

ICMA response to HM Treasury's Consultation on the first Financial Market Infrastructure Sandbox – The Digital Securities Sandbox

22 August 2023

Introduction

ICMA welcomes the opportunity to respond to HM Treasury's Consultation on the first Financial Market Infrastructure Sandbox – The Digital Securities Sandbox (hereafter referred to as "Sandbox" for ease of reference).

ICMA promotes well-functioning cross-border capital markets, which are essential to fund sustainable economic growth. It is a not-for-profit membership association with offices in Zurich, London, Paris, Brussels and Hong Kong, serving over 600 member firms in 66 jurisdictions. Among its members are private and official sector issuers, banks, broker-dealers, asset managers, pension funds, insurance companies, market infrastructure providers, central banks and law firms. It provides industry-driven standards and recommendations, prioritising four core fixed income market areas: primary, secondary, repo and collateral and sustainable finance. ICMA works with regulatory and governmental authorities, helping to ensure that financial regulation supports stable and efficient capital markets.

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Executive Summary

ICMA welcomes HMT's proposal for a UK Digital Securities Sandbox to support innovation in capital markets. ICMA's response reflects the views of a subset of its [DLT Bonds Working Group](#), notably issuers, banks, investors, market infrastructures and law firms across the international debt capital markets.

Key points:

- (i) ICMA members are in principle supportive of the proposed approach to digital securities in scope and related activities outside the Sandbox.
- (ii) Commercial viability is a key factor for success of the Sandbox, which requires flexibility in terms of issuance size and trading activity. ICMA members therefore welcome HMT's flexible approach to setting limits with regard to the overall capacity per asset class and per individual entity participating in the Sandbox. However, the methodology and process for determining and applying such limits need to be transparent.
- (iii) Members welcome the broad scope of settlement assets considered, including the use of existing market infrastructure for the settlement of the cash leg of a transaction as well as new DLT-based settlement assets in the absence of compatible central bank money arrangements (2.90).

However, guidance on characteristics of tokenised commercial bank deposits and what is included (eg deposit tokens), on-chain and off-chain solutions, would be helpful. Further clarity on digital bearer models and digital record models will also be required for firms that consider taking part in the Sandbox.

- (iv) In principle, ICMA members welcome HMT's approach to make permanent changes to the UK legislative framework with a view to removing any barriers for the use of particular technologies. In terms of scope, members note the recommendation made in the [Law Commission's final report on Digital Assets](#) (June 2023) for a broad review of UK company law which should be considered as and when appropriate.
- (v) The distinction between "digitally native securities" and "digital representations of traditional securities held at a CSD" is broadly aligned with the definition in [ICMA's FAQs on DLT and blockchain in bond markets](#) (see question 5.)
- It would be helpful, however, if the term "digitally native securities" were clarified to make it clear that such securities may be in traditional registered form, digital bearer form and digital claim form as discussed in the UK Jurisdiction Taskforce's legal statement on digital securities.
- (vi) Common standards play a critical role to enable interoperability and facilitate reporting across different jurisdictions. ICMA's DLT Bonds Working Group supports the use of [ICMA's Bond Data Taxonomy \(BDT\)](#), which is technology and vendor neutral, to define DLT-based securities (in both tokenised and digitally native form) unambiguously, as well as the [Common Domain Model \(CDM\)](#), an open-source model developed by ICMA, ISDA, ISLA and hosted by FINOS.

Responses to selected individual questions can be found below.

Please don't hesitate to contact Gabriel Callsen, Director, FinTech and Digitalisation (gabriel.callsen@icmagroup.org) to discuss further ICMA's consultation response.

Chapter 2: Digital Securities Sandbox: Key Features

Question 1. Do you agree with the broad approach set out above to digital securities in scope of the DSS? Please outline any comments or concerns as part of your answer.

ICMA response: ICMA members are in principle supportive of the proposed approach.

ICMA members would further recommend the issuance of a digital gilt in the Sandbox with a view to cultivating broader profile and stakeholder interest.

Question 5. Do you have any comments or concerns with the process outlined in Annex A?

ICMA response: According to the process outlined in Annex A, regulators will "at various points hold a formal review of that platform's performance against requirements". It will be important for regulators to ensure they have sufficient capacity to deal with multiple Sandbox participants and avoid bottlenecks in the absence of limits in terms of Sandbox participants.

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

ICMA response: ICMA members are in principle supportive of the proposed approach.

Question 7: Do you agree with the broad approach to capacity and limits in the DSS described above? Please explain your answer.

ICMA response: Commercial viability is a key factor for success of the Sandbox, which requires flexibility in terms of issuance size and trading activity. ICMA members therefore welcome HMT's flexible approach to setting limits with regard to the overall capacity per asset class and per individual entity participating in the Sandbox. However, the methodology and process for determining and applying such limits need to be transparent. ICMA remains at HMT's, the Bank's

and FCA's disposal to provide any further input reflecting the perspectives of diverse market constituents.

Question 13: Do you agree with the approach to legislative modifications and regulator rules outlined?

ICMA response: In principle, ICMA members welcome HMT's approach to make permanent changes to the UK legislative framework with a view to removing any barriers for the use of particular technologies. Members re-iterate the importance of ensuring that there will be no gaps between the Sandbox ending and legislative changes taking effect, as also set out in paragraphs 1.17 and 2.75 of the consultation. Transparency around the legislative process and roadmap for implementing legislative or regulatory changes will be critical for firms to consider participating in the Sandbox. Regulators should disclose which laws and regulations will be disapplied as well as proposed timelines.

Question 14: What other specific regulatory barriers have you identified to the use of digital securities within markets, either in relation to the legislation above or generally?

ICMA response: In addition to provisions relating to CSDR already referenced (2.58), the following barriers have been identified in CSDR:

- **Article 35** requires the use of messaging systems and compliance with international standards. This requirement may not necessarily be compatible with DLT systems using different communication protocols and standards. Additionally, some requirements, for example, to use book entry systems (Art.3-4) in a DLT environment can be addressed through structuring choices ie outside the Sandbox.
 - **Article 54** requires separate authorisation for the provision of ancillary banking services, notably the requirement to set up a standalone bank. This constitutes a major barrier for the development of any Sandbox activity given the high costs of setting up a standalone bank and Sandbox limits. Consideration should therefore be given to proportionality and relevant provisions of Article 54 amended or disapplied accordingly.
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Question 15: Are there any pieces of legislation in addition to the above that should be brought into scope of the DSS (either listed in the FSMA 2023 as "relevant enactments" or outside of this)?

ICMA response: Members note the recommendation made in the [Law Commission's final report on Digital Assets](#) (June 2023) for a broad review of UK company law to assess the merits of reforms that would confirm the validity of and/or expand the use of crypto-token networks for the issuance and transfer of equity and other registered corporate securities. The Law Commission specifically emphasised that this review should consider the extent to which applicable laws could and should support the use of public permissionless ledgers for the issuance and transfer of such securities.

It will be important for legislative modifications in the Sandbox to take into consideration any reforms that may be proposed in this respect as and when appropriate.

Question 17: Is five years an appropriate timeline? Should it be longer or shorter if not? (note that we anticipate entities exiting the DSS before the overall timeline expires)

ICMA response: ICMA members are in principle supportive of the proposed duration. However, any adjustments of the duration should be communicated in a timely and transparent manner.

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

ICMA response: Members welcome the broad scope of settlement assets considered, including the use of existing market infrastructure for the settlement of the cash leg of a transaction as well as new DLT-based settlement assets in the absence of compatible central bank money arrangements (2.90), in particular wholesale CBDC, to support settlement of DLT-based instruments.

To provide greater clarity, guidance on the characteristics of tokenised commercial bank deposits and what is included (eg deposit tokens), on-chain and off-chain solutions, would be helpful. Further clarity on digital bearer models and digital record models will also be required for firms that consider taking part in the Sandbox.

Members further recommend that the sandbox also accommodates the settlement of assets denominated in currencies other than sterling, noting the precedence for multi-currency DLT issuance (eg EIB). Given that the UK is considered to be an international jurisdiction it would seem remiss to limit the scope of settlement assets denominated in sterling.

However, member firms across the spectrum of bond markets consider a wholesale CBDC to be a cornerstone to support wholesale payments, securities settlement, and collateral management in a DLT environment. Key features include programmability and smart contracts, enabling next-generation automation and innovation. Ultimately, the aim of a CBDC in conjunction with DLT-based securities is to facilitate access to funding for the real economy.

Several ICMA members have executed transactions or conducted pilots based on DLT for the issuance, trading, and settlement of securities and securities financing (see ICMA's [New FinTech applications in bond markets](#) compendium). The forms of digital cash utilised in such transactions vary and range from tokenised commercial bank money or e-money, to stablecoins backed by commercial bank money or central bank reserves to wholesale CBDC, for example, in the context of [Project Helvetia](#) and [Project Jura](#) involving the BIS Innovation Hub, central banks and private-sector stakeholders.

Chapter 3: Further Policy Issues

Question 25: Are there any aspects of the existing regime that would prevent effective reporting in the context of digital securities?

ICMA response: We note that “coupled with the costs and complexities of any changes to regulatory reporting regimes, [HMT] therefore do not currently propose to make any changes in the DSS in this area” (paragraph 3.9). In line with the Bank of England’s and the FCA’s joint Transforming Data Collection programme and vision to simplify and reduce the cost of data collection from the UK financial sector, the use of common data standards should be considered if changes were proposed in the future. As [communicated](#) on 1 August 2023, the Industry Data Standards Committee, which will become a permanent body of the regulatory landscape in the UK, will play a key role and should be consulted where appropriate.

Question 29: Do you see any UK rules or requirements as obstacles to this model [for retail users]?

ICMA response: We note that HMT does “not envisage any change to the circumstances in which retail clients are able to access trading venues” (paragraph 3.11). In the event that changes were proposed in the future, it is important to consider limitations for the participation of retail users resulting from the Settlement Finality Directive/Regulations as well as selling restrictions, amongst other considerations.

Question 32: How should information regarding DSS activity be shared with the wider financial services sector?

ICMA response: Sharing information on Sandbox activity, notably individual tests and use cases, in a timely manner would be welcome. However, it is equally important to consider that proprietary information should not be shared.

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

Common standards play a critical role to enable interoperability and facilitate reporting across different jurisdictions. ICMA's DLT Bonds Working Group supports the use of [ICMA's Bond Data Taxonomy \(BDT\)](#), which is technology and vendor neutral, to define DLT-based securities (in both tokenised and digitally native form) unambiguously. The [Common Domain Model \(CDM\)](#), an open-source model developed by ICMA, ISDA, ISLA and hosted by FINOS, can also be leveraged to define the transaction process, generate executable code (eg in Java) and automate the trading and settlement workflow. For example, the CDM provides a standardised data model and functions for trading and settlement as well corporate events such as coupon payments.

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

ICMA response: A key objective of ICMA's DLT Bonds Working Group is to promote cross-border DLT bond markets. ICMA and its members have identified a number of obstacles and frictions hindering the use of DLT-based securities on a cross-border basis:

- (i) Divergence of legal frameworks and inconsistent regulatory treatment across jurisdictions¹;
- (ii) Lack of interoperability between DLT networks and traditional market infrastructure based in different jurisdictions;
- (iii) Lack of cross-border wholesale CBDC arrangements or alternative, reliable forms of DLT-based cash to facilitate frictionless settlement of DLT-based instruments;
- (iv) Diverging approaches to reference data standards for digital assets. To increase transparency, new identifier standards such as the Digital Token Identifier (DTI) are required for reporting under the EU DLT Pilot Regime, for instance, in addition to existing security identifiers such as ISIN and FIGI.

Members advocate for a coherent approach to minimize cross-border frictions.

Chapter 4: Legal considerations

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

ICMA response: We refer to paragraph 4.4 of the consultation: *"The **Law Commission**, in its Final Report has recommended that most private law principles should be modified as appropriate by common law, as opposed to statutory means, given that the result will be more flexible, responsive to changing technologies and likely quicker.*

¹ One of the questions arising in a cross-border context is how to locate an investor's entitlement in bonds if the registrar, clearing system, custodian and bondholder are all in different countries with different laws. For further information, see the article ***Where's my blockchain bond*** by Scott Farrell, King & Wood Mallesons, [published](#) in ICMA's Quarterly Report, Second Quarter 2019.

In the absence of using statutory instruments, clarification as to how modifications of private law will be made in practice would be welcome, notably in the context of the broader review of UK company law referred to above (Q15.).

Question 37: Do you agree with the categories above [typology of digital securities]?

ICMA response: The distinction between “digitally native securities” and “digital representations of traditional securities held at a CSD” is broadly aligned with the definition in [ICMA’s FAQs on DLT and blockchain in bond markets](#) (see question 5.).

It would be helpful, however, if the term “digitally native securities” were clarified to make it clear that such securities may be in traditional registered form, digital bearer form and digital claim form as discussed in the UK Jurisdiction Taskforce’s legal statement on digital securities, as the references to “the top-tier register of ownership” and “entity with legal responsibility for managing the ledger” could be construed as excluding securities in digital bearer form.

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

ICMA response: Potential conflicts of law are likely to depend on specific arrangements and parties involved in the Sandbox.

For example, if the terms and conditions of a bond are governed by English law, should a related “platform services agreement” be governed also by English law? How would this apply to a blockchain infrastructure based outside the UK? Answers to these questions warrant further consideration in light of their potential complexity and are likely to be determined on a case-by-case basis.

ENDS

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