EMAIL SUBMISSION TO: DSSCPResponses@bankofengland.co.uk & cp24-5@fca.org.uk

To whom it may concern,

Re: Digital Securities Sandbox joint Bank of England and FCA consultation paper

About Global Digital Finance (GDF)

GDF is the leading global members association advocating and accelerating the adoption of best practices for crypto and digital assets. GDF's mission is to promote and facilitate greater adoption of market standards for digital assets through the development of best practices and governance standards by convening industry, policymakers, and regulators.

The input to this response has been curated through a series of member discussions, industry engagement, and roundtables, and GDF is grateful to its members who have taken part.

As always, GDF remains at your disposal for any further questions or clarifications you may have, and we would welcome a meeting with you to further discuss these matters in more detail with our members.

Yours faithfully,
Elise Soucie - Director of Global Policy & Regulatory Affairs - GDF

Response to the Consultation Report: Executive Summary

GDF convened its UK Policy & Regulatory Working Group to analyse the Digital Securities Sandbox joint Bank of England and FCA consultation paper. GDF also engaged with other industry bodies to convene and streamline industry feedback. GDF supports in particular the Association for Financial Markets in Europe (AFME) response and their key points of feedback on the Sandbox. The Digital Pound Foundation (DPF) as a partner of GDF endorses and supports this response.

Overall GDF is supportive of the aim of the proposals and the broader aims of the recommendations made in the Consultation Paper (referred to henceforth as the CP). GDF believes firmly in the UK's stated intent to support innovation and provide end to end regulation while following the principles of same risk, same regulatory outcome and simultaneously developing new regulatory requirements for new risks. We also appreciate the industry engagement and thoughtfulness with which the UK authorities have developed their approach. Our response to this CP looks to provide suggestions of areas where further consideration and clarity may be needed for the sandbox, but overall GDF firmly supports the initiative and believes in the benefits it can deliver to the UK and the broader financial services industry.

GDF has worked with our members to provide constructive feedback on the Digital Securities Sandbox (referred to henceforth as the DSS), and also aims to identify options to overcome challenges identified in the CP through conversations with authorities on the operational processes. Through this process GDF members identified key areas that may require further drafting consideration or additional guidance for purposes of clarity, proportionality, and effective scaling of the sandbox. The core areas identified are:

1. **Transparency – Feedback Loop**
2. **Flexibility – Preparing and Adjusting for Market Evolutions**
3. **Further Consideration and Additions for the Scope of Instruments**
4. **Clear Operational and Spend Requirements for Each Gate**
5. **Reducing Barriers to Entry & Proportionality for Firm Size**

1. Transparency – Feedback Loop

Our key operational consideration that we would encourage regulators to include is for a more formal, and therefore transparent, feedback-loop to be established between regulators and industry throughout the Sandbox process. We see the flexibility and agility of the DSS as a key strength, whereby the regulators' approach will evolve over the course of the DSS, and transparency will be key to ensuring that the benefits of that approach are recognised.

Our proposal detailed below Question 1 sets out three ways in which this public/private sector collaboration could take place that would establish a comprehensive forum for discussion.

2. Flexibility – Preparing and Adjusting for Market Evolutions

Throughout the consultation there are several areas where we would encourage the regulators to build flexibility in the Sandbox to prepare for future market evolutions. For example, we would encourage the BoE/FCA to consider further how to incorporate solutions for CeBM (such as RTGS renewal, omnibus accounts etc.) into the DSS. Another point raised by members was that to allow for atomic settlement, it will be important to enable on-chain settlement of the payment leg rather than requiring settlement of the payment leg to be in fiat currency. However, the PFMIs currently require settlement in central bank money which precludes on-chain settlement of the payment leg until at least the introduction of CBDCs and, even then, it is not clear that CBDCs will necessarily be "on-chain" to facilitate atomic settlement. These areas, among others, are noted as key components of the Sandbox which may need to evolve with the market in the coming years.

3. Further Consideration and Additions for the Scope of Instruments

GDF would encourage further consideration is around the scope of instruments. First, members would encourage the BoE and FCA the DSS team to consider including structured products like warrants. GDF would also encourage further consideration of unbacked crypto as the market continues to evolve and, in particular, once unbacked crypto is brought within the regulatory perimeter as a specified investment (although we recognise that there is a threshold question as to what types of crypto would need to be settled via a CSD in the first place).

Members would also encourage the BoE and FCA to provide guidance on the relationships between DSDs and CSDs and the relationships that could exist.

Further clarity is also requested on how the DSS structure will differentiate between issuer DSDs (the one who issues the instrument) and an investor DSD as the issuer may not tokenise but the investor may choose to, but both can be operated within a CSD.

Finally, it was also proposed that the "Emissions allowances" scope definition be clarified to include several other categories which are further detailed under Question 1 and throughout our response.

4. Clear Operational & Spend Requirements for Each Gate

GDF would note that further clarity may be needed for the gates so that a clear case for sandbox participation can be made internally at firms. These requirements may vary in cost and to encourage broader industry participation it will be necessary to make accurate projections at the outset. Operational steps from POC to Production are important and we would encourage regulators to think about how the technical gates can be clarified at the outset in order to reduce barrier to entry and enable firms to prepare appropriately.

5. Reducing Barriers to Entry & Proportionality for Firm Size

GDF would note several points of consideration throughout the consultation in order to reduce barriers to entry and support firms in participating in the DSS. These include for example, proportionality in fee structure, the DSS enabling non-sterling denominated issuances, operational steps from POC to Production as set out above, and how firms could prepare for the sandbox process particularly if they are not already regulated firms. These areas of consideration are set out in greater detail throughout the response.

Response to the Discussion Paper: Questions for Public Consultation

Please note that given our focus areas set out in the executive summary that we have not responded to each question in the CP. Instead, we have provided feedback and input on the specific questions and chapters that are relevant to the key areas.

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

GDF is supportive of the approach set out by the BoE/FCA. Our key operational consideration that we would encourage regulators to include is for a more formal, and therefore transparent, feedback-loop to be established between regulators and industry throughout the Sandbox process. We see the flexibility and agility of the DSS as a key strength, whereby the regulators' approach will evolve over the course of the DSS, and transparency will be key to ensuring that the benefits of that approach are recognised.

Our proposal below sets out three ways in which this public/private sector collaboration could take place that would establish a comprehensive forum for discussion.

1. An Open Working Group to function as a convening body for all industry

- This could occur at regular intervals to discuss and communicate about the Sandbox process and BoE/FCA could share any relevant updates.
- GDF would be happy to support this initiative, as well as to host and convene the meetings, but the forum would be open to all industry bodies and firms.

2. A Closed Working Group – For Sandbox Participants Only

- GDF could provide the secretariat on behalf of the participants.
- BoE /FCA could observe and participate as appropriate.

3. A Website for Broader Communications

- This could be on the BoE/FCA website and provide a dashboard for status updates on the sandbox as well as changes to legislation and rules (including firm specific rule modifications and waivers, where possible) and we would encourage that it be open the public.

These forums would be beneficial in order to both support transparency and provide a unifying access point for firms to discuss their projects and troubleshoot any operational concerns. For example, it was noted that it would be beneficial to have transparency around the regulators' approach to setting capital requirements for DSDs as well as transparency both with individual firms and communication to the broader industry on progress and legislative changes as well as the allocation of capacity for the asset classes.

In addition to these dedicated points of collaboration, we would note that for complex regulatory questions that firms may wish to raise to the BoE/FCA teams individually, it may be beneficial to have a dedicated and centralised Sandbox email address where firms could raise queries in writing as well.

An additional operational aspect where GDF would encourage further consideration is around the scope of instruments.

First, members would encourage the BoE and FCA the DSS team to consider including structured products like warrants. GDF would also encourage further consideration of unbacked crypto as the market continues to evolve and, in particular, once unbacked crypto is brought within the regulatory perimeter as a specified investment (although we recognise that there is a threshold question as to what types of crypto would need to be settled via a CSD in the first place).

Members would also encourage the BoE and FCA to provide guidance on the relationships between DSDs and CSDs and the relationships that could exist. For example, if a company set up a CSD in Luxembourg and DSD in the UK, GDF would encourage additional clarity on how these could be linked and what structure would need to be implemented for approval to operate such a model within the sandbox.

Further clarity is also requested on how the DSS structure will differentiate between issuer DSDs (the one who issues the instrument) and an investor DSD as the issuer may not tokenise but the investor may choose to, but both can be operated within a CSD. Clarity is requested as to if that distinction carries over into the DSD world. Furthermore, we would welcome clarification that banking-type services are classified as 'ancillary' and not 'core' DSD services. Clarification that these ancillary services could be provided to Sandbox entrants by eligible non-DSS participants, irrespective of their home jurisdiction, would be supported by GDF members.

Finally, it was also proposed that the "Emissions allowances" scope definition be clarified to include:

1. Energy Attribute Certificates [EACs - i.e., General Global Classification];
2. Guarantee of Origins [GOs - i.e., UK/EU equivalent to RECs];
3. Renewable Energy Certificates [RECs];
4. International Renewable Energy Certificates [I-RECs];
5. Digital International Renewable Energy Certificates [DIGIRECS]; and
6. Any other Analogue or Digital Voluntary or Compliance Certificates.

GDF would note that all the above broad-based EACs are "Solving for Electricity" tightly/specifically "SCOPE 2 Emissions", rather than Carbon Credits/Carbon Offsets that are "Solving for Carbon" loosely/generally "SCOPE 1; SCOPE 2; SCOPE 3 Emissions". The relevance for widening the definition scope is further highlighted in BlackRock's TCFD Annual Report 2023.[1]

While "Emissions allowances" are in Scope of the DSS, most documents, including the Law Commission Digital Assets Final Report[2] tend to refer to "Emission allowances" narrowly as only Carbon Admission Allowances, European Carbon Admission Allowances, and Voluntary Carbon Credits. Energy Attribute Certificates EACs examples listed 1. To 6. above, including Digital International Renewable Energy Certificates [DIGIRECS] are not mentioned.

On the cash-leg settlement, GDF would support in particular the points raised in the AFME consultation response noting that GDF members also support the development of tokenised wholesale central bank money (CeBM) as a beneficial component for the evolution of the financial services ecosystem. Given this, we also encourage the BoE/FCA to consider further

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[1] https://www.blackrock.com/corporate/literature/continuous-disclosure-and-important-information/tcfd-report-2023-blkinc.pdf

[2] https://lawcom.gov.uk/document/digital-assets-final-report/),

how to incorporate solutions for CeBM (such as RTGS renewal, omnibus accounts etc.) into the DSS. This is important for the broader flexibility which GDF members believe it will be important to build into the sandbox at the outset.

Furthermore, noting the importance of flexibility as well as reducing barriers to entry for industry participation in the DSS, GDF would also support DSS enabling non-sterling denominated issuances. As multi-currency settlement is possible in traditional CSDs, this is also likely to be a necessary business function for evolving infrastructure models.

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

In support of the proposal for transparent forums raised above, GDF would note that to mitigate cliff edge risks it is crucial that potential legislative changes and the progress on those changes are communicated throughout as legislation is reviewed. GDF would support the legislative review being communicated through the working groups to both Sandbox participants, as well as broader market participants who may also need to prepare for regulatory change.

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

GDF would note that further clarity may be needed for the gates so that a clear case for Sandbox participation can be made internally at firms. These requirements may vary in cost and to encourage broader industry participation it will be necessary to make accurate projections at the outset. Operational steps from proof-of-concept (POC) to Production are important and we would encourage regulators to think about how the technical gates can be clarified at the outset in order to reduce barrier to entry and enable firms to prepare appropriately.

Additionally, in also reducing barriers to entry and enabling firms to smoothly approach the glidepath, we would consider further consideration of applicants that don't meet one of the existing categories of Sandbox participant set out in the consultation, and how firms could prepare for the sandbox process particularly if they are not already regulated firms. GDF would encourage regulators to have discussions with potential applicants earlier so as not to disadvantage start-ups who may not have a pre-existing relationship with dedicated supervisors.

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?

Yes, overall GDF is supportive of 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?

GDF members raised an additional point that as technological evolution continues, changes to some rules may need to be made throughout the sandbox process. To that end, it is crucial that flexibility is built into the Sandbox at the outset. For example, in order to allow for atomic settlement, it will be important to enable on-chain settlement of the payment leg rather than requiring settlement of the payment leg to be in fiat currency. However, the PFMIs require settlement in central bank money which precludes on-chain settlement of the payment leg until at least the introduction of CBDCs and, even then, it is not clear that CBDCs will necessarily be "on-chain" to facilitate atomic settlement.

While it is noted and supported that the PFMI principles may not need to be strictly enforced and fully applied at Gate 2, whereas they will be fully applied at Gate 4, we would encourage additional consideration of how the PFMIs may need to be adapted along with technological change to allow sufficient flexibility to promote innovation.

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?

GDF is supportive of the proposed approach, but as noted under Question 1, believe that having open and transparent forums for DSS participants as well as the broader industry to communicate about the DSS would also support these interactions.

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

GDF is supportive overall of the Bank's proposals. Members also expressed their support for a "higher-of" approach with regards to capital requirements for the operational aspects. While noting this may be reviewed on a case-by-case basis by the BoE/FCA, GDF believes that this approach is will be proportionate and appropriate for most sandbox projects.

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

As noted in response to Question 10, GDF is supportive of the proposed approach but would support a "higher-of" approach with regards to capital requirements.

GDF would also note that where an MTF is operating a DSD to support its own business activities it is most likely the activities will be conducted by separate companies within the group owned by the same parent. This is because customers would like to see that the DSD activities are legally separate to the MTF activities for business continuity purposes in a scenario where the MTF is winding down. In this circumstance the regulatory capital calculation should be considered at the group level, and as noted the "higher of" methodology should still be applicable. There is already precedent for this approach, for example ICARA considers the "investment firm group" when calculating regulatory capital.

Whilst a firm is in the DSS, GDF would encourage that and support that full regulatory capital should only be required in time for customer go live and not during beta testing, this would support the firms' liquidity, private equity investment in the business, and would also reduce barriers to entry.

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?

GDF believes that the regime appropriately balances financial stability and would note that it is important to continue to review the limits and have open discussions about them as participants progress through the gates. While it is crucial to protect financial stability, we would caution that this should not come at the cost of the limits being restrictive as this would hamper innovation and could disincentivise industry participation. Given this, GDF members support a flexible approach to limits and progression to Stage 4 to be based on a case-by-case individual assessment.

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

Members noted that the fee structures seem to have been designed for existing companies and could limit innovation for the start-ups as the cost may be prohibitive. Industry encouraged regulators to look at the companies, consider what is proportionate, then adjust for the size of companies dealing with in order to reduce barriers to entry.