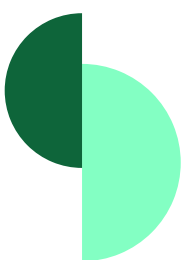


The Exberry logo features the word "exberry" in a lowercase, sans-serif font. The "x" is stylized with a red and green gradient, while the "b" is solid green. The remaining letters are white.

White Paper

What are the Potentials with the UK's Digital Securities Sandbox?

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It is widely accepted that digitized or betokened securities are the next evolutionary step for capital markets infrastructure. That is, securities that can be defined or created using smart contracts and then transferred and stored on ledgers, which may in some cases be blockchains.

But how will we get there? Regulators and financial institutions worldwide are scrambling to get ahead and position themselves at the forefront of this evolution once the inflection point arrives and transition to the new technology accelerates. No one wants to risk being left behind and jeopardize their current market standing, while many are actively seeking to use this shift to gain a competitive edge.

A good example of these efforts can be seen in the UK with its recent consultation for a first-ever financial market infrastructure sandbox in an effort to keep Britain at the forefront of technological change. The [consultation for a Digital Securities Sandbox \(DSS\)](#) was launched by the UK government on 11th July. Many [organizations are eager](#) for the opportunity to participate in the Sandbox itself, especially those trading venues interested in launching new platforms offering the creation of digitized securities.

The UK's Digital Securities Sandbox

The financial market infrastructure sandbox will provide a more flexible regulatory environment in which participants can provide trading and/or settlement infrastructure for digital securities. The intention behind the framework is to offer a significant level of adaptability while providing companies with a clear route to putting projects on a permanent legislative footing. The Sandbox provides a means of testing technology through temporary adjustments to existing legislation, and can modify legislative frameworks as the tests progress.

The consultation paper proposes that the Sandbox will extend to arrangements for the trading and settlement of digital securities such as equities, bonds and money market instruments.

The proposal does not, however, include derivatives, unbaked crypto assets or payments effected through systems that are not embedded in a "digital securities depository".

There are two suggested categories of digital securities. The first is "digitally native securities", where the digital record represents the "top-tier register of ownership". The second is "digital representations of traditional securities held at a CSD", where in respect of securities immobilized with a CSD, the token or other record represents beneficial ownership interests. Further, limits will most likely be set on the volume of digital securities that can be tested in the Sandbox.

In terms of real-world market activities and assets, it is intended that the issuance, trading, settlement and maintenance of digital securities should be through entities within the Sandbox that will be able to interact with wider financial market activities, for example, for collateral posting or repos. Activities will most likely fall into two categories: (1) notary, settlement and maintenance services (similar to central securities depositories (CSDs)); and (2) the operation of a trading venue (i.e. similar to multilateral trading facilities (MTFs) or organized trading facilities (OTFs)).

There are typically two distinct stages of a Sandbox, including:

- **Application:** Applications may be made by authorized CSDs and MTFs / OTFs as well as new entrants that are not yet authorized, provided they are established in the UK .
- **Sandbox Approval Notice:** Once accepted as a Sandbox Entrant, they would be issued with a Sandbox Approval Notice (SAN). The Sandbox Entrant would not be able to perform any live activity until designated as a Digital Securities Depository or authorized as an investment firm operating an MTF or OTF. The UK's Financial Conduct Authority (FCA) will be the regulator for the operating trading venues appointed as Sandbox Entrants.

Next Steps

The deadline for responses to the consultation was 22nd August 2023 and it is hoped that the proposal will be finalized by the end of this year.

For trading venues interested in applying for the DSS, the time to start planning is now. Typically trading venues would need to provide a proof of concept to demonstrate a project to the regulator, as well as an eventual prototype that can perform both mock and live transactions. Exberry can help provide this technology with significantly reduced timescale (in the region of 95%), and dramatically lower initial upfront investments.

The concept behind DSS is quite clever as it allows interested parties to pilot test new regulations, new types of securities, and new types of markets, without having to firstly go through a cumbersome legislative process. This approach to eligibility and risk-based supervision is welcome because it is hoped it will help kindle innovation within the UK. Specifically, it will be exciting to see what types of innovations trading venues will progress.

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