depend on the outcome of activity in the DSS.

The regulators and HMT will learn from the activity in the DSS and intend to create a new permanent regime which applies to the wider market. It is the shared intention of the regulators and HMT to design the DSS such that it is not a bridge to nowhere. However, there is no guarantee that individual sandbox entrants will emerge from the DSS with permission from regulators to operate outside of it. Permission to operate outside the DSS will only be granted to those applicants meeting the relevant standards. Persons that interact with sandbox entrants (for example to issue or trade securities on the FMIs they operate in the DSS) should take note of the above and consider the temporary nature of the DSS when engaging with a sandbox entrant.

The Bank is continuously developing wholesale payments. Alongside the new **omnibus accounts** available as part of the Banks' Real-Time Gross Settlement (RTGS) service, the Bank is exploring as part of its **future roadmap for RTGS** the possibility of using a synchronised settlement interface to allow RTGS to interoperate with other ledgers (such as digital securities ledgers in the DSS). Alongside the DSS, this places the UK in a strong position to create an end-to-end digital wholesale infrastructure that embraces new technology and deliver greater efficiencies to financial market participants.

3: Joint Approach to the Digital Securities Sandbox

The DSS is jointly overseen by both the Bank and the FCA. The approach to how the regulators will jointly operate and supervise the DSS will depend on the combination of activities that firms undertake in the DSS.

Potential models in the DSS

The DSS Regulations allow for three possible business models: (1) undertaking the activities of a CSD by being a DSD; (2) operating a trading venue; or (3) combining both into one FMI to create a hybrid entity.

Undertaking the activities of a CSD as a DSD (notary, maintenance and settlement).

HMT's consultation in July 2023 highlighted that the key potential legal and regulatory barriers and obstacles to using developing technology such as DLT in FMIs were primarily in relation to the activities of a CSD. Traditionally, a CSD has been a large entity that centralises and manages settlement risk across key financial markets. CSDs are typically systemically important, and this is reflected in the approach taken to their regulation and supervision. As such, under the unmodified framework, firms wanting to undertake the activities of a CSD must be authorised as such. The current process and requirements for authorisation as a CSD are extensive and compliance with them can be challenging for new entrants. The relevant enactments also assume that firms operate a traditional 'book entry' ledger system, which may not be compatible with the use of developing technology such as DLT.

The Bank's approach to the DSS looks to address these barriers and obstacles by allowing firms performing one, or a combination, of the activities of a CSD in the DSS to apply to be a DSD and making the supervisory and regulatory requirements for DSDs more proportionate to the financial stability risks they pose given the scale and the type of technology. This means that in the early stages some requirements will be lower and will then increase proportionately to the financial stability risks as firms scale. In order to protect financial stability when requirements are temporarily lower, the Bank proposes to also impose temporary limits on activity in the DSS.

Operation of a trading venue

The framework governing the operation of a trading venue has not been modified for the purposes of the DSS. As HMT noted in its consultation response, feedback from industry largely did not suggest that particular changes were needed to UK Markets in Financial Instruments Regulation (MiFIR), or the wider framework that applies to the operation of a trading venue.

Of the issues that were raised, it was determined that these did not pose significant barriers that are likely to uniquely affect the use of developing technologies for the operation of a trading venue. In the light of the above, the FCA considers it unlikely that a firm only intending to operate a standalone trading venue would be accepted into the DSS as a sandbox entrant, as such a firm would need no modification to regulation in order to operate. If a firm did consider that it requires the modified framework in order to realise its optimal business model, the FCA would consider that application on a case-by-case basis. By maintaining the existing framework, the FCA also aims to facilitate the ability for activity in the DSS to interact smoothly with the wider financial services ecosystem

Hybrid entity

The DSS Regulations, through the disapplication of Article 18 UK Central Securities Depositories Regulation (UK CSDR) (the effect of which is to prevent a CSD from also undertaking non-CSD activities), allow for the creation of a hybrid entity which combines the roles of operating a trading venue and operating the activities traditionally undertaken by a CSD (and in the DSS, a DSD). A firm that operates as a hybrid entity will be supervised by the FCA for its operation of a trading venue, and by the Bank for the operation and activities traditionally conducted by a CSD (Figure 1). Where a firm undertakes its DSS activity from the same entity as other regulated activities not in scope of the DSS, it will continue to be supervised by the appropriate regulator in the usual way for those other activities.

Figure 1: Roles of the Bank of England and FCA in the DSS

Notwithstanding the above, HMT's consultation response stated that the government will keep the scope of the DSS, including whether further legislation needs to be brought into scope, under review. Where new barriers or obstacles are identified, firms may approach the regulators, and these will be considered on a case-by-case basis. One area raised by industry in response to HMT's consultation was the application of the Money Laundering Regulations 2017 to DSS activity. The regulators are working with HMT to determine whether and how this should be addressed.

Glidepath to operation outside the DSS under a new permanent settlement regime

As set out above, a sandbox entrant that intends to undertake the activities of a CSD, including when combining them with a trading venue to be in a hybrid entity, will need to apply to be a DSD. Equally, a firm which wishes to operate a trading venue in the DSS will need to have the necessary authorisations or exemptions to do so. The DSS permits activity in a broad range of securities and will have overall limits within key sterling assets classes at a minimum (the Bank may consider introducing limits for other asset classes if justified).

The DSS is composed of different stages of permitted activity, reflecting the Bank's approach to managing financial stability risks. There will be a series of gates for sandbox entrants to move through to progress from one stage to the next, with the amount of permitted activity increasing with each stage. This glidepath will enable sandbox entrants eventually to graduate from the DSS to a possible new settlement regime, if they meet the relevant standards. In the case of a DSD (or, as explained above, a hybrid entity in so far as it concerns the operating firm's DSD activities), each stage will have higher regulatory requirements (proportionate to the financial stability risks) which the sandbox entrant will be assessed against before being permitted to progress and conduct additional activity. Box A and Figure 2 summarise these different stages and gates of the DSS.

Box A: The stages of the DSS

Stage 1 (initial application) is the initial application for firms outside the DSS to enter the DSS. In this stage, **firms can submit an application to enter the DSS to the regulators**. Firms that meet the 'Gate 1' criteria will be approved as 'sandbox entrants' (see section on Stage 1 in Appendix A for more details on this stage). Section 3 of the CP details the Gate 1 criteria.

Stage 2 (testing) firms are approved as sandbox entrants but do not have any new permissions to undertake FMI activities. Sandbox entrants wanting to be a DSD will be in **a 'testing stage' where they are not yet given permission to conduct live business as a DSD but are expected to begin engagement with the Bank's supervisors**.[6] The purpose of this stage is to ensure firms can begin testing their systems, engage with Bank supervisors, and prepare to meet the expected regulatory and supervisory outcomes at Gate 2 (Gate 2 requirements) (see section on Stage 2 in Appendix A). Sandbox entrants that demonstrate to the Bank that they can meet Gate 2 requirements will become DSDs and move into Stage 3.

Sandbox entrants seeking to operate a trading venue should apply to the FCA for permission to operate a Multilateral Trading Facility (MTF) or Organised Trading Facility (OTF). Alternatively, sandbox entrants who already hold a relevant Part 4A permission or exempt persons under FSMA 2000 should engage with their FCA supervisors, who in some circumstances may determine that such persons are already able to undertake their desired activity in the DSS. However, this will ultimately depend on the permissions a firm holds and its proposed business model for the DSS. In some cases, a Variation of Permission (VoP) or further permissions may therefore be required. As stated above, the FCA only anticipates a sandbox entrant operating a trading venue when combined with a DSD to form a hybrid entity.

Stage 3 (Go live) sandbox entrants become DSDs and are given permission by the Bank to undertake the activities of a CSD. Where relevant, they are also appropriately authorised by the FCA. At this stage, firms are permitted to undertake live activity subject to limits outlined by the regulators. Each DSD can choose which financial instruments it wants to trade and/or undertake notary, maintenance or settlement activities in. For established, key sterling asset classes, the DSD is allocated a portion of the overall capacity of the DSS (see Section 5 of the consultation) known as the 'Go live limit'. These Go live limits are uniform across DSDs to promote fairness and calibrated to be proportionate to the Gate 2 requirements for DSDs (see Appendix A for further details about the Go live limits). DSDs will be required to operate within these limits.

At this point, a DSD will not be subject to the full CSDR nor the full end-state Bank rules but to the Gate 2 requirements which reflect the risks posed by firms during this stage, given the limits they are subject to. As set out below, the FCA proposes to maintain its existing risk-based supervisory approach to the operation of a trading venue.

As DSDs mature, and activity begins to reach their Go live limits, the Bank will open ‘review points’. At these review points, DSDs wanting to increase their limits will need to demonstrate they can meet higher regulatory requirements known as the ‘Gate 3 requirements’ which are proportionate to their increasing scale and associated financial stability risk. DSDs that successfully meet the Gate 3 requirements at the review points will be able to move onto Stage 4 (the scaling stage).

The Bank will hold two review points in the DSS for DSDs to demonstrate they meet Gate 3 requirements. These review points are set to ensure that the overall limits in the DSS (in the asset classes for which they have been set) are allocated to firms in a fair and prudent way.

After the second review point, the DSS will be closed to new sandbox entrants.

Stage 4 (scaling stage) firms that enter this stage will have access to higher limits. At this point, DSDs can increase their activity within the higher limits and begin to consider how they meet end-point requirement after the DSS.

Stage 5 (operating outside the DSS under new regime) the regulators and HMT, having learned from the activity in the DSS, intend to create a new permanent regime for settlement if this is considered appropriate.[7] The Bank’s DSS rules instrument includes the anticipated end-state rules of such a possible new permanent regime to help firms to understand what requirements that is likely to entail.

Table B: Stages of the DSS

Stage	Purpose	Legal designation	Criteria/applicable rules
Stage 1: Initial application	Identify firms eligible to join the sandbox.	**None**	Eligibility criteria for Gate 1 (assessed via application form): • UK based entity (not branches). • Activities and assets in scope of the DSS. • There are potential regulatory barriers or obstacles to activity outside the DSS.
Gate 1			
Stage 2: Testing	Testing stage and seek authorisation to operate a trading venue or to be a DSD. No live business.	**Sandbox entrant** Sandbox Approval Notice (SAN) issued confirming status.	Continue to meet eligibility criteria.
Gate 2			
Stage 3: Go live	Ability to carry out live business under initial limits.	**DSD/authorised operator of trading venue.** SAN updated covering permissions and any conditions.	Gate 2 Bank rules for DSDs (assessed via Gate 2 application form). FCA Authorisation requirements for operators of trading venues.
Gate 3			
Stage 4: Scaling	Scaling the business, with a glidepath to authorisation for DSDs.	**DSD/authorised operator of trading venue.** SAN updated for any changes in permissions and/or conditions.	Gate 3 Bank rules for DSDs. FCA requirements for operators of trading venues apply.

Stage	Purpose	Legal designation	Criteria/applicable rules
Gate 4			
Stage 5: Operating outside DSS under new regime	Authorisation to operate outside the DSS for DSDs.	**CSD/new category of FMI.**	Revised CSD regime reflecting sandbox learnings or alternative regime. Bank end-state rules to provide the 'default' of what the revised regime could look like to provide a glidepath.

In the longer term, the regulators, working with HMT, will reflect on whether it may be necessary to put in place a separate regime for non-systemic DSDs, the regulatory requirements of which would reflect the lower financial stability risks posed by such entities. This could mean that sandbox entrants judged to be non-systemic may be able to graduate the DSS under a different set of requirements, which are less stringent than the Bank's end-state rules which are designed for systemic firms. The regulators will use the DSS to understand the merits of a possible non-systemic regime further and update sandbox entrants as any new permanent regime takes shape.

Questions:

2. Does the approach mitigate cliff-edge risks for sandbox entrants graduating out of the DSS?

3. Do you have any comments on the effectiveness of the glidepath approach described above?

4: Proposed approach to Gate 1

Gate 1 criteria and application

The DSS Regulations specify the following types of FMI entity, where they are established in the UK, are eligible to apply to become a sandbox entrant:

1. a recognised investment exchange that is not an overseas investment exchange;
2. a recognised CSD;
3. a person who has a Part 4A permission to operate a MTF and is an investment firm; and
4. a person who has a Part 4A permission to operating an OTF and is an investment firm.

The DSS Regulations also allow the regulators to further determine that other persons established in the UK can apply to become a sandbox entrant. Consequently, the regulators propose to open the DSS to persons otherwise specified in the DSS Regulations, to apply to be a sandbox entrant.

The DSS is open to existing financial institutions or new entrants to this market. The regulators are open to applications from firms of all sizes and at all stages of development. However, they must be legal persons established in the UK and obtain the relevant authorisation or permissions before undertaking any regulated activity.

Furthermore, the DSS Regulations give the regulators the power to determine an application process for firms that apply to become a sandbox entrant. While much of the eligibility criteria is already specified by the DSS Regulations, namely the type of entity eligible to apply, the requirement for applicants to be established in the UK, and the FMI activities and financial instruments in scope of the DSS, the regulators can specify the information accompanying the application to determine the eligibility of the applicant.

The regulators propose to require firms to identify the regulatory or legal barriers and/or obstacles to using developing technology such as DLT which prevent them from operating their optimal business model outside of the DSS. This will help focus the DSS on those business models which do need modifications and allow the Government and regulators to better assess what permanent legislative and regulatory changes are needed to allow for a more widespread adoption of these new practices or developing technologies.

The regulators propose to consider the supervisory record of applicants and any past enforcement action taken against them. If the regulators become aware of any adverse information, this information will be taken into account and can result in the rejection of the application. This approach will contribute towards increasing trust in and the reputation of UK financial markets.

The regulators also propose to require a consortium of firms who wish to apply together to operate an FMI within the DSS to establish a single UK entity. The regulators consider this approach to be necessary because the DSS is designed so that only the operator of the FMI needs to become the sandbox entrant, so it would not be practicable for this to be a consortium of firms.

As part of their DSS application, firms should inform the regulators of non-DSS activities they intend to operate from the same entity. Regulators may take this into account when considering the application. During the course of the DSS, if the firm's non-DSS activities change materially, the regulators should be informed.

Proposed approach to rules in the DSS

Background

The DSS Regulations made targeted modifications to Regulation No. 909/2014 (UK CSDR), FSMA 2000, Uncertificated Securities Regulations 2001 (USRs 2001) and Companies Act 2006 (CA 2006). These were made to facilitate the use of developing technology such as DLT for the operation of a trading venue and undertaking the activities of a CSD, and to give the regulators the powers to implement and operate the DSS. A key feature of the DSS Regulations is that some requirements placed on firms in legislation governing CSDs have been disapplied.

Specifically, the DSS Regulations give the regulators the power to make rules applying to sandbox entrants and other persons engaging in DSS activity, but which are not themselves a sandbox entrant (see Regulation 3(4) of the DSS Regulations) as appears necessary or expedient in order to implement and operate the DSS. This includes the power to waive or modify a rule for an individual entity or a class of entity.

Under the modified framework, the regulators have the power to:

- make rules, including to replace requirements placed on firms disapplied by the DSS Regulations;
- waive or modify rules including those made under FSMA 2000 or other relevant enactments;
- provide for the application of existing rules to sandbox entrants of a specified description or for individual sandbox entrants; and
- modify (including the power to provide for them not to apply) technical standards.[8]

This section of the CP explains how regulators propose to use these broad rulemaking powers to operate the DSS.

This breadth of the regulators' rulemaking powers reflects the need for flexibility in the DSS. The regulators may need to update the regulatory framework as they learn from the activity, technology and business models of sandbox entrants, in order to provide a glidepath to a possible new permanent regime. The regulators may need to temporarily relax certain requirements to allow firms to scale up their operations gradually. Additionally, the regulators may need to adapt rules to specific sandbox entrants to reflect their technology and/or business models, although the bar for this will be high.

The regulators are alive to the possibility that, as sandbox entrants commence live activity in the DSS, they may identify further barriers that prevent them from realising their optimal business models. Firms may approach the regulators in these instances and the barriers identified will be considered on a case-by-case basis. If it is determined that a barrier might be removed while maintaining good regulatory outcomes, the regulators may consider doing so, while not being able to guarantee that this will be carried through to any new future permanent regime.

Bank rules

The Bank proposes to use its flexible rulemaking powers to create 'Bank's DSS rules' which will contain the rules that will apply to DSDs after Gate 2 and the 'end-state' rules which are the Bank's 'default' of what it anticipates the future requirements placed on firms may look like. The end-state rules themselves can be found in Appendix B. In addition, please refer to Appendix C for a comparison of the requirements that will apply to firms at Gate 2 and our end-state rules.

The SAN – that will act as a 'visa' for firms participating in the DSS – will specify which set of rules apply to DSDs at a given point in time and can also specify any modifications or waivers granted to them by the Bank, alongside other relevant information. By studying the Bank's DSS rules (alongside the DSS CSDR and DSS USRs) and the SAN of a sandbox entrant, users of a DSD and broader market participants will be able to see the regulatory requirements that individual DSDs are being held to at a particular point in time.

The Bank will reserve the right to make changes to the rules that apply to DSDs across the different stages of the DSS and may vary requirements imposed on individual DSDs as the regulators learn from the DSS. To preserve financial stability, the Bank may choose to tighten the rules for DSDs if it finds there are new risks from the combination of technology and business models in the DSS. Conversely, the Bank may also disapply or make more proportionate certain rules if it finds that risks are lower than anticipated. The Bank will consider any proposed changes to rules carefully and will endeavour to balance the need to create a predictable operating environment for sandbox entrants while continuing to meet its primary objective of protecting financial stability.

The Bank's approach to creating the end-state rules

The 'end-state' rules have been drafted to maintain broadly equivalent regulatory standards as those in CSDR and the USRs. However, where the wording of certain provisions appears to be potentially incompatible with the use of developing technology such as DLT, those provisions have been adapted. The aim of the end-state rules is to shed light on the regulatory standards that will need to be met by DSDs that wish to operate under a possible new permanent regime after the DSS.

As stated above, the DSS Regulations disapplied the requirements placed on firms in CSDR and the requirements placed on issuers and operators of 'relevant systems' in the USRs, against which the Bank also supervises CSDs. Using its rule-making powers, the Bank proposes to reinstate the requirements placed on firms into its end-state rules while removing known regulatory barriers to innovation and making some consequential changes, but without diluting the standards in those regulations.

Finally, the Bank proposes to bring across a limited number of the requirements placed on firms that were in the CSDR Regulatory Technical Standards (RTS) into Bank rules to maintain the level of detail for those standards where it deems it appropriate. These include RTS for capital requirements and for CSD links (a CSD link is an arrangement between two CSDs that allow clients of one CSD to access and trade securities in another CSD without being a direct participant in both CSDs), whereas the rest of the RTS will be disapplied.

The regulators are unlikely to anticipate all regulatory barriers and novel issues and risks posed by new business models before the DSS opens. This goes to the heart of objectives of the DSS. The Bank can use its powers to continue to evolve the Bank's DSS rules as it learns from the experience of the DSS, both to remove regulatory barriers and to address new risks from new technologies and business models. By evolving its rules over the life of the DSS, the Bank aims to provide a glidepath for sandbox entrants and market participants towards a possible new permanent regime.

The regulators would expect the Bank's end-state rules to be modified based on any learnings from the DSS. It should be noted that the FCA is not consulting on its approach to rules under a possible new permanent regime as the industry has not highlighted any required changes to the FCA's existing regime. There is therefore no guarantee that the end-state rules would apply in their current form to a sandbox entrant that left the DSS at the end of its term. However, the intention is that sandbox entrants which meet the requirements of any new permanent regime would be able to apply to continue activity outside the DSS. The Bank has chosen to consult on the Bank's DSS rules ahead of the DSS opening. It is possible that the Bank may choose not to do so in future due to the temporary nature of the DSS and for the need for regulators to remain agile. See [Appendix B] for the full end-state rules.

Questions:

4. Are there any known regulatory barriers and/or risks to/from the technology or business models not covered in the end-state rules that the Bank should consider at the outset?

5. Is the full set of rules set out in Appendix B consistent with the objectives and design principles of the DSS?

The Bank's approach to creating the Gate 2 rules

The Bank also proposes to use its powers to put in place modified rules at Gate 2 and Gate 3. At Gate 2, these modified rules will represent fewer requirements than those applied at later stages, reflecting the lower financial stability risk. The limits on the activity of DSDs allow the Bank to temporarily lower regulatory requirements, allowing them to scale their business while maintaining minimum guardrails appropriate to their activity to mitigate financial stability risk. Please refer to Appendix C for a comparison of the requirements that will apply to firms at Gate 2 and our end-state rules. The Bank's rules in place at Gates 2 and Gate 3 will be lower relative to CSDs operating outside of the DSS, including standards such as those contained in the CPMI IOSCO Principles for Market Infrastructures (PFMI) as a consequence of the limits being applied. This means that users of DSDs and wider market participants should expect a higher risk of failure and operational disruption relative to activity outside of the DSS. However, any broader, systemic disruption from DSS activity will be contained as long as DSDs stay within their limits and are able to wind down their DSS activity safely. The Bank will supervise DSDs to achieve this.

The Bank proposes to create Gate 2 rules by:

1. Applying some end-state rules in full.
2. Disapplying some end-state rules and replacing them with more proportionate Gate 2 rules.
3. Disapplying some end-state rules and not replacing at Gate 2 in any form.

While some sandbox entrants may need to make investments or adjustments in order meet Gate 2 requirements, the Bank considers these requirements to be necessary to ensure DSDs meet minimum standards to operate in the DSS. Firms will need to meet Gate 2 requirements in full to conduct live business as a DSD. There may be a limited set of circumstances where firms have identified specific features of their technology and/or business models that will render them unable to meet Gate 2 rules. Firms should provide evidence so that the Bank can consider whether there is a case to vary the way rules apply to an individual firm, including through providing a waiver. The bar for this is likely to be high.

See Appendix B for the full Gate 2 rules.

Questions the Bank is seeking views on in relation to the Gate 2 draft rules:

6. Do you have any feedback on the Bank's approach to creating the Gate 2 rules or the Gate 2 rules themselves?

7. Are there any specific features of technology and/or business models that would be incompatible with the proposed Gate 2 rules?

Application of Bank, PRA and FCA rules to hybrid entities

One of the objectives of the DSS is to allow firms to experiment with different business models, potentially combining activities that are required to be legally separate under existing legislation, such as the operation of a hybrid entity to provide for the trade and settlement of securities.

It is also possible that a bank applies to participate in the DSS with the intention of continuing its existing banking activities alongside operating a DSD or hybrid entity as described above, without creating a separate entity to undertake DSS activities. UK CSDR prevents the comingling of commercial banking activities with CSD activities, requiring instead a stand-alone banking entity to be set up which undertakes only banking activities for the CSD. The Bank is proposing to disapply the relevant requirements at Gate 2 to allow this comingling. In the interest of clarity, the Bank is only proposing to relax this requirement at Gate 2 where activity is subject to strict limits – the requirement to separate regular banking activities from CSD banking activities remains in place at end-state. This creates another potential area of overlap between Bank's DSS rules and the PRA regulatory framework for banks (which includes PRA rules).

The regulators are aware that in some cases there may be overlaps across the different regimes which apply to a sandbox entrant. The regulators recognise that firms may have questions about how the different rules that apply to them will interact and encourage such firms to discuss these questions with them at the early stages.

Sandbox entrants will be required to meet all applicable rules and/or requirements relating to the regulated activities they undertake, whether within or outside the DSS. The Bank's DSS rules will apply to sandbox entrants that are (i) DSD-only and (ii) a hybrid entity in so far as it concerns being a DSD. The Bank's DSS rules apply only to activities undertaken in the DSS and not to any activity outside of it. In general, the scope of the Bank's rules is limited to a DSD's activities of notary, settlement, and maintenance. However, the Bank proposes that the scope of the rule on capital (Article 47 in draft Bank's DSS Rules) is broadened to ensure that sandbox entrants take account of all activities that take place inside the DSS in the capital calculation.

Subject to the above, the regulators' intention is to ensure that requirements are proportionate to the risks and to avoid introducing any duplication of requirements because of firms' participation in the DSS. For instance, sandbox entrants may already be meeting specific regulatory and supervisory outcomes relating to the DSS through ongoing compliance with requirements that apply to their other regulated activities. In such instances, the regulators have powers to waive or modify rules that apply to a sandbox entrant on a case-by-case basis.[9]

Questions:

8. Are there any requirements in the proposed Bank's DSS rules which would conflict with the frameworks that govern a firm which is also regulated by the FCA and/or the PRA?

9. Do you agree with the proposed approach to managing potential interactions between Bank, FCA and PRA requirements?

Approach to capital requirements in the DSS

To pass Gate 2 and commence live activity, all sandbox entrants will have to hold sufficient resources to cover the risks of participating in the DSS. The requirements a sandbox entrant must meet will depend on its business model and the activities it proposes to undertake.

Bank's capital requirement for DSDs

DSDs will be required to comply with the Bank's DSS rules relating to capital requirements. Article 47 in its end-state form contained in the Bank's DSS rules is in line with current requirements that CSDs must meet under Article 47 of UK CSDR, including the associated Regulatory Technical Standards that provide the detailed requirements for calculating both going-concern capital and the wind down costs.

However, at Gate 2, Article 47 will be less prescriptive relative to the end-state. While DSDs may choose to use the methodology prescribed in the end-state rules, they will also be able to use their own approaches and assumptions to calculate the level of capital they are required to hold at Gate 2 as set out in Article 47. This level of capital should be sufficient at all times to cover the main risks arising from their DSS activity when a going concern and to wind down their DSS activities in an orderly way. The Bank does not propose to prescribe a methodology for this calculation at Gate 2 but will review firms' approaches and use these as input in determining the appropriate requirements.

The Bank proposes that at Gate 2, as a minimum, DSDs hold the higher of: (a) the amount of resources needed to cover all their going concern risks and the cost of wind down or (b) resources equivalent to at least nine months' operating expenses for their DSS activities at all times, in order to cover the risks from these activities.

Consistent with the principles set out above, a DSD which is also subject to FCA or PRA capital requirements due to other regulated activity will need to meet both the applicable FCA/PRA requirements and the Bank's DSS rules on capital requirements for its DSS activities.[10] The regulators' intention is that a sandbox entrant holds sufficient capital to cover both the going concern risks and the cost of winding down all its activities in the DSS, and, in addition, to satisfy its requirements for any regulated activity outside of the DSS (where relevant). This will ensure that the sandbox entrant can operate safely in the normal course of business and provide for an orderly wind down of all DSS activities if the circumstances required. The regulators will also have the powers to waive or modify Bank's DSS rules on a case-by-case basis if they create unforeseen disproportionate interactions with other capital requirements. The regulators will look to ensure that firms' requirements are proportionate to the risks from DSS activities while aiming to avoid double counting of capital.

Questions:

10. Do you agree with the Bank's proposed capital requirements for DSDs, both at Gate 2 and end state?

11. Do you agree with the proposed approach to capital requirements where firms are also subject to other prudential regimes?

5: Approach to managing financial stability and market integrity risks in the DSS

The key financial stability risk from the DSS is the potential for large-scale failures in the recording, trading and settlement of securities, causing a wider market impact. While key protections around operational resilience and wind-down planning will be in place for the DSS, developing technology such as DLT remains novel and untested at scale, particularly in traditional markets. As discussed above, the Bank will also allow sandbox entrants to undertake the activities of a CSD while meeting a modified set of regulatory standards. In addition to this risk, the use of developing technology such as DLT may enable new business models which, while potentially offering benefits in terms of innovation, could give rise to novel financial stability risks (for example from the use of instant settlement). The risks are therefore uncertain relative to established practices and strict limits will be necessary, especially in markets which are key to the functioning of the wider financial system.

To manage financial stability risks, the Bank will place limits on the activity of DSDs in the DSS, while the FCA's approach is intended to mitigate any risks to market integrity by ensuring that the operator of a trading venue inside the DSS must meet the same standards as an operator outside of it. By retaining the existing framework, the FCA will provide for the orderly operation of financial markets and protect against financial crime and market abuse. Current investor protections will also apply equally to FCA-regulated activities in the DSS.

Scope of financial instruments in the DSS

The digital securities in scope of the DSS are all financial instrument types listed in the Regulated Activities Order (RAO), with the exception of derivatives.[11] This includes transferable securities (eg, equities and bonds), money market instruments, units in collective investment undertakings (fund units), and emissions allowances. Other assets not covered by the RAO – including unbacked cryptoassets such as Bitcoin – are not in scope of the DSS. Firms that wish to settle such assets should plan to conduct this activity outside of the legal entity from which the DSD is operated.

Prospective participants in the DSS, both sandbox entrants and other firms looking to issue digital securities, should note the requirement under Article 3 of UK CSDR for financial instruments defined as transferable securities[12] that are traded on a trading venue (such as on an MTF or on a regulated market) or in financial collateral arrangements to be recorded in a book-entry form at a central depository. For digital securities being issued utilising developing technology such as DLT, this central depository would be a DSD in the DSS. Firms looking to issue digital securities and prospective DSDs should take care to understand whether a digital security being issued would be caught by this requirement.

In general, digital securities in the DSS can be used in wider financial market activities, including for example in securities financing transactions, or as collateral, in line with regulations covering these activities. However, this should be in line with market best practice and take place under established market legal frameworks.[13] However, regulators may choose to restrict these uses if financial stability concerns arise.

Aggregate limits in the DSS

The Bank is proposing overall capacity limits for established key sterling asset classes. Trading and settlement for other asset classes will also be possible in the DSS, but limits on those activities would require further discussion with firms on the detail of their proposals and potential impact to financial stability.

Table C outlines the overall capacity of the DSS for established, key sterling asset classes – gilts,[14] corporate bonds, asset-backed securities, money market instruments (commercial paper and certificates of deposits), and FTSE 350 equities. The limits are expressed as a range to provide the Bank with the necessary tools to manage limits for individual DSDs within the overall capacity, as well as ensure that financial stability risks are contained as the regulators learn more about the risks of the activity taking place in the DSS. These will be based on a variety of factors, including, for example, observed risks of activity (both in the creation of digital securities and their utility), resilience of sandbox entrants, and the number of sandbox entrants progressing beyond Gate 2. As firms move to Stage 3 (‘Go live’), the Bank will distribute the capacity among DSDs who wish to trade or settle specified sterling asset classes based on the lower bound of the limit range. However, as the DSS matures, the Bank may decide to allocate based on overall capacity further into the range, up to the upper bound of the limits subject to considerations around financial stability.

Given the risk profile and market of each asset class is different, the management of limits in the DSS will vary depending on the asset class and, in some cases, the specific characteristics of the security – for example, the tenor or credit rating of the asset. For example, in the case of sovereign debt issuance, the Bank will also consider whether limits may be justified on specific tenors, reflecting the importance of gilts and specific tenors for financial stability and monetary policy transmission. For financial instruments in scope of the DSS Regulations but for which a limit is not specified in Table C, the Bank reserves the right to assess the specific use cases and the potential impact on financial stability, and to set limits as required.

Limits will apply to the stock of both digitally native issuances and tokenisation of existing securities.

Initially, the Bank intends to limit the scope of assets to GBP-denominated assets only and for settlement to take place in GBP. However, it will review this restriction as it learns more about risks in the DSS. This reflects an expectation that firms operating in the UK would be focused primarily on GBP markets initially.

Table C: Aggregate limits for key asset classes in the DSS (a)

Asset	Limits (£ billions)
Gilts	8–13.1
Corporate bonds	17–28
Asset-backed securities	8–16
Short-term money market instruments, such as Commercial Paper and Certificates of Deposit (CP/CD)	4.4–8.8
Shares in FTSE 350 companies	6% of outstanding shares for the company (b)

(a) Within these overall limits, specific ranges will exist for subsets of assets (for example, high yield corporate bonds, or long-dated gilt issuances). Specific details will be shared with applicants as required.
(b) Firms looking to immobilise and tokenise FTSE 350 companies' equities will need to demonstrate how they will reflect corporate action events (such as share buybacks) in the tokenised securities holdings at the DSD to maintain these limits.

Box B: The Bank's methodology for setting DSS capacity

The aggregate limits in Table C are calculated with reference to the Bank's tolerance for settlement failures and outages occurring in the DSS. Due to the use of new and untested technologies, the probability of such failures and outages may currently be higher in the DSS than in established financial infrastructure. Settlement failures and outages of financial infrastructure can affect financial stability by undermining confidence in the financial system, reducing participation in financial markets, and negatively impacting wider market functioning.

The Bank's tolerance was calibrated to ensure that severe but plausible disruptions in the DSS would not have a material negative impact on the functioning of traditional financial markets even when added to typical day-to-day disruptions (eg, settlement failures observed) in traditional financial markets. More specifically, the Bank examined the historical ability of financial markets to absorb settlement fails and market capacity to cover settlement fails, by using observed historical distribution of settlement fails and market volumes, among other measures.

The regulators believe that financial stability risks are most appropriately mitigated by limiting the stock of open outstanding securities in the DSS, rather than placing restrictions on the trading volumes of those securities, as the latter will prevent trading, and in turn impact market liquidity and hamper market functioning. This also ensures that when a financial instrument matures, the DSD can reuse that limit for other issuances.

The above limits are calculated for key sterling markets for which the Bank has sufficient data to make assessments. The regulators are also aware of the wider opportunities that new technologies may open up for other financial instruments within the scope of the DSS.

Firms that wish to explore operating in these asset classes will need to engage with regulators to ensure the proposals are fully understood, and to enable a full assessment of the risks (particularly financial stability risks). This will ensure appropriate limits on activity are put in place prior to any live activity being permitted.

This is particularly the case for financial instruments that have an existing role in the wider financial ecosystem – for example, units in money market funds (MMFs) that play a crucial role in treasury management functions.

The regulators are aware of the interest surrounding fund tokenisation, which could allow units in funds such as MMFs to be used more easily as collateral. The Bank's Financial Policy Committee has previously highlighted risks and resilience issues in MMFs. The Bank will monitor activity and risk management approaches and stand ready to take action in the event of a large build-up of risk, including the imposition of limits on activity relating to MMF units by a DSD, or the use of MMF units or tokens as collateral. The FCA recently consulted on proposals to enhance the resilience of MMFs based in the UK, including the effect of tokenisation (see **FCA CP23/28**). The FCA is currently reviewing the responses to the consultation and will publish its policy response in due course. The Bank will do further work on assessing whether and what limits are appropriate on fund tokenisation activity and how they could be applied after consulting firms on their plans. The regulators would welcome views from firms who may wish to carry out fund tokenisation within the DSS including on the potential financial stability implications of this activity.

Question:

12. Do respondents have views on how the proposed regime balances the need to protect financial stability while allowing enough activity in the DSS to facilitate innovation?

6: Approach to supervision in the DSS

Both the Bank and FCA tailor their supervisory approach to the risks posed by firms. Regulators also have access to existing powers under FSMA 2000 for the purpose of operating the DSS by consequence of the DSS Regulations.

Bank supervisors will assess DSDs against the relevant rules as part of the decision whether to allow them to go through Gates 2 and Gate 3. DSDs should not assume that passing through gates is automatic as this will depend on their progress against applicable requirements and related supervisory engagement. Firms will need to provide evidence that they are meeting all relevant rules at each stage. Supervisory assessment against the requirements will be proportionate to the size and risk of the business and may depend on the technology being used and the proposed business models. Regulatory requirements will grow as firms scale. Following a successful supervisory assessment against Gate 2 or Gate 3 rules, those rules will continue to apply until the firm is ready to progress to the next stage, including seeking authorisation under a possible new permanent regime.

An important difference between the Bank and FCA's approach is that the operators of trading venues will need to meet the same standards as currently exist outside of the DSS. These are already designed to accommodate non-systemic firms. DSDs do not have to meet the same standards as are currently in place for CSDs. Instead, the Bank is putting in place proportionate standards for DSDs, which will change to reflect their progress in the DSS, and therefore their risks.

7: The Bank of England's proposed fee regime for firms/entities participating in the DSS

The DSS Regulations give the Bank powers to levy fees on applicants to the DSS and sandbox entrants in connection with the discharge of any of its functions relating to the DSS. The Bank has proposed a new fee regime for the DSS as this is a new function for the Bank. A new fee regime is required to allow the Bank to ensure it has the resources it needs to operate the DSS. The Bank is proposing a 'Pay As You Go' approach to levying fees in the DSS.

A sandbox entrant seeking authorisation to operate a trading venue in the DSS, specifically a MTF or an OTF, will be subject to the existing FCA fee regime. The current **FCA application fees** for authorisation to operate an MTF or OTF of £50,000 will apply. A firm which already holds a Part 4A permission and which requires a VoP to operate an MTF or OTF in the DSS will need to pay the usual fee of £25,000. As described in **Section 3**, the FCA's approach to implementing and operating the DSS will not require major regulatory changes or new processes. In consequence, FCA fees will not be amended. The FCA's fees are therefore not subject to this consultation.

The effect of the Bank's proposed fee regime is that a hybrid entity would be subject to the Bank's fee regime to become a DSD and the FCA's regime for its operation of a trading venue.

The Bank will consider its approach to fees for hybrid entities on an ongoing basis. An important consideration will be around the impact of a dual supervisory approach. There may be areas where Bank supervisors find efficiencies and avoid having to look at the same information separately (eg, around governance), thus reducing the amount of effort required. Given that it is not possible to estimate potential overlap at this stage, the Bank has made no adjustment for hybrid entities in this fee consultation but will explore whether a rebate is appropriate for hybrid firms and whether specific adjustments need to be made for such firms in the fee regime more generally.

Box C: FMI fees and Bank's powers to levy fees for the DSS

The Bank levies fees for its FMI supervisory activity and the policy activity which supports this, as permitted by the Bank's fee powers.[15] This includes the costs of FMI supervision staff together with relevant policy support, specialist resources and corporate services and other costs associated with the work of the Bank's Financial Market Infrastructure Directorate. The Bank also levies fees on **incoming FMIs**.

The Bank consults every year on its FMI supervisory fees. The Bank consulted on its fee regime for FMIs in July 2023. Fee rates for 2023/24 were published in November 2023 and can be found in **the Bank of England's fees regime for financial market infrastructure supervision 2023/24**.

As part of its role in the DSS, the Bank needs to ensure supervisory and policy activities in relation to the DSS are adequately resourced. In July 2023, HMT **consulted** on the DSS, which included the approach to supervision and enforcement for the DSS. As part of the DSS consultation, HMT noted that the regulators would need to set out their respective approach to fees to supervise specific participants in the DSS and the policy activity required to support this. The DSS Regulations have extended the Bank's fee raising powers in connection with the discharge of its functions under the DSS Regulations. The fee powers allow the Bank to levy fees across all stages of the DSS, which included the approach to supervision and enforcement for the DSS.[16]

Respondents to the **consultation published in November 2023** highlighted the need to ensure that the regulators have the necessary resource capacity to run the DSS. Responses further emphasised that it was important to retain an efficient supervisory process.

Summary of approach and proposals

Pay As You Go approach

The Bank is proposing a 'Pay As You Go' approach to fees in the DSS. This means that applicants to the DSS and sandbox entrants will have to pay the appropriate fees as they apply to become a sandbox entrant and pass through the stages and gates of the DSS.

The proposed approach is designed to maintain consistency with fees levied on other FMIs in the Bank's remit and seeks to meet three main objectives:

1. **Ensure adequate resourcing** for the Bank's supervisory and policy activities across all the stages of the DSS.
2. **Have a proportional regard to the potential impact on innovation.** The Bank's proposed fee regime aims to allow for safe and sustainable innovation. The Bank seeks to set out a fee regime that allows for an adequate operationalisation of the DSS without creating unnecessary barriers for participation. The fees have been set taking into account the current levies on similar FMIs such as domestic and incoming CSDs. However, the fee regime is intended to also be flexible to allow the Bank to strike the right balance between supporting innovation while ensuring adequate resources.
3. **Provide the right incentives for firms seeking to become a sandbox entrant.** The proposed fee regime is designed in a way that incentivises applicants and sandbox entrants to carefully consider their readiness and suitability at each stage of the DSS and encourages credible high-quality engagement throughout.

In line with the fee-levying approach applicable to FMIs that fall within the Bank's remit, the Bank will need to reconsult on the DSS fee regime on a regular basis, as it currently does every year on the fees for FMI supervision.[17]

Proposed fees under the Pay As You Go approach

Sandbox entrant application fee

The Bank proposes to introduce a £10,000 application fee payable at the point of submitting an application to become a sandbox entrant and where that firm wishes to be a DSD. This fee is estimated to cover the cost for the Bank of making the Gate 1 decision against the application criteria set out in **Section 4**. This is a fixed fee that applies to all applicants and is not conditional on the outcome of the decision. The FCA will not be charging a fee at this stage.

Gate 2 DSD fee

The Bank proposes to introduce a £40,000 fee payable at the point that a sandbox entrant becomes a DSD. This fee is estimated to cover the cost for the Bank of assessing whether a sandbox entrant meets its Gate 2 rules and can therefore be given permission to undertake live activity as a DSD. This is a fixed fee applicable to all DSDs that would apply at the point the Bank confirms the sandbox entrant passes the Gate 2 assessment and becomes a DSD by updating its SAN.

The Bank took a bottom-up approach to estimate the fees for Gate 1 and Gate 2, considering the policy and supervisory work that will be needed to make the respective decisions. However, there are uncertainties around the effort required due to the novel nature of the DSS. The Bank therefore reserves the right to revise fees, subject to further consultation in due course.

In calibrating both the Gate 1 and Gate 2 fees, the Bank took into account the fee regimes for domestic and incoming CSDs and FCA fees for operators of trading venues. The fees proposed for Gate 1 (£10,000) and Gate 2 (£40,000) are comparable to the fees levied on incoming CSDs and the FCA's authorisation fee for an operator of a MTF or an OTF of £50,000.

Stage 3 annual DSD supervision fee

The Bank proposes to introduce an annual supervision fee for DSDs, which it estimates to be £85,000 in Stage 3. Similar to FMI fees described in Box C, this fee is intended to cover the Bank's cost of operating the DSS, including supervision of DSDs as well as relevant policy activity. This fee will be charged on a cost recovery basis and will match the actual resources required for the Bank to carry out its functions. In practice, the Bank will estimate the total cost of supervising Stage 3 DSDs along with any chargeable policy work and allocate the cost equally across all Stage 3 DSDs. The fees will be pro-rated to take account of different DSD entry points into Stage 3. As a result, all DSDs in Stage 3 will be charged the same fees, reflecting the point they became DSDs.

The fee has been estimated to cover the costs of the Bank conducting supervision and policy work (eg, to revise the Bank's DSS rules) in Stage 3 and reflects the Bank's assumptions around the likely number of DSDs. The actual fee may be higher or lower than the Bank's estimate if the number of DSDs or its estimates of the effort required differ from those expected. In line with the approach for existing FMIs, the Bank may make a final adjustment where applicable, at the end of each fee year[18] via a rebate or request for additional fees. In line with the fees regime for the other FMIs in the Bank's remit, it is expected that invoices will be issued no later than Q3 of the ongoing fee year.

Fees after Gate 3

Fees beyond Gate 3 where DSDs move into the scaling stage, are not subject to this consultation as the Bank has not considered its supervisory approach past Gate 3 in detail. However, as the Bank expects supervisory activity to increase after Stage 3, it is likely that annual supervisory fees may be higher in Stage 4. The Bank will set out its approach and consult on the applicable fees in due course. Table D sets out a summary of the fees in each stage of the DSS.

Table D: Summary of fees proposal

Stage	Bank of England fees	FCA fees
Stage 1: Initial application	**£10,000 Gate 1 sandbox entrant application fee** • Payable at the point of submitting an application to enter the DSS to be designated as a sandbox entrant.	N/A
Gate 1		
Stage 2: Testing	N/A	N/A
Gate 2		
Stage 3: Go live	**£40,000 Gate 2 DSD/application fee** • Payable at the point that a sandbox entrant is designated as a DSD. • Applicable to all DSDs at the point the Bank makes the decision of the DSD application by updating the Sandbox Approval Notice (SAN).	**FCA regime remains unchanged** **£50,000 MTF and/or OTF authorisation application** **£25,000 Variation of Permissions fee** • Applicable to trading venues with existing authorisations that also want to participate in the DSS and require a Variation of Permissions.
	£85,000 Stage 3 Annual DSD supervision fee • Charged on a cost recovery basis. • Fee will be pro-rated and shared equally across DSDs.	**FCA existing fee regime continues to apply in relation to regular annual fees for operators of trading venues.**
Gate 3		
Stage 4: Scaling	Fees not subject to this consultation. The Bank will set out its approach and consult on the applicable fees in due course.	FCA existing regime continues to apply.
Gate 4		

Stage	Bank of England fees	FCA fees
Stage 5: Operating outside DSS under new regime	Fees not subject to this consultation. Revised Bank fee regime for CSDs/new types of legal entities. The Bank will set out its approach and consult on the applicable fees in due course.	FCA existing regime continues to apply.

Alternative approaches considered

The Bank considered alternative approaches to levying and setting fees for the DSS. One alternative option included levying a flat, uniform one-off fee to recover both the Gate 1 and Gate 2 application costs only at the point when a firm passes Gate 2 and becomes a DSD. Another alternative included charging only the Gate 2 application cost to become a DSD, without recovering the Gate 1 application. In the alternative options considered the Bank would not be able to recover the costs of both gates in full.

The Bank judges that the Pay As You Go approach provides the best incentives for firms while also recovering the full cost for the Bank. This approach also ensures the Bank can adequately resource its estimated supervisory and policy processes for each stage of the DSS.

Question:

13. Do you agree with the Bank's proposed fee regime for the DSS?

8: Summary of questions for consultation

1. Do you have any comments on the draft Guidance on the Operation of the Digital Securities Sandbox (Appendix A)?
2. Does the approach mitigate cliff-edge risks for sandbox entrants graduating out of the DSS?
3. Do you have any comments on the effectiveness of the glidepath approach described above?
4. Are there any known regulatory barriers and/or risks to/from the technology or business models not covered in the end-state rules that the Bank should consider at the outset?
5. Is the full set of rules set out in Appendix B consistent with the objectives and design principles of the DSS?
6. Do you have any feedback on the Bank's approach to creating the Gate 2 rules or the Gate 2 rules themselves?
7. Are there any specific features of technology and/or business models that would be incompatible with the proposed Gate 2 rules?
8. Are there any requirements in the proposed Bank's DSS rules which would conflict with the frameworks that govern a firm which is also regulated by the FCA and/or the PRA?
9. Do you agree with the proposed approach to managing potential interactions between Bank, FCA and PRA requirements?
10. Do you agree with the Bank's proposed capital requirements for DSDs, both at Gate 2 and end state?
11. Do you agree with the proposed approach to capital requirements where firms are also subject to other prudential regimes?
12. Do respondents have views on how the proposed regime balances the need to protect financial stability while allowing enough activity in the DSS to facilitate innovation?
13. Do you agree with the Bank's proposed fee regime for the DSS?

9: Regulator compatibility statement

FCA compatibility statement

The FCA’s proposals set out in this consultation are primarily intended to advance the FCA's operational objective of enhancing market integrity. They are intended to achieve this by supporting market efficiency and effective competition to further the soundness, stability and resilience of the UK financial system. They will also provide for the orderly operation of financial markets and protect against financial crime and market abuse by ensuring that the operator of a trading venue inside the DSS must meet the same standards as an operator outside of it.

At the same time, this approach will also support the interoperability of digital securities by facilitating their interaction with the wider financial system. The FCA considers a strong participation in DSS FMIs to be important if the benefits of the DSS are to be realised. These proposals are also compatible with the FCA’s strategic objective of ensuring that the relevant markets function well.

These proposals will contribute to strengthening the UK’s position in global wholesale markets by supporting innovation in FMIs and the wider market while maintaining high standards of market integrity and consumer protection.

The DSS serves to advance the FCA’s secondary international competitiveness and growth objective by positioning the UK as one of the countries which has taken proactive steps to allow for the use of developing technologies such as DLT in traditional markets. The proposed approach, including the Gate 1 application process and criteria which is aimed at facilitating innovative business models, should allow for HMT and the regulators to more easily determine the permanent changes which are needed to accommodate a wider adoption of such technologies. The FCA’s adoption of a proportionate regulatory approach is supportive of its secondary international competitiveness and growth objective by enabling regulatory costs on firms to be proportionate to the expected benefits.

The FCA also aims to foster innovation by providing for a same risk, same regulatory outcome’ approach with regard to sandbox entrants’ technology choices. This technology-neutral approach will help to promote competition and positive change, however it will simultaneously provide for the setting and testing of higher standard by ensuring firms remain responsible for meeting the existing operational resilience requirements. As such the DSS will help the UK to play a leading role in setting international standards. Further, the draft guidance will ensure firms have clarity as to how they can apply to the DSS, the expectations and limits which will be placed on them and how the regulators will provide for financial stability and market integrity. This should give firms the confidence to participate in the DSS and contribute towards increasing trust in and the reputation of UK financial markets. This can in turn make the UK more internationally competitive.

In preparing the proposals set out in this consultation, the FCA has had regard to the following regulatory principles set out in section 3B FSMA.

The need to use our resources in the most efficient and economical way.

Where possible, the FCA has sought to leverage existing processes, which includes maintaining the current authorisation process for firms wishing to operate a trading venue.

The principle that a burden or restriction should be proportionate to the benefits.

The FCA has chosen to maintain the existing framework that governs the operation of a trading venue as it believes that this adequately accounts for any risks presented by firms' activity in the DSS.

The need to contribute towards achieving compliance by the Secretary of State with section 1 of the Climate Change Act 2008 (UK net zero emissions target) and section 5 of the Environment Act 2021 (environmental targets).

The FCA has considered the environmental, social and governance implications of its proposals and its duty under section 1B(5) and 3B(c) of FSMA to have regard to contributing towards the Secretary of State achieving compliance with the net-zero emissions target under section 1 of the Climate Change Act 2008 and environmental targets under section 5 of the Environment Act 2021. Overall, the FCA does not consider that the proposals are relevant to contributing to those targets. The FCA will keep this issue under review during the course of the consultation period.

The general principle that consumers should take responsibility for their decisions.

The FCA does not believe the proposals in this consultation will affect the way in which consumers interact with the financial instruments in scope of the DSS and note that the trading venue access rules have remained unchanged for firms operating trading venues in the DSS.

The responsibilities of senior management.

As above, the FCA is maintaining the existing framework that governs the operation of a trading venue and therefore do not consider this to be relevant to our proposals.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation.

The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies, nor on any other specific kind of business organisation.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA or requiring them to publish information.

The FCA is maintaining its existing approach to supervision and enforcement and therefore does not consider this to be relevant to its proposals.

The principle that we should exercise our functions as transparently as possible.

This consultation sets out the FCA's proposals to implement and operate the DSS. Any feedback will be considered before opening the DSS for applications.

In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by section 1B(5)(b) FSMA). However, it does not believe that its proposals create any new risks in this regard.

The FCA has considered how its proposals and guidance will support the recommendations made by HMT under section 1JA FSMA 2000. Firstly, the FCA's approach to implementing and operating the DSS will support the government's objective of medium to long-term economic growth in the interests of consumers and businesses. It will do this by allowing a broad range of firms to take advantage of the opportunity which the DSS presents to test the use of developing technology such as DLT in traditional financial markets. To achieve this outcome, the FCA has designed its Gate 1 application process and criteria to be as streamlined and easy to navigate as possible, making it accessible for a diverse range of firms including small to medium-sized entities. By providing for a diversity of business models to enter the DSS, the FCA will be better placed to learn what permanent changes are needed to the regulatory framework. This separately furthers the government's aim to deliver smart regulatory reform, and support innovation and new developments in financial markets.

The FCA has had regard to the FCA's duty to promote effective competition in the interests of consumers and considers that by facilitating the use of new practices and business models it is promoting such competition.

The FCA has considered the equality and diversity issues that may arise from the proposals in this consultation paper. It does not consider the proposals to have any equalities impacts for persons who share a protected characteristic.

The FCA has had regard to the principles in the LRRA 2006 for the parts of the proposals that consist of general policies, principles or guidance and considers that it is providing for regulatory activities to be carried out in a way that is transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed.

Finally, the FCA has had regard to the Regulators' Code and considers its proposals to be compatible. The proposed approach to implement and operate the DSS is intended to allow for those regulated by the Bank and the FCA to comply and grow, while the approach to the supervision of sandbox entrants, including the new Memorandum of Understanding that will be agreed between the Bank and the FCA, will provide for the FCA to share information about compliance and risk as appropriate.

Bank of England's Statutory Objectives

The learnings from the DSS will also serve to further the Bank's secondary objective under FSMA 2023 in the long term to facilitate innovation in the provision of clearing and settlement services with a view to improving the quality, efficiency and economy of the services, while also maintaining resilience in those services in line with the Bank's primary financial stability objective.

Bank Equality and diversity

The Bank is required by the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services, and functions. The Bank considers that the proposals in this CP would not give rise to adverse equality and diversity implications.

Glossary

Bank – Bank of England.

Bank DSS Rules Instrument 2024 – The rules instrument containing the rules that apply to sandbox entrants in the DSS (DSS Rules).

Central Maintenance – Defined as providing and maintaining securities accounts at the top tier level.

Central Securities Depository (CSD) – traditionally an entity that centralises and manages settlement risk across key financial markets. CSDs undertake Financial Market Infrastructure (‘FMI’) activities, such as providing notary, settlement and maintenance functions for financial securities such as shares and bonds.

Central Securities Depositories Regulation (CSDR) – The Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012.

Digital Securities – The financial instruments in scope of the DSS as specified in Regulation 3(7) of the DSS Regulations and defined as ‘FMI sandbox instruments’. For the purposes of this consultation paper, such financial instruments are referred to as ‘digital securities’.

Distributed Ledger Technology (DLT) – A type of technology that enables the sharing and updating of records in a distributed way.

Digital Securities Depository (DSD) – Has the same meaning as the definition given in regulation 2 of the DSS Regulations: ‘a sandbox entrant permitted to engage in one or more DSS activities referred to in DSS Regulation 3(5)(b) as a result of the FMI sandbox arrangements’.

Digital Securities Depository Link (DSD Link) – an arrangement between (i) DSDs; or (ii) DSDs and CSDs whereby:

a) a DSD becomes a participant in the securities settlement system of another DSD or a CSD; or

b) a CSD becomes a participant in the securities settlement system of a DSD; to facilitate the transfer of securities from the participants of the latter DSD or CSD to the participants of the former DSD or CSD.

or an arrangement between (i) DSDs; or (ii) DSDs and CSDs whereby:

a) a DSD, accesses another DSD or a CSD indirectly via an intermediary; or

b) a CSD accesses a DSD indirectly via an intermediary.

DSD links include standard links, customised links, indirect links, and interoperable links.

Digital Securities Sandbox (DSS) – This is the first financial market infrastructure sandbox in the UK that allows firms to use DLT in the undertaking of activities traditionally performed by a Central Securities Depository (CSD) and in the operation of trading venues under temporarily modified legislation.

DSS activities – As defined in regulation 2 of the DSS Regulations.

DSS CSDR – As defined in Part 2 of the Schedule to the DSS Regulations

DSS Regulations – The Financial Services and Markets Act 2023 (Digital Securities Sandbox) Regulations 2023. These Regulations created the temporary framework under which sandbox entrants and regulators will operate.

DSS USRs – The Uncertificated Securities Regulations as modified in Part 5 of the Schedule to the DSS Regulations.

FCA – UK Financial Conduct Authority.

FSMA 2000 – The Financial Services and Markets Act 2000.

Gates – The DSS is structured in five main stages and four 'gates' between those stages. To progress through the DSS, a firm will need to pass through a series of gates. At Gate 1, an applicant will be assessed against the eligibility criteria. At subsequent gates successful applicants will be required to demonstrate their enhanced ability to meet the expected regulatory standards to supervisors. Each gate has different requirements that are a pre-requisite to moving onto the next stage (see Appendix A for individual gate details).

Go live limit – The allocated portion of the overall capacity of the DSS that each DSD is given for certain asset classes once they have successfully got past Gate 2 and have been given permission to undertake live activities. There are rules (see draft Bank DSS Rules Instrument) that DSDs have to meet with respect to limits.

HMT – His Majesty's Treasury.

Hybrid entity – A sandbox entrant which has been allowed to undertake both the functions of a trading venue and those traditionally performed by a CSD. Such a firm would be supervised jointly by the FCA and the Bank.

Modified framework – The temporarily modified legislative and regulatory framework created by HMT through the DSS Regulations to allow firms to apply to become a DSD and to carry out activities within the DSS.

Notary function – Initial recording of securities in book-entry forms or forms of recording of securities using developing technology.

Stages – The DSS is structured in five main stages and four 'gates' between those stages. The stages represent the different stages which a firm will pass through from first applying to become a sandbox entrant to operating in a possible new permanent regime outside of it.

SAN – A 'sandbox approval notice' as defined in regulation 2 of the DSS Regulations.

Sandbox entrant – As defined in Regulation 2 of the DSS Regulations: 'a person that makes an application to participate in the FMI sandbox arrangements and has its application approved under regulation 5(2)(a) or (b)'.

Scaling stage – DSDs that successfully meet the Gate 3 requirements at the review points will be able to move onto Stage 4 (the scaling stage). In Stage 4 (the scaling stage), firms that enter this stage will have access to higher limits. At this point, DSDs can increase their activity within the higher limits and begin to consider how they meet end-point requirement after the DSS.

Securities Settlement System – A securities settlement system as defined in the DSS CSDR, or a system operated by a DSD that settles transactions in financial instruments against payment or against delivery, irrespective of whether that settlement system is a system in relation to which a designation order made under Regulation 4 of the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 is in force.

Tokenisation – Generally used to refer to the representation of traditional assets – eg, financial instruments, a basket of collateral or real assets – on distributed ledger technology (DLT) or similar technology.

UK CSDR – Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, which forms part of assimilated law by virtue of section 3 of the European Union (Withdrawal) Act 2018.

USRs – The Uncertificated securities Regulations 2001.

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1. Under the Financial Services and Markets Act 2023 (Digital Securities Sandbox) Regulations 2023, there is no

statutory duty to consult on the regulators' proposals to implement and operate the DSS. While the regulators are choosing to consult on their approach to implement and operate the DSS, they may choose not to in future for further rules or guidance.

2. Other FMI functions such as operating a central counterparty or payment system will be outside the scope of the DSS.
3. This is a category of firm for the purposes of the DSS. This includes DSD undertaking the activities of CSDs in the DSS, either as a standalone entity or alongside operating a trading venue as a 'hybrid entity'.
4. While shorter settlement times can help reduce the build-up of credit risk in the system, they could also lead to changes in the way market participants manage liquidity, which could impact liquidity risk in the system more broadly which is something that the DSS can help us to explore.
5. **Consultation on the Digital Securities Sandbox**.
6. This also includes where the firm wishes to combine the role of the DSD with that of a trading venue ('a hybrid entity').
7. Permanent amendments to modified legislation would require HMT to lay a statutory instrument after having reported to Parliament on the DSS.
8. Regulatory technical standards (RTS) set out very specific requirements and standards to ensure financial services institutions are able to comply with UK financial services regulation.
9. We anticipate that PRA Rules would not be waived or modified for banking entities wishing to operate a DSD.
10. The PRA expects banks to take responsibility for ensuring that the capital they hold is adequate at all times and covers risks from any new activities, with the Individual Capital Adequacy Assessment Process being an integral part of meeting this expectation.
11. Namely, instruments specified in any of paragraphs 1 to 3 and 11 of Part 1 of Schedule 2 of the RAO. The focus of the DSS is on the regulation of activities (including trading and settlement) directly relating to securities, rather than clearing activity related to derivatives. However, there is no restriction on the creation of derivatives contracts that refer to assets held at a DSD and that are settled bilaterally or at a regulated CCP.
12. As defined in **MiFIR**.
13. For example, assets could be used in repurchase agreements governed by a Global Master Repurchase Agreement, in a securities lending transaction governed by a Global Master Securities Lending Agreement, or as collateral to transactions governed by a Credit Support Annex.
14. Due to differences in liquidity and the structure of the market segment relative to conventional gilts, index-linked gilts are not eligible for the DSS.
15. The Bank's general fee raising powers for FMIs comes from **Paragraph 36 of Schedule 17A, FSMA 2000**. The Bank's powers to raise fees for the DSS comes from the same paragraph as modified by **Part 3 of the Schedule to the DSS Regulations**.
16. The Bank also has the power to recover any fees owed to it under Paragraph 36 of Schedule 17A of the modified DSS FSMA 2000 Regulations as debt due to the Bank.
17. Following the Bank's consultation in August 2017 on **Levying fees for financial market infrastructure supervision**, the Bank proposed to consult every year on the fees for FMI supervision to provide industry with the opportunity to respond. See the **Fees regime for financial market infrastructure supervision 2018/19**.
18. The Bank's fee year runs from 1 March to the end of February. **Policy Statement: Fees regime for the supervision of financial market infrastructure**.

Appendices

- Appendix A: Draft Guidance on the Operations of the Digital Securities Sandbox (PDF 0.6MB)
- Appendix B: Bank's Draft DSS Rules (PDF 1.6MB)
- Appendix C: Bank's Draft DSS Rules summary table (PDF 0.3MB)
- Appendix D: FCA's Amendment of the Decision Procedure and Penalties Manual (PDF 0.2MB)