HM Treasury

Digital Securities Sandbox

Response to consultation

November 2023

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Executive Summary

1.1 In July the Government published a consultation on its proposal for implementing a Digital Securities Sandbox (DSS).[1] The DSS is an initiative to be run by the Bank of England and Financial Conduct Authority that will help facilitate the adoption of digital asset technology in UK financial markets. It will do this enabling participating entities to have access to modifications to the UK legislative and regulatory framework, in cases where there are currently barriers to conducting digital assets activity. Participants will be subject to limits on their activity and close supervision by the regulators. The DSS is not mandatory, and where a proposal can already be accommodated within existing legislation firms will be expected to utilise existing authorisation processes.

1.2 The DSS will be the first Financial Market Infrastructure (FMI) Sandbox set up under the powers given to the Government in the Financial Services and Markets Act (FSMA) 2023. The July consultation set out, and sought feedback on, the key features of the DSS, as well as further policy and legal issues around the utilisation of digital securities. This document summarises the feedback from industry on the consultation, and provides a response from Government to the issues raised.

1.3 The fundamental design of the DSS was well received. Feedback praised the emphasis on facilitating innovation, without compromising on regulatory outcomes. Responses emphasised that while the starting point is existing legislation, the flexibility to change requirements in response to novel use cases through the DSS was also important.

1.4 Specific aspects of the DSS proposal were also highlighted in responses. This included the decision not to hard-wire limits on activity in the DSS into legislation (instead giving the regulators flexibility to set such limits). The interdependence between activity inside and outside the DSS, and the principle that digital securities in the DSS should be treated the same as traditional securities, were praised. Responses were positive about the ability for participating entities to transition from the DSS and operate outside the DSS without limits, and about the fact that, facilitated by the powers in FSMA 2023, the Government can efficiently make permanent legislative amendments.

1.5 Feedback stressed the need for further clarity in various areas, including the application process, the management of limits set in the DSS, the interaction of activities in the DSS with activities outside the

1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1168457/Consultation_on_Digital_Securities_Sandbox.pdf

DSS, and the process for exiting the DSS. In most cases these details will be provided by the regulators in due course.

1.6 1.6 The proposed modifications to legislation to be made through the DSS also elicited responses. These largely agreed with the legislation proposed to be in scope, in some cases identifying specific provisions to be modified. Broadly, the Government will proceed on the basis that the focus of modifications will be UK Central Securities Depositories Regulation (CSDR) and associated legislation (such as the Uncertificated Securities Regulation). In some cases, legislative requirements will be disapplied in the DSS, with the appropriate regulator putting rules in place as necessary.

1.7 Modifications to some pieces of legislation will be considered in parallel to the DSS, in particular the Settlement Finality Regulations (SFRs) and Financial Collateral Regulations (FCARs).

1.8 Some responses suggested that the full extent of necessary modifications may not yet be known. The Government will work with the regulators and industry to identify any further legislative provisions that need to be brought into scope, and if necessary can facilitate this via further statutory instruments amending the DSS. Under the powers in FSMA 2023, the Government can also set up further FMI Sandboxes, if this is desirable.

1.9 Feedback was positive about the flexibility to be offered on the use of digital cash for settlement in the DSS.

1.10 The consultation also covered a number of further policy issues regarding the DSS and the adoption of digital assets more widely across markets. Responses were receptive to keeping the DSS technologically neutral. They were largely content with the use of existing regulatory reporting regimes, and with existing requirements relating to the participation of retail investors. Feedback was provided regarding the UK's custody regime where the FCA is separately conducting a review.

1.11 Responses noted the need to consider further how entities in the DSS will interact with the existing tax regime in the UK. On cross industry collaboration, feedback express support for setting up a cross-industry body and for global coordination on digital assets regulation.

1.12 Finally, some legal issues were raised in the consultation. The Government will consider further how to respond to the issues raised, both in the DSS and outside, particularly regarding how clarity can be provided around the accommodation of digital assets within existing public and private law.

Chapter 1
Introduction

2.1 In July the Government published a consultation on its proposal for implementing a Digital Securities Sandbox (DSS).[2] We received a wide range of responses, including from incumbent FMI firms, financial services firms interested in the adoption of digital assets, new entrants intending to use digital asset technology to perform FMI functions, technology firms, nongovernmental organisations and more.

2.2 This document summarises the responses received and the Government's intended course of action. It follows the structure of the original consultation: in Chapter 2 we summarise the feedback received regarding the key features of the DSS proposal, responding directly in some cases, while in others noting that the regulators will provide guidance in due course. In Chapter 3 responses to various policy issues relating to the DSS and the adoption of digital assets more widely are set out. Chapter 4 covers the responses to some specific legal issues raised in the consultation document.

2.3 After having analysed the responses, the Government intends largely to retain the approach originally outlined in the consultation. This will involve instituting a broad framework for the DSS in legislation, with the regulators given appropriate flexibility to manage requirements for participating entities.

2.4 The Government will shortly lay a statutory instrument before Parliament to implement the DSS. The Bank of England and Financial Conduct Authority will set out the application process, as well guidance and rules for the DSS.

2.5 The consultation also asked for expressions of interest from those considering participating in the DSS, noting that these can be sent beyond the closing date of the consultation. To date, the Government has received 19 expressions of interest, across a mix of incumbent FMIs, existing regulated FS firms, and new entrants. Informal engagement with industry suggests that more will be sent, and we continue to welcome expressions of interest from potential applicants.[3] These should continue to be submitted to the email address at: digitalsecuritiessandbox@hmtreasury.gov.uk.

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2 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1168457/Consultation_on_Digital_Securities_Sandbox.pdf

3 Note that submitting an expression of interest does not constitute an application to the DSS- the application process will be set out in due course by the regulators.

Chapter 2

Digital Securities Sandbox: Key Features

Assets in scope

Summary of feedback

3.1 Industry responses to the consultation were mostly supportive of the proposed approach to assets in scope. Feedback emphasised the need to retain flexibility, and to ensure that the broadest array of assets possible are included within the DSS.

3.2 Responses were largely content with the proposed inclusion of existing categories of security within the regulatory perimeter, with the utilisation of existing terminology and categories of security being beneficial. Respondees felt that it was important that both the final legislation and regulators rules/guidance are clear about the specific assets that are allowed and the precise legal language for this.

3.3 The consultation responses highlighted that it would be desirable for debt, equity and money market instruments to be in scope. In some cases, it was pointed out that securities that closely resemble these instruments should be included, for instance 'equity-like' instruments (such as depository receipts and certificates) and all securitised instruments as opposed to just bonds. There was a strong preference that interests in funds should be included - this included UCITS, but also other types of funds (such as property and exchange traded funds).

3.4 Responses also advocated the inclusion of government and public securities, particularly sovereign debt such as gilts and T-Bills. Other instruments raised included those giving entitlement to investments, certificates representing securities and rights/interests in investments. Further assets highlighted in responses included mortgage-backed securities, structured notes, commodities/tokenised commodity units, derivatives for hedges, foreign exchange and carbon offset credits.

3.5 Responses were mixed on whether to include derivatives directly in scope of the DSS. A minority of responses were critical of the decision not to include unbacked cryptoassets. Debate over the correct treatment of unbacked cryptoassets, such as defining them as a commodity, was raised.

Government response

3.6 The Government intends that all relevant assets currently in scope of the regulatory perimeter, aside from derivatives, are capable of being included in the DSS. This will be set out in the statutory instrument implementing the DSS, which will refer to Schedule 2 of FSMA 2000 (Regulated Activities Order) 2001. The particular assets that can be issued/traded/settled on a specific entity in the DSS will be stipulated as part of the Sandbox Approval Notice (SAN) issued to each Sandbox Entrant, which will also set out the limits they are subject to.

3.7 It is worth clarifying that derivatives are only excluded from the DSS in the sense that no derivatives-focused legislation is being brought into the process for amendment. We believe that the existing regulatory and legal framework allows for the creation of derivatives that refer to assets within the DSS (for example, those registered at a Digital Securities Depository). Concerns raised – for example about hedging transactions – should be addressed by this clarification. See the section on non-DSS activities for further discussion of the interaction between activities in the DSS and non-DSS activities.

3.8 On unbacked cryptoassets, the government will maintain the policy of exclusion for the DSS, given there is currently no established regime for cryptoassets that could be amended in the Sandbox. There is an existing separate workstream underway to put in place a regulatory framework for cryptoassets, which will proceed separately to the DSS.

3.9 The FMI Sandbox powers in FSMA 2023 could potentially be a helpful mechanism in future for assessing appropriate regulatory innovation in relation to cryptoassets. The Government will continue to assess the desirability of a further sandboxes to help inform the development of legislation and regulation in the cryptoasset space.

3.10 The Government will leave open the possibility of including non-GBP assets in the DSS. However, the early activity in the DSS is likely to be focused on GBP-only assets. The ability to included non-GBP assets in the DSS will be left to the discretion of the Bank of England.

3.11 The drafting of the SI will not preclude the inclusion of a digital sovereign debt instrument, if the Government deems this to be desirable in future. Such an approach may also require an additional statutory instrument (for example to bring changes to the Government Stock Regulations into scope if these are required). For the time being, the expectation is that the focus of the DSS will be on the issuance of private sector debt instruments.

Activities, designations and authorisations

Summary of feedback

3.12 Responses broadly agreed with the approach set out. There were calls for more detail regarding the minimum requirements for entry, as well as clarity around the different stages within the DSS. Respondents asked about the ability to seek other designations/authorisations at

later stages (for example by becoming an MTF at a later point having become a DSD earlier).

3.13 On the activities in scope, responses were broadly positive about the inclusion of notary, settlement, and maintenance activities, and operating a trading venue. Some responses suggested that the scope could be made broader, and include activities such as payments, custody, and other services. The ability to combine further activities into one entity (in addition to combining the roles of trading venue and CSD/DSD), such as being both a DSD and a payment system, was raised as potentially desirable.

3.14 Some responses raised concerns that the scope would be too narrowly inspired by existing FMIs, with the risk of embedding current market structures, and cautioned that flexibility would be needed to test new proposals (particularly proposals that distribute functions).

3.15 For example, there was concern that the 'DSD' designation would draw too much on the existing features and authorisation processes for a CSD, which would prove a substantial barrier to entering the DSS to perform this activity. Similar feedback was provided regarding the authorisation process for trading venues. Ensuring that the time to authorisation for DSS trading venues is sufficiently quick was also raised.

3.16 Some responses cautioned that structural innovation could come at a cost, noting that any new structures or processes should not undermine the Principles for Financial Market Infrastructures (PFMIs).[4]

3.17 Responses felt that while the approach outlined was an appropriate starting point, there was an expectation that the DSS would over time be extended to include other activities or that other FMI sandboxes would be implemented.

3.18 There was agreement that both primary and secondary market activity should be in scope. The need to ensure that an entity in the DSS could perform both public and private financial market activity was highlighted.

3.19 Some responses noted that existing activities may become very different, particularly when using public blockchains (for example self-custody and peer to peer trading). The issues around public versus private blockchains will be covered in later section.

3.20 Some feedback highlighted that clarity should be provided regarding the use of DLT internally by firms (e.g. for their own internal book/record-keeping, rather than interacting with the wider market), and whether this would be out of scope of the DSS, or compliant with existing regulation.

Government response

[4] https://www.bis.org/cpmi/info_pfmi.htm

3.21 The Government's approach is that the starting point for the DSS is existing legislation, given many of the same fundamental activities will exist in digital FMIs (even if the nature of those activities will change). However, the DSS should be flexible enough to accommodate different structures: this includes not only the ability to function as both a trading venue and a DSD, but also the ability to distribute functions in a different way.

3.22 The Government intends to do this in some cases by giving flexibility to the Bank of England to manage the requirements for being a Digital Securities Depository (DSD) in the DSS. In particular, some regulations in UK CSDR will be converted into regulator rules within the DSS. This will give the Bank the flexibility to make, amend, and waive rules for all DSDs in the DSS and to tailor rules to accommodate individual proposals. The Bank will consult on regarding rulemaking in the DSS.

3.23 On the trading venue side, there was far less feedback indicating that the relevant legislation (particularly UK MIFIR) needs substantive change. The Government believes that the existing authorisation processes for trading venues should therefore be sufficient.

3.24 Applicants seeking to operate a trading venue in the DSS will be able to either use: 1) an existing Part 4A permission or exemption as a Recognised Investment Exchange (RIE), or 2) apply for authorisation as an investment firm operating an MTF/OTF. Requests to use an existing permission will be decided on a case-by-case basis and will ultimately depend on the extent to which the DSS business model differs from the trading venue for which authorisation has already been given. We anticipate that in many cases a Variation of Permissions will be required.

3.25 The requirement and process for becoming authorised to operate an MTF or OTF are set out on the FCA's website. If potential applicants are unsure of whether their business model would require authorisation as a trading venue, they should consult the Perimeter Guidance manual in the FCA's Handbook.

3.26 The Government does not currently intend to expand the scope of activities beyond notary, settlement, maintenance and operating a trading venue. This is largely because it is still unclear what the case is for extending the scope to other activities, given that in many cases the authorisation and supervisory processes for such activities is already compatible with digital assets. However, the Government will continue to liaise with industry and examine the case for inclusion of other activities in future - this could be facilitated by setting up a separate FMI sandbox.

3.27 An important point to reiterate is that it will be possible to perform activities other than the four activities directly in scope (i.e. notary, settlement, maintenance, operating a trading venue), provided that is done in line with existing regulations and rules. Further detail on the interdependence between DSS and non-DSS activities is contained in the next section.

3.28 The Government also notes that the DSS should be sufficiently flexible to enable different designations/authorisations to be sought at different points (for example, it should be possible to get DSD designation at one point, and permission to operate an MTF/OTF at a later point).

3.29 Regarding firms use of digital asset technology/DLT for internal purposes, we do not consider this to be a DSS-related issue. Firms should assess how their use of DLT internally sits within the wider financial services regulatory framework.

Non-DSS activities

Summary of feedback

3.30 Responses were broadly supportive of the principle of using existing regulatory and industry frameworks for non-DSS activities. The ability for activities in the DSS to be interdependent with those outside the DSS was welcomed, particularly given the need to ensure all stages of an asset lifecycle can take place.

3.31 A minority of responses disagreed with this approach on the basis that it would be too limited in ambition (given the need for full authorisation under existing legislation for such non-DSS activities), and called for a quicker and more streamlined licencing process across a greater array of activities.

3.32 Some responses wanted the core scope of the DSS to be broadened to other activities, as covered in the previous section. Feedback stressed the need to consider further the impact of non-DSS legislation and regulation on DSS assets (such as UCITS, AIFMD, CASS rules and the capital treatment of DSS assets) and consider moving further pieces of legislation into the scope of the DSS in future.

3.33 Some responses wanted more clarity on what is permissible, such as the handling of DSS assets by entities not directly participating in the DSS (for example, when being used as collateral outside the DSS, or making use of a depository to safekeep relevant fund assets), particularly by existing FMIs. Further clarity on the interaction with payment systems, and the relevant authorisations necessary to provide digital cash in the DSS, was sought.

3.34 Some responses asked about the ability to perform both non-DSS and DSS activities as part of the same entity, for instance whether an entity in the DSS, such as a DSD, could also be a CCP or payment system at the same time. A minority of responses expressed support of continuing to segregate roles where appropriate.

3.35 Responses supported the intention to treat DSS securities in the same way as traditional securities, and to facilitate functionality outside the DSS.

Government response

3.36 The Government intends to take forward the approach to non-DSS activities outlined in the consultation. A key principle will be that

digital securities are the same as their traditional equivalents, meaning they should accordingly be treated in the same way from a legal and regulatory perspective. Digital assets issued/settled/traded in the DSS should in principle be capable of being utilised across markets, for example as collateral or as part of repo transactions.

3.37 It will be possible to perform activities other than the four activities directly in scope (i.e. notary, settlement, maintenance, operating a trading venue), provided it is done in line with existing regulations and rules.[5]

3.38 As noted, the government will keep the scope of the DSS – including whether further legislation needs to be brought into scope – under review.

3.39 In line with the proposal in the consultation, firms will not need to apply directly to participate in the DSS in order to handle DSS assets. An application will only be necessary where an entity wants to directly perform the activities of notary, settlement, maintenance (the activities of a CSD) and operating a trading venue in relation to digital assets, under a modified legislative and regulatory framework.

3.40 Regarding the ability of a Sandbox Entrant to perform non-DSS activities as part of the same entity, the same principle will apply in that, unless otherwise specified in their SAN, a Sandbox Entrant may carry out non-DSS activities so long as these continue to meet all relevant requirements in unmodified legislation.

Limits on DSS assets and activity

Summary of feedback

3.41 Responses welcomed the flexible approach to limits and capacity set out in the consultation document. In particular, not hard-wiring quantitative limits into legislation was positively received, and in general responses recognised that this framework approach will give the regulators the ability to set limits on a case-by-case basis, lifting limits based on the meeting of requirements and management of risk.

3.42 The main ask in responses was for further clarity on how limits and capacity will be managed in the DSS; in particular how the meeting of requirements would unlock higher amounts of permitted activity. More understanding was sought on how DSS-wide capacity would be set and allocated among participants, as well as how individual entity-level limits would be set. Some responses requested a transparent methodology up front, to help potential applicants to the DSS determine the viability of their proposal.

3.43 In general, feedback stressed the need for limits to be sufficiently high to ensure commercial viability in the DSS, or even for there to be

[5] For example, if an entity in the DSS wants to ensure that custody services can be provided in relation to its platform, then this should be possible provided the entity providing those custody services is properly authorised and meets the relevant requirements (particularly CASS rules)

no limits at all. Responses were mostly not able to provide clear data regarding the volume of activity required to achieve commercial viability. In some cases responses suggested that entities participating in the DSS should be looking to longer term development, and that establishing commercial viability or a positive return on investment in the DSS itself was less relevant.

3.44 Responses noted that the consequences of breaching limits were not addressed in the consultation document.

Government response

3.45 Most of the issues raised in this section will be addressed in guidance provided by the regulators. This will include:

- Detail regarding the basis for DSS capacity allocations
- Discussion on DSS-wide limits for certain asset classes (for example, systemically important and/or established asset classes)
- Details of how limits will be allocated to participating entities, including how they will change as they progress

Eligibility to participate in the DSS

Summary of feedback

3.46 There was broad agreement in responses about the proposed approach to eligibility for the DSS. Responses wanted the DSS to be able to facilitate different kinds of entity, using potentially different structures. The ability for both existing authorised firms and new entrants to apply was positively received.

3.47 Some feedback called for branches of non-UK firms to be able to participate directly in the DSS, though others disagreed. Feedback was supportive of the possibility of applications being submitted from groups of entities, or entities acting as a consortium. In some responses, there was a desire to avoid complexity and cost, such as by having to establish a special-purpose vehicle to participate in the DSS.

3.48 Some feedback asked that the requirement to establish a legal entity should be a condition of approval to enter the DSS, rather than be required at the point of application.

3.49 Most responses were comfortable with demarcating a Sandbox from any non-Sandbox business. Some responses sought clarity on whether clients of an entity in the DSS would themselves need to apply to the DSS.

Government response

3.50 To conduct live activity in the DSS as a Sandbox Entrant (and be designated as a DSD or authorised as an MTF), we would require the registered entity to be established in the UK. This is because the four activities in scope would carried out according to modified UK regulations and rules and require direct supervision by the UK regulators. This will not be possible if the applicant is supervised in another jurisdiction.

3.51 However, it is intended that there will be no specific limitation in the DSS legislative framework on overseas firms utilising or interacting with a Sandbox Entrant, subject to meeting regulatory requirements. For example, an overseas firm could be a participant in/user of a Sandbox Entrant, or provide ancillary services to it.

3.52 Regarding the ability of firms to apply as a group/consortium, this should be acceptable in principle, though a single entity with a clear governance structure may need to be formed by the group in order to be able become a DSD/trading venue.

3.53 Regarding when a legal entity will need to be formed by an applicant (i.e. at the application stage, Sandbox Entrant stage or when performing live activity), the view of the Government is that a legal entity will likely need to be an established legal entity at the application stage (for example, applicants may be asked to provide an LEI to the regulators as part of an application).

3.54 Further detail on the approach to eligibility will be provided in regulator guidance and rules.

Applying to participate in the DSS

Summary of feedback

3.55 There was little objection in responses to the scope of any likely request for information from applicants outlined in the consultation. There was a desire from respondents that the application process should be progressive and flexible, with clear criteria. Respondents wanted to ensure the regulators were required to give clear response times for applications, and clear reasons for rejections.

3.56 There was a desire for application windows to be as flexible as possible. This included avoiding limited application windows that were not open throughout the DSS. Being able to ask questions of the regulators prior to formal submission of an application was highlighted as desirable in some responses. Some responses indicated that they would like the ability to comment on application templates before publication by the regulators.

3.57 Enabling applicants to identify provisions for modification in DSS as part of their applications was advocated in some responses. Some feedback indicated that setting out wind-down arrangements may prove challenging at the application stage.

3.58 A minority of responses criticised the approach to applications as being too lengthy and comprehensive, and as potentially favouring incumbents. Concerns were raised about the intention to use the existing authorisation process for MTFs, raising the danger that new entrants could end up waiting for a lengthy period to achieve authorisation.

3.59 The handling of third-party providers in the application process was also raised, specifically whether any additional processes were required.

Government response

3.60 The framework in the regulations is intended to provide flexibility to the regulators regarding the application process, while ensuring that the regulators can meet their statutory objectives. The FCA and Bank are expected to set out their approach to applications, supervision and the use of the powers which have been delegated to them through the DSS arrangements. Industry will have the opportunity to provide feedback on the draft guidance. In parallel with this publication, the Bank of England will consult on the proposed rules and fees that will apply to DSDs undertaking live activity in the DSS.

3.61 Applicants will need to set out the regulatory barriers that prevent them from innovating without using the DSS. Without clear regulatory barriers to their technology and/or business model, the applicant would not be eligible to participate in the DSS. As the next section sets out, the converting of requirements into rules should provide flexibility for modifications not anticipated in advance. HMT can lay further SIs amending the DSS, though given the need to manage Parliamentary time we would expect these to be infrequent.

3.62 The arrangements for application windows will be established by the regulators. As the consultation document set out, we do not expect all entities to apply to the DSS immediately. This would entail an application window that is open for a significant period of time, or multiple application windows at different points. Requirements on wind down plans will also be set out by regulators in due course.

3.63 As noted, firms that interact with an entity in the DSS (such as a user, for instance a firm using a DSD to settle trades) should not need to apply to the DSS themselves, given they would not be directly performing the four activities in scope.

Legislative modifications

Summary of feedback

3.64 Responses broadly agreed with the proposed approach to legislative modifications in the DSS. Feedback stressed the need for case-by-case flexibility to cater for exemptions and modifications. While responses tried to set out all current legislative barriers as far as possible, it was noted that there were likely to be further unknown barriers emerging once use cases begin to be implemented that may require further legislation to be brought into scope.

3.65 Where responses identified specific provisions in need of modification, the focus was mostly on the UK Central Securities Depositories Regulation (CSDR). In most other cases, responses tended not to identify specific requirements, but noted broadly where legislation may need changing to accommodate digital assets.

3.66 Feedback highlighted that the Government and the regulators should ensure that modifications can apply to entities using or otherwise interacting with Sandbox Entrants in the DSS, as well as the Sandbox Entrants themselves. Some said that there may be overlap

with frameworks out of scope of DSS, such as custody frameworks, where changes may be needed to support activity in the DSS.

3.67 Clarity was sought on whether it will be regulatory or legislative barriers being dealt with in a DSS (i.e. will rules or underlying legislation change). Feedback also highlighted the difference between modifications to enable the use of DLT, and alleviations from regulation/legislation where requirements prove too burdensome for early-stage small-scale activity.

3.68 Some responses noted that while applicants should outline needed modifications/exemptions in their applications, they shouldn't have to provide legal drafting for any modifications required. Responses asked that firms undertaking similar activities should be granted similar modifications to ensure fairness.

3.69 Feedback on UK CSDR made a number of points, including the need to change definitions, and to change requirements in different places (such as around use of central bank money, international open communication procedures, outsourcing requirements, the provision of banking services, and separation of trading and settlement functions).

3.70 Some responses also commented on the USRs, noting that deemed approval as operator of a relevant system under the USRs would be necessary, in order to ensure legal certainty of title of securities transfers. In some cases, it was felt that the requirements in the USRs would be too onerous (though it was not clear what particular requirements were problematic.) Linked to the USRs was feedback on the Companies Act, where some responses raised a number of issues, including around whether clarity was needed on the ability to issue a proper instrument of transfer.

3.71 Responses were mixed on the correct approach to the UK Settlement Finality Regulations (SFRs). Some supported the suggestion that temporary designation with proportionate requirements might be suitable. However, some responses noted that particular care should be taken with the SFRs, given their fundamental legal importance, and that there was a need for high standards, rigorous oversight and proper capitalisation even within the DSS. Some raised issues around the compatibility of public blockchains with the SFRs. Some of the key concepts and definitions were cited as potentially difficult to apply (e.g. references to a 'system operator' responsible for the operation of the system and 'book-entry' records and the maintenance of 'accounts').

3.72 Responses generally supported the recommendation of the Law Commission regarding the need to assess potential clarifications to the Financial Collateral Arrangement Regulations (FCARs).

3.73 Feedback largely did not suggest particular changes to UK MiFIR, although some respondents suggested that there may be issues in relation to transaction reporting, and access rules relating to trading venues and CCPs. A minority of responses also asked about the relaxation of the rules on retail participation. The ability of trading venues using public blockchains to comply with the definition of

"trading venue" in MiFID (and with MiFID more generally) was also questioned.

3.74 Feedback was also set out on legislation not currently in the proposed scope of the DSS. Responses suggested that enabling the use of digital asset technology in relation to funds may entail changes to Undertakings for the Collective Investment in Transferable Securities (UCITS) and Alternative Investment Fund Managers (AIFM) legislation (for example to rules regarding custody and depositories).

3.75 Responses also noted that the current Money Laundering Regulations 2017 requires providers of cryptoasset services to register with the FCA. Some responses also suggested there was a need to rethink Know-Your-Client and Anti-Money Laundering functions to remove duplications (for example where different DLT-based FMIs interact each other, with responsibilities capable of being passported across systems).

3.76 Other legislation raised as potentially in need of modification included payments legislation (such as the Payment Services Regulations (PSRs), Electronic Money Regulations (EMRs) and provisions in the Banking Act 2009) the UK Securities Financing Transactions Regulation (UK SFTR), UK disclosure regimes and the Law of Property Act 1925. In many of these cases, while responses pointed to the possible need for modifications, they did not identify specific provisions.

3.77 Legislation relating to government securities, such as the Government Stock Regulations and Treasury Bill Act, was highlighted as in need of change if in future the UK Government chooses to issue a digital sovereign debt instrument.

3.78 Some responses emphasised the need for clarity on the legal form of digital assets, for example whether they can be in registered, digital record or bearer form. Some feedback suggested that the fractionalisation of tokenised securities may face ambiguities due to lack of legislative clarity.

Government response

3.79 The Government intends to proceed with the approach to legislative modifications outlined in the consultation.

3.80 For CSDR, the Government will disapply many existing legislative requirements, some of which will be replaced by rules within the DSS. This is so that the Bank of England will be able to manage CSDR requirements for entities participating in the DSS more flexibly. This approach will enable the Bank to both provide modified requirements where they are a barrier to using digital assets, but also provide alleviations where particular requirements are too burdensome for entities that are starting at a small-scale.

3.81 The Government will set out any relevant changes to the USRs and Companies Act via the legislation implementing the DSS. We believe that it will not be necessary to amend the Law of Property Act

1925, given that the USRs disapply the former requirements for designated operators (and DSDs will be able to operate a relevant system under the USRs as part of the DSS).

3.82 On the SFRs, the Government will give the Bank the power to offer an optional exemption from having to seek SFR designation to entities while they are in the DSS. Entities which wish to seek full SFR designation whilst in the DSS will be able to do so. Entities in the DSS will ultimately be required to obtain full designation under the SFRs on exiting the DSS if they wish to operate a securities settlement system, though the Government will consider whether this will be necessary for non-systemic operators. Entities which wish to seek SFR designation whilst in the DSS will be able to do so.

3.83 In parallel to the DSS, the Government will consider whether and how to modify the SFRs permanently, in order to accommodate digital assets. Similarly, the Government will further consider how to take forward the recommendations made by the Law Commission in relation to FCARs. In both cases, the Government has the capability to lay statutory instruments outside the DSS to implement changes, and work will be taken forward separately to the DSS.

3.84 The Government recognises that DLT could enable future innovations in MiFIR transaction reporting, but we will not be facilitating an exemption from Article 26 at present as we consider the current schema to be compatible with reporting by DSS trading venues.

3.85 We do not identify a need for the CCP access rules in MiFIR to be modified, given that a DSS trading venue is currently entitled to deny a request by a CCP. Trading venues in the DSS will be expected to maintain transparent and non-discriminatory rules of access in the same way that they would outside the DSS. We do not consider retail participation to be ruled out by the current framework and also do not view this as a barrier unique to the DSS, therefore, as above, we will be maintaining the current access rules for trading venues.

3.86 Regarding legislation not currently in scope of the DSS (and the FMI Sandbox powers in FSMA 2023), the government received feedback that suggested changes may be desirable, but the nature of these changes was not specific. The government encourages industry to identify further specific provisions in legislation and regulation that do not support use of digital asset technology.

3.87 The Government does not rule out bringing further pieces of legislation into scope of the DSS. A further amending SI can be laid before Parliament to make the necessary changes if this is desirable.

3.88 Some respondents expressed an interest in fractional securities and queried how these would fit into the existing legal framework, in addition to how reporting requirements would apply. It was unclear from consultation responses what legal form such securities would take. In principle, regulators will consider innovative proposals, provided they meet the eligibility requirements set out above.

Duration

Summary of feedback

3.89 There was near universal agreement in responses that five years would be an acceptable duration for the DSS, on the understanding that permanent amendments to legislation can be made before the end, and that the DSS is capable of being extended. Participants also have the ability to leave in a timely manner if desirable. Generally, there was a call for certainty and clear communications about the duration and timing of the DSS, particularly where an extension would be needed.

Government response

3.90 While a diverse array of possible timelines was highlighted in responses, there was little opposition to the proposed time of five years. Throughout the DSS, the Government, working with the regulators, will communicate the process for making any permanent amendments or extending the DSS in a timely fashion.

Exiting the DSS

Summary of feedback

3.91 The aspiration for a smooth transition out of the DSS was welcomed, particularly the assertion that the DSS will not be a bridge to nowhere. Feedback sought further detail about the exit process, noting that timelines for exit may depend on the individual entity and therefore may need to be flexible. The need for a quick and safe transition out of the DSS was seen as essential, with a need to avoid legislative, regulatory, technological and administrative gaps.

3.92 The suggested approaches to wind down were seen as pragmatic. Some feedback highlighted that it may not be possible for applicants to fully define an exit strategy at the outset, and that exit strategies may, in some cases, depend on other factors (including further legal/legislative clarity).

3.93 Responses pointed out some practical concerns with the wind-down process: commercial arrangements may need to be put in place between an entity in the DSS and a traditional FMI operator to facilitate a wind down, and there would need to be an understanding on the part of both the entity in the DSS, and its users and investors, on the anticipated process. In some cases, this could be simple, particularly if instruments have short maturity profiles.

3.94 Industry pointed out that exit strategies may also need to evolve during the DSS, depending on how the activities being conducted change in scale and quality. Clarity was sought on the ability to transition out quickly before the end of the DSS, particularly if it was possible to comply with the requirements applying outside the DSS at that time.

3.95 Feedback suggested that further guidance could be provided by the regulators to understand the requirements in the event of a wind-down.

3.96 The ability for HMT to make permanent amendments to legislation before the end of the DSS was highlighted as an important benefit. Some responses asked for further practical details, including how frequently statutory instruments could be laid before Parliament making permanent amendments.

3.97 It was noted that the authorisation process post-DSS is unclear, including the grounds on which regulators would make any decision. Participating entities may want different authorisations (for example, some firms performing DSD functions may not want to be authorised as a CSD). Feedback also noted that SFR designation, for example, may be unnecessary if an entity is not continuing to conduct securities settlement when it leaves the DSS.

Government response

3.98 The Government reiterates that, as far as is possible, certainty and transparency regarding any transition out of the DSS (whether winding-down or exiting to operate without limits outside the DSS) should be provided and communicated by regulators in good time.

3.99 Though a wind-down plan will not be required as part of an application to enter the DSS, it may need to be in place and agreed with regulators before live activity can commence. On exit, the regulators will make any decisions, including around any necessary permanent authorisations in the case of DSDs, in line with their objectives (and not on the basis of other factors, such as commercial viability).

3.100 The Government has set out clearly that it has the tools to put in place permanent amendments reasonably quickly. The process can be undertaken via statutory instrument, after having reported to Parliament, avoiding the need for further primary legislation to make the necessary changes. There is no limit to the number of times that this can occur, but respect for Parliamentary time will be a limiting factor.

3.101 The specific nature of any permanent changes made in future is uncertain, given this will depend on the outcome of activity in the DSS (a necessity given the need to retain flexibility to test novel forms of entity and activity). As such, the authorisation firms will need to seek outside the DSS may be different to the current regulatory framework. During the lifetime of the Sandbox, regulators will consider whether and how to adapt the regulatory regime to account for new entities, such as non-systemic CSDs, and those combining the function of a CSD and trading platform.

3.102 The Government will also need to consider what designations will continue be necessary in the end state regime, for instance whether or settlement finality designation should be required where an entity is not systemic. The Government will consider, working with the

regulators alongside the DSS, how such requirements should change in future.

Supervision and enforcement

Summary of feedback

3.103 Responses generally agreed that existing regulatory powers were sufficient for supervising participating entities. It was noted that the DSS could help support the regulators' new secondary objectives (on competitiveness and innovation for the FCA and Bank respectively). The importance of close cooperation and a clear division of responsibilities between the Bank and FCA was highlighted, as was the need to ensure the regulators have the necessary resource capacity.

3.104 Feedback emphasised that it was important to retain an efficient supervisory process, for example through the ability to give notice to the regulators quickly if business plans are changed, and to seek guidance and clarification where necessary.

3.105 On disclosure, responses suggested that if regulatory requests are consistent with current requirements, then there is unlikely to be sensitivity in disclosing information. There may be more reluctance to share proprietary information with the Government, given some information (such as on proprietary technology or the identity of participants) is likely to be confidential, though in some cases it was unclear precisely what information is likely to be sensitive.

Government response

3.106 The Government will proceed on the basis of the approach set out in the consultation document. The Bank and FCA will develop a joint approach to the supervision of hybrid entities in the DSS (I.e. those providing both trading and settlement activities), which will be shared in regulatory guidance. Meanwhile, a memorandum of understanding will set out broader principles about how the regulators intend to work together for the purposes of the DSS.

3.107 The DSS process is intended to facilitate regular dialogue between the regulators and participants. We expect that the Bank and FCA will also set out guidance on the operation of the DSS in due course.

Digital cash/payment leg

Summary of feedback

3.108 Responses firmly supported maximum flexibility for the settlement leg, welcoming the ability to use either existing market infrastructure or new arrangements. Feedback supported the ability to use commercial bank money, as well as central bank money solutions. Guidance was sought on the use of tokenised commercial bank deposits, as well as on different options more generally such as stablecoins.

3.109 Some responses advocated for solutions that did not skew the DSS in favour of incumbent banks. Some feedback advocated for the ability to utilise an even broader range of novel cash settlement solutions than those mentioned in the DSS. The ability to access the Omnibus Account mechanism operated by the Bank of England was also highlighted as desirable.

3.110 Some responses called for the inclusion of non-GBP digital currencies to facilitate the settlement of non-GBP denominated digital assets.

3.111 Responses noted the possible long term solutions to digital cash, potentially through the creation of a wholesale CBDC. Initial digital cash solutions used in the DSS may be a bridging mechanism for permanent initiatives to be implemented in future. Alignment with other digital payments experiments and initiatives happening globally would be beneficial, particularly to facilitate interoperability.

3.112 Some feedback suggested that running a digital payment system should be brought directly in scope of the DSS or made the subject of a future sandbox, Some responses highlighted that they may want the same entity to be both a DSD and classified as a payment system.

3.113 For public blockchains, some responses noted that the boundary between the payments and securities leg of transactions could blur, given that investors could potentially use a variety of settlement assets to complete transactions.

Government response

3.114 The Government intends to retain the original position of not bringing payments directly into scope of the DSS (in other words, the DSS will not modify existing payments legislation), but will enable flexibility around the digital cash solutions that can be used in the DSS provided this is line with existing payments legislation.

3.115 The Government will convert the requirements around cash settlement in UK CSDR into rules, meaning it will be for the Bank to decide what the requirements will be for the cash leg (including digital cash solutions) in the DSS.

3.116 The DSS legislative framework will enable non-GBP solutions to be utilised by participating entities. However, it is expected that GBP-only solutions will be utilised in the early stages of the DSS.

Chapter 3
Further Policy Issues

Technology considerations

Summary of feedback

4.1 Responses set out a variety of views on different forms of digital asset technology, particularly public/private and permissioned/permissionless systems. There was general agreement that systems should safeguard existing regulatory outcomes, and in particular not create financial stability concerns.

4.2 Many responses suggested that private permissioned DLT systems were better suited to being regulated than permissionless, and would fit better with the PFMIs and existing legislative and regulatory concepts. Permissioned systems could entail use of a 'master node' with override powers, enabling intervention where necessary (for example to manage financial stability and market integrity risks). It was cited in some responses as more secure than permissionless systems.

4.3 Feedback also suggested that permissionless systems could suffer from governance issues (and that not all rules could be embedded in smart contracts) and would struggle to properly guarantee settlement finality. The irrevocable nature of permissionless systems could be undesirable in some cases (for example on enforcing anti-money laundering requirements).

4.4 Some responses were positive about permissionless systems, noting that they could deliver decentralised governance, peer-to-peer trading, self-custody and disintermediation of legacy infrastructures. Regulatory compliance could be embedded into smart contracts. Feedback encouraged HMT and the regulators to avoid ruling out permissionless at the outset by remaining technology neutral.

4.5 Some argued that permissionless systems could be designed to be PFMI-compliant, while others felt that the PFMIs themselves would need to be redesigned to accommodate permissionless systems and their innately non-jurisdictional structure.

4.6 Some responses pointed to the existence of hybrid systems, such as 'public-permissioned' systems which combine aspects of both private and public, and highlighted the possibility of combining the benefits of decentralised systems with robust legal/regulatory frameworks.

Government response

4.7 The Government intends to keep the DSS technology neutral, while acknowledging that the starting point for the DSS is existing

legislation/regulation, which may render compliance more difficult for permissionless systems. We would welcome any further views on proposed business models (and the technology which will be used), and their compatibility with UK legislation.

4.8 On the PFMIs, the Government and regulators will continue to use this as the basis for regulating FMI activity both inside and outside the DSS. The PFMIs cannot be adjusted unilaterally, however the activity in the DSS can inform the Bank of England's engagement with work on digital assets at BIS-IOSCO.

Reporting

Summary of feedback

4.9 Responses highlighted many potential benefits of digital asset technology in meeting reporting requirements. These included the real time availability of data (with regulators able to directly access systems via an observer node), greater data consistency and transparency (given there would be a single source of truth for data), lower costs given greater operational efficiencies, more granular detail and better adaptability to changes in reporting requirements.

4.10 In some cases, feedback highlighted caution about whether all the benefits could be delivered, which would require interoperability with other digital systems as well as regulator systems. Some respondees suggested that while some adaptation of the existing reporting regime might be necessary (for fractionalised assets, for example), responses were generally of the view that it was sufficiently adaptable to accommodate digital assets.

4.11 Responses highlighted existing regulatory initiatives and bodies on data, such as the Bank and FCA joint Transforming Data Collection programme and Industry Data Standards Committee. Some feedback commented on data identification protocols, for example by suggesting that ISINs could be replaced by Digital Token Identifiers (DTIs).

Government response

4.12 The Government recognises that there could be substantial benefits to regulatory reporting through the use of digital asset technology. In the DSS, the Government intends to facilitate reporting via existing reporting regimes, as set out in the original consultation. Working with the regulators, the Government will continue to monitor regulatory requirements and their compatibility with digital reporting practices.

Custody

Summary of feedback

4.13 In principle, industry supported the application of the Client Assets Sourcebook (CASS) framework for digital assets, but pointed to uncertainty around the potential differences between digital and traditional custody, with CASS requirements based on a book entry model. Feedback therefore called for clarity around how the existing

framework will apply (particularly regarding segregation and commingling of assets, safeguarding of cryptoassets and/or means of access (e.g. private keys or a shard of a private key), as well as liability standards, noting that the latter is generally set in legislation rather than FCA rules).

4.14 It was noted that there may be different options for holding securities (such as direct custody, sub-custody, global custody), with control held by different types of entity depending on the model adopted. Omnibus accounts were seen as feasible in a digital asset/DLT environment.

Government response

4.15 The FCA is intending to consult separately on the application of the custody framework to cryptoassets. For cryptoassets that already meet the definition of a specified investment (therefore those in scope of the DSS), the existing regulatory framework that currently applies will be replaced by the new custody regime. This will address the application of CASS rules and other considerations unique to the safeguarding and administering of cryptoassets and/or means of access. However, in the interim, firms who safeguard and administer securities in scope of the DSS will need to meet requirements of the current regulatory framework in CASS.

Retail users

Summary of feedback

4.16 The Government received a relatively low number of responses on retail. In most cases, little direct retail interaction was expected with use cases intended for the DSS. Instead, responses largely anticipated the use of existing intermediaries to service investors, though in some cases there was ambiguity around how traditional models would work if fractionalised assets were to be created.

4.17 Some feedback suggested that if more direct access to retail were to be facilitated, this would have to take place once an entity in the DSS had achieved maturity. If retail clients were given more direct access in future, this would raise further issues (for example whether a system can be designated under the SFRs if it has direct retail participants).

4.18 A minority of responses did envisage retail investors trading directly peer-to-peer on DSS entities, which would also facilitate self-custody. These responses noted that the current structure of the DSS effectively mandates intermediation (citing provisions in MiFID), thereby not allowing natural persons to participate directly in an entity in the DSS and to execute and settle transactions.

Government response

4.19 The Government will adopt the consultation approach of retaining existing requirements around intermediation and investor protection. We do not consider retail participation to be ruled out by

the current MiFIR framework. It is possible that future sandboxes could look at more novel retail focused solutions if this was desirable.

Taxation

Summary of feedback

4.20 The Government received a relatively small amount of responses covering tax issues in relation to digital assets. Generally, feedback emphasised that existing procedures should apply where possible, with digital securities treated like conventional securities.

4.21 Responses raised questions around who the burden for processing Stamp Taxes on Shares (STS) payments in the DSS would fall on. It was noted that settlement taking place outside of CREST would currently require participants to file STS returns individually. This would involve sending a written notice to HMRC (setting out buyer and seller details, what securities and in what amount have been transferred, and any relief or exemption to be claimed).

4.22 Whether or not STS is owed depends on whether an exemption is in place for a given instrument (most debt securities are already exempt from STS for example). It was noted that this is a complex area and could mean different obligations for different participants.

4.23 Responses expressed a wish to work with HMRC to understand and provide the required reporting. The possibility was raised of entities in the DSS being able to put in place agreements with HMRC, in line with the arrangements under the SDRT regulations that apply to an Operator of a Relevant System. This would enable STS payment to be processed by the system rather than individual participants in that system.

4.24 Some feedback suggested that requirements in the Companies Act around submission and stamping of an instrument of transfer by HMRC could be burdensome. The current HMRC work to modernise the collection of STS (which will enable self-assessment via an online portal) was noted as potentially making it simpler to accommodate digital securities and generally make tax processes less onerous.

Government Response

4.25 As outlined in the consultation document, the Government intends that in the DSS the SD and SDRT will continue to apply as it currently does. Those wishing to participate in the DSS facilitating transfers where SD and SDRT would usually apply will need to communicate with HMRC outlining how they expect the tax to be accounted for, which will result in further engagement to establish an agreement with HMRC covering the participants obligations to HMRC as an operator within the DSS.

4.26 As part of the application process companies will be asked to confirm that they have contacted HMRC. It is intended that some applicant details will be shared with HMRC to ensure that they are aware of the intended participation. Engagement with HMRC should be undertaken as early as possible.

4.27 There is an ongoing STS modernisation project that was raised by some respondents, which is a long term project designed to modernise and digitise the STS framework. The government published a Call for Evidence in 2020, followed by a consultation which closed in June 2023. We are analysing the feedback from that consultation and will publish a Summary of Responses in due course.

Cross-industry collaboration

Summary of feedback

4.28 Feedback universally indicated the desirability of cross-industry collaboration alongside the DSS, particularly the setting up of a working group or committee. Responses advocated that as diverse a group as possible be included, including participants in the DSS, different parts of the market, Government, regulators, law and academia. The need to liaise with other bodies such as the UK Jurisdiction Taskforce and the Asset Management Taskforce Technology Working Group was also emphasised.

4.29 Subjects that such a working group could explore include interoperability, cybersecurity, financial stability, and global coordination. Some feedback suggested that guidance on market practice or law could be provided by this body. However, concern was expressed that such a body could be overcomplicated and that there are existing bodies (particularly the trade associations) facilitating cross market collaboration.

4.30 Responses supported disseminating as much information as possible about activity in the DSS to the wider market. This could include what exemptions from or modifications to legislation and regulation are being granted to participating entities, what activities are being performed, what limits on activity are being imposed, and the outcomes of testing.

4.31 Responses suggested various types of data would potentially be too sensitive to share. This could include data around pricing/charging, business operations/strategies, proprietary information and client information in line with existing competition law. Different methods were suggested for managing this, such as by aggregating and anonymising data to hide individual firms/persons.

4.32 Feedback suggested various ways of sharing information, such as by publishing lessons learned documents, running webinars, and setting up clear review and reporting points. Information sharing agreements may be necessary to facilitate this. Some responses noted that certain information may be easier to share in private rather than publicly to the wider market, and that any approach would need to balance the two.

4.33 Creating common data standards was a particular focus in responses, given that a lack of consistent standards could create frictions. Responses pointed to existing ISO standards (such as LEIs and ISINs), as well as new standards such as the Digital Token Identifier (DTI)

but cautioned that industry is some way from common standards around data formats, APIs and protocols.

Government response

4.34 The Government intends to proceed with setting up a body to facilitate dialogue on digital assets issues, to be put in place once live activity in the DSS starts. It will work with industry to consider how such a body should be structured, its composition, what subjects it will consider, and how it will share information with the rest of industry.

4.35 It will also consider the interaction with other existing and possible future Government, regulator and industry bodies, as well as the recommendation by the Law Commission to create a panel of industry experts (who can provide guidance on technical and legal issues relating to digital assets).

International coordination

Summary of feedback

4.36 Responses highlighted the need for international coordination on various issues relating to the adoption of digital asset technology, in order to avoid frictions cross-border. These include the need to build cross-border interoperability of systems, harmonisation of regulation, taxation and compatibility of legal frameworks,. Current initiatives by supranational organisations (in particular FSB, BIS and IOSCO) are helpful, but will need to be built on further.

4.37 Feedback noted that some digital FMIs may be multi-jurisdictional (or even non-jurisdictional when public blockchains are used), making the determination of any governing law very difficult. Digital securities may not be fully recognised under the laws of some jurisdictions.

Government response

4.38 The Government recognises that global coordination is essential for facilitating the successful adoption of digital securities worldwide. It recognises that a mixture of regulator and industry-led initiatives is desirable, as now.

4.39 The UK has been a major contributor to publications by the FSB and CPMI-IOSCO on initial standards. These are being used as the basis for frameworks both in the UK and in other jurisdictions. The UK is also an active participant in initiatives such as the BIS Innovation Hub. The FCA has recently announced its participation in the Monetary Authority of Singapore's Project Guardian, a collaborative initiative with the financial services industry on asset tokenisation and decentralised finance.

Chapter 4
Legal Considerations

English and Welsh law

Summary of feedback

5.1 Responses were positive about the existing initiatives that have sought to clarify whether digital securities can be accommodated within English and Welsh law and encouraged Government to take forward the recommendations. Specifically, these were the UK Jurisdiction Taskforce statement concerning the issuance and transfer of digital securities on DLT-based systems, and the Law Commission report on Digital Assets. In particular, the confirmation that digital assets can be constituted and transferred under English and Welsh law was welcomed.

5.2 In some cases, feedback indicated that further clarification around how use cases will fit with private law principles may be needed. This could potentially be taken forward via a form of industry guidance, or via the implementation of the recommendation in the Law Commission report to convene a panel of industry experts (which would provide guidance on technical and legal issues relating to digital assets). This could be especially necessary if the courts are unable to address issues with private law at speed. In some cases, responses felt that the steps taken to clarify that digital securities can be constituted under English and Welsh law should be put on a statutory footing, to provide greater certainty.

5.3 The need to further review UK legislation (in particular the Companies Act) was noted in some cases. The need to ensure clear and consistent terminology around digital assets across different regulatory regimes was emphasised.

Government response

5.4 The Government will set out in due course how it intends to respond to the recommendations of the Law Commission report. In particular, it will assess how an expert working group could be convened, potentially as part of the cross-industry body highlighted in the previous chapter.

5.5 As previously stated, the Government generally does not intend to provide clarification of private law in legislation, given this is not in keeping with the operation of common law, and could undermine the ability of the common law to operate flexibly (and risks creating unintended consequences). The Government will continue to assess whether guidance provided by industry bodies, including a future

expert working group, can establish the necessary clarity for firms to operate in.

Typology of digital securities

Summary of feedback

5.6 Responses mostly agreed with the two categories of digital asset set out in the consultation. Some feedback suggested there was uncertainty about the term 'digitally native', particularly whether this covered bearer as well as registered securities. Again, the need for consistency of terminology was raised.

5.7 Some feedback questioned how fractionalised securities would sit in existing legal concepts, or whether a new category of security would need to be created. The legal treatment of 'hybrid securities', whereby both a traditional and digital representation of an asset exists, was raised. In a minority of cases, responses disagreed with the categorisation outlined in the consultation document, for example by suggesting that there could be a third category of asset depending on the use case.

Government response

5.8 The Government intends to follow the two category approach outlined in the consultation. For different use cases, the Government, working with regulators and industry, will need to take a view around whether statutory intervention is needed to provide clarity, or whether clarity can be provided by the evolution of case law and guidance. As highlighted above, the Government has the ability to further amend the DSS, so it will be possible to make further interventions relatively swiftly if justified.

Jurisdiction/choice of law

Summary of feedback

5.9 Responses noted that English and Welsh law is governed by the concept of lex situs, which may make it difficult to accommodate digital assets. Establishing a single jurisdiction for a given asset may be difficult, given that the DLT-based system it sits in may not exist in one particular jurisdiction, but instead be cross-border (this will be an even more acute issue for permissionless systems, given they may be incapable of specifying a governing law/jurisdiction). Requiring a system to be controlled by a 'UK based entity' may be incompatible with certain kinds of digital platform.

5.10 Responses were divided regarding as to whether or not English and Welsh law should be the choice of law and jurisdiction in the event of a dispute. While many responses agreed to this proposal, some suggested that they should have the ability to select other laws to regulate rights and obligations, and to have disputes resolved in another jurisdiction, with choice of law determined by contract.

Government response

5.11 The Government does not intend to hard-wire a requirement mandating use of English and Welsh law into the legislative framework for the DSS. However, as noted potential applicants will need to be aware that they will need to have an established legal entity in the UK, and that the activity in the DSS is being tested against UK regulatory requirements.

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This document can be downloaded from www.gov.uk

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