

# Response to consultation

## THE FIRST FINANCIAL MARKET INFRASTRUCTURE SANDBOX: THE DIGITAL SECURITIES SANDBOX

### About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £10 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 46% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

### Executive summary

The future of financial markets is unquestioningly digital and this first iteration of a long-awaited FMI sandbox, the Digital Securities Sandbox ('DSS'), is a welcome development in enabling the digitisation of mainstream securities for the UK market and providing better outcomes for all types of investors.

We support the aims of the sandbox, especially the principles of experience-based policymaking and the ability to effect change at the structural FMI level rather than incremental change at a lower-level.

It is our view that investment funds should be included in the sandbox, as suggested, which could leverage our current and ongoing work on this subject with policymakers, to which HMT is sighted. We suggest that this is extended beyond just UCITS funds to all types of investment fund, particularly where there are specific use cases based upon the underlying assets that they hold, such as money market funds.

It will be important that in designing the DSS we learn from the drawbacks of other regulatory sandboxes, and make sure that the wider industry is able to draw on the experiences that participants have within them. Similarly, we must ensure that both buy side and sell side voices help to shape the future digital ecosystem to ensure its success. To those ends, we would be willing to join the suggested cross-industry body to help maximise its effect.

### General comments

The future is unquestioningly digital and the long-awaited FMI sandbox is a welcome development in facilitating the necessary change and in enabling the digitisation of mainstream securities to provide better outcomes for all types of investors.

Having looked enviously at other jurisdictions, financial market infrastructure providers will now be able to pilot their solutions within the UK and help to at least maintain, and hopefully enhance, the UK's position as a major capital markets hub. This will help demonstrate the regulators' new secondary objective to facilitate the **international competitiveness of the UK economy** and its growth in the medium to long term.

### The Investment Association

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For too long, UK firms have had to turn to other jurisdictions to locate their innovative products and services, using options such as the Project Guardian initiative from the Monetary Authority of Singapore. We hope that the DSS is a meaningful first step in transforming the UK's reputation to one as a leading location for innovation.

This would be built upon a wealth of resources, with the UK having a number of strengths including a world-renowned legal system, a flourishing centre of excellence for fintech and a world leading location for sell side (investment banks / brokerages) and buy side (investment managers) expertise at the heart of the capital market eco-system. It is important to stress that the depth of the UK's capital markets experience, in mainstream form, was developed at the intersection of multiple viewpoints and interests, and the future digital asset technology-enabled market will be no different. **We must therefore ensure that both buy side and sell side voices shape the future eco-system to ensure success.**

The DSS should **focus primarily on areas of the market where substantial improvements** can be made that will derive immediate benefits for the UK market, its economy and/or its investors. These may be areas such as private assets rather than more established, efficient markets such as equities. In the longer term, we would like to see services come to market that will enable a reduction in settlement timescales for all asset classes as the global markets move to T+1 and beyond.

## Answers to selected questions

### 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.

We do support the broad approach which will enable timely legislative change as a direct result of what is learnt from relevant uses of digital asset technology. There is probably a case for including the two specifically excluded asset classes – derivatives and unbacked cryptoassets – in due course, but on balance the asset classes selected represent sufficient scope for the output of the DSS to effect meaningful change, and we are supportive of a targeted approach that delivers innovative outcomes.

### 2. What specific kinds of digital securities/asset classes should be considered for inclusion in the DSS?

As referenced within the paper, we urge you to include tokenised units of investment funds within the scope at the earliest opportunity. As well as the UCITS funds mentioned, we should include other types of fund (as the concept is the same), such as property funds and money market funds as they are popular instruments and having a tokenised fund containing these underlying assets is for liquidity reasons and use as collateral. Funds are generally not classified as financial market infrastructure and currently the funds network is made up of a diaspora of separate and independent messaging systems, transfer agents, settlement methods and multiple parties. However, we understand that your intention is not to apply a restrictive definition on market infrastructure and we are encouraged that you are open to including the use of fund tokens within the sandbox at a later stage. As you know, there is substantial work ongoing that will provide greater clarity on the shape of UK-domiciled fund tokenisation, and the timing of this should be complimentary for the DSS.

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

Although the regulatory capacity and limits will be set in sterling, we assume that participants will be able to include assets not valued in GBP, such as USD, EUR etc. Other tokenisation tests, such as the European Investment Bank issuances, have been in multiple currencies and the UK is an international market that should be using this opportunity to at least maintain, and hopefully enhance, the UK's position as a major capital markets hub. Of course, by including assets of other currencies the capacity and limits can still be held at a sterling-equivalent value.

### 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)

The DSS should focus on delivery and effecting meaningful change that is of value to the market and the UK. Given that the important elements are not time-bound (such as your ability to permanently amend legislation before the end of the process and that successful participants can exit once their testing has completed) five years seems a reasonable time period, with the additional flexibility provided by the option of an extension. As we note below, it might also be prudent to build in review checkpoints to take stock of progress to date and potential lessons to learn, alongside periodic reporting to the wider market.

**18. Do you agree with the approaches to exiting the DSS outlined above?**

The approach appears to be sensible and we would suggest just one additional element, based upon previous experience with other sandboxes. Non-participants firms generally do not have visibility of lessons learnt within a sandbox, which might help support them and the wider industry in their innovation efforts. With many tens of thousands of regulated firms operating in the UK and many more supporting firms and emerging disruptors also with a vested interest, there is a very large pool of resources that will be outside of the DSS. The wider industry will be able to infer what has worked by monitoring the resultant legislative changes, but will not benefit from the knowledge of what did not work, and the reasons why. This knowledge would be extremely useful to the wider industry in helping to inform their technological design and future strategy, as well as aiding competition. We therefore suggest that the DSS and other sandboxes should produce periodic lessons learned outputs throughout the five-year duration so that non-participating entities can also learn from the valuable experience and insights of the sandbox.

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

We completely agree with your list of money settlement assets. Clearly a wholesale CBDC would be the ultimate settlement tool but while we wait for the conclusions of the Bank's Synchronisation and wider RTGS Renewal programme work to complete, the others listed are good alternative options.

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

A lessons learnt document should be published periodically throughout the duration of the sandbox, providing information to the wider industry including detail of what did not work and the reasons why, as well as the more obvious successes that have or will result in legislative change.

**34. Would a cross-industry body, set up to scrutinise DSS activity and provide policy recommendations, be appropriate? If so, how should this be set up, and who should participate?**

Yes. Buy-side firms are unlikely to participate directly in the DSS but will clearly have an interest in ensuring that the changes provided by participants will be effective for the investors that will interact with the digital asset technology or other services that result. It is therefore vital that the buy side has a voice and is represented in some form within the DSS structure. We would very strongly support the creation of a cross-industry body and would be happy to participate in it.

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