Memorandum of Understanding between the Bank of England and the Financial Conduct Authority with respect to the Digital Securities Sandbox (DSS)

Purpose and scope

1. This Memorandum of Understanding (MoU) sets out the high-level framework that the Bank of England (the Bank) and the Financial Conduct Authority (FCA) (together, the Regulators) will use to cooperate with one another in relation to the operation of the Digital Securities Sandbox (DSS). It fulfils the FCA and the Bank's obligations under regulation 10(2) of the Financial Services and Markets Act 2023 (Digital Securities Sandbox) Regulations 2023 (DSS Regulations). This MoU is not intended to replace or supersede any existing MoU between the Regulators.

2. The DSS is the first sandbox created under the Financial Market Infrastructure (FMI) sandbox powers conferred on HM Treasury by the Financial Services and Markets Act 2023 (FSMA 2023). The aim of the DSS is to facilitate the use of developing technology, such as Distributed Ledger Technology (DLT), in the undertaking of financial market activities traditionally performed by a Central Securities Depository (CSD) (notary, settlement and maintenance) and the operation of a trading venue.

3. This MoU uses the following terminology which is specific to the DSS:

    a) **Sandbox entrant**: This 'catch all' term refers to a firm which has been approved to enter, and remains in, the DSS, irrespective of that firm's business model or the stage they have reached in the DSS.
    b) **Digital Securities Depositary (DSD)**: This term is used to refer to a sandbox entrant permitted to engage in one or more DSS activities referred to in regulation 3(5)(b) of the DSS Regulations. References to a DSD include a sandbox entrant that undertakes other regulated activity alongside its DSD operations, whether it does so within or outside of the DSS.
    c) **Hybrid entity:** This term is used to refer to a sandbox entrant which combines the roles of a trading venue and the DSS activities referred to in regulation 3(5)(b) of the DSS Regulations into one FMI. Such a firm would be both a DSD and have authorisation to operate a trading venue.

4. Note that references to the Financial Services and Markets Act 2000 (FSMA 2000) should be read as references to the Act as modified by the DSS Regulations (namely, DSS FSMA).

5. The Bank and the FCA will use this MoU to provide a formal basis for co-operation, including for the exchange of information and consultation before taking certain types of actions, to facilitate the dual regulation of the operation of the DSS and particular sandbox entrants. This MoU makes provision for:

    a) granting or varying of an approval of a sandbox entrant's participation in the FMI sandbox arrangements;
    b) making of rules;
    c) exercise of enforcement powers; and
    d) general furtherance of the purposes of the DSS.

Roles of the Regulators

6. The Regulators have different mandates in relation to markets and market infrastructure which will impact the way they work together for the purposes of the DSS.

7. This means that the actions of each Regulator may have implications for the objectives of the other Regulator. It is therefore essential that, in the context of the DSS, the Regulators work together where practicable in exercising their functions, to ensure each can advance its objectives.

Information exchange

8. Timely and focused exchanges of information between the Regulators will be essential to effective coordination and cooperation for the purposes of the DSS in pursuit of their public functions.

9. Given the regulators' statutory obligation in regulation 10 of the DSS Regulations to co-ordinate the exercise of their respective functions; the desirability of minimising the compliance burden for sandbox entrants and the supervisory co-operation outlined elsewhere in this MoU, there will be a high level of information sharing among the Regulators.

10. As outlined below, the Regulators will share information related to markets and markets infrastructure in relation to the DSS where it is materially relevant to the other Regulator, using their own initiative and upon a request from the other Regulator, and where legally permissible. The Regulators acknowledge that information related to a firm in its capacity as a sandbox entrant could be relevant to the other Regulator's responsibilities towards that firm for its activities outside of the DSS. The Regulators are responsible for considering their own respective obligations regarding whether and how they can disclose data, including confidential information. This arrangement is without prejudice to the Regulators' statutory, legal or other powers, responsibilities or discretion and is subject to the applicable law.

11. Exchange of information will take place at many levels. Information available to one Regulator that is relevant to the DSS and relevant to the responsibilities of the other Regulator will be shared where requested.

12. Some information may be received from third parties, such as overseas supervisors. The ability to share such information with the other Regulator may in some instances be constrained by the terms of agreements with those third parties and by the law. The Regulators will seek to ensure that these instances are minimised.

Consultation in relation to supervision of sandbox entrants

13. The Bank will consult the FCA on issues that arise in respect of DSDs, or participants in such systems operated by sandbox entrants, where it considers such issues materially relevant to the FCA's responsibilities for the supervision of trading venues or market integrity responsibilities. These issues may include, but are not limited to:
    a) material changes to system rules, practices, and structures;

b) material changes to system access and participation requirements;
c) issuing or proposing changes to a Sandbox Approval Notice (SAN) for a sandbox entrant which is also supervised by the FCA, including when that is not in its capacity as a sandbox entrant, or which would be supervised by the FCA if its application to operate a trading venue in the DSS were successful;
d) material operational issues.

14. The FCA will consult the Bank on issues that arise in respect of trading venues, or their participants, operated by sandbox entrants in the DSS where it considers such issues materially relevant to the Bank's responsibility for supervision of DSDs or wider financial stability. These issues will include, but are not limited to:
    a) material changes to trading venue rules, practices, and structures;
    b) material changes to system access and participation requirements;
    c) issuing or proposing changes to a Sandbox Approval Notice (SAN) for a firm which is also supervised by the Bank of England, or which would be supervised by the Bank of England if its application to operate a DSD in the DSS were successful.
    d) material operational issues.

15. The Regulators will consult one another at an early stage wherever practicable and consider each other's views. If conflicts arise between the Regulators and cannot otherwise be resolved, they will be escalated through the relevant management and governance structures of each organisation.

<u>Cooperation and information gathering in respect of groups and sandbox entrants who are regulated by both the Bank and the FCA</u>

16. It is possible that a sandbox entrant approved as a DSD may also be an authorised person or a Recognised Investment Exchange (RIE). In both cases, the firm will be supervised as an authorised person or RIE by the FCA, whilst its activities as a DSD will be supervised by the Bank.

17. The Regulators will coordinate the exercise of their DSS functions according to the following principles:

    a) In line with paragraphs 8-12, they will regularly exchange information so as to ensure that the supervisory judgment of each can take into account relevant information, including the risks that such a sandbox entrant faces from its wider activities or from its group in relation to its DSS activities and the relationships between each activity and entity. This information exchange will include but not be limited to:
        i. findings and conclusions on material prudential risks or key conduct risks relevant to the safety and soundness, or adequacy of the entity or its group's financial resources.
        ii. material changes in such a sandbox entrant or its group's organisation, governance, risk management, or ownership, material operational stresses or incidents, and assessments of resolvability.

b) Where practicable, the Regulators will consult each other in advance of taking any of the following actions in respect of such a sandbox entrant in relation to its DSS activities, amongst others:
   i. withdrawing or amending recognition/approval (e.g. revocation of a SAN or a restriction on the activity of a sandbox entrant);
   ii. issuing directions;
   iii. issuing warning or decision notices;
   iv. triggering resolution or wind down, where applicable; and decisions relating to prospective changes of control.

18. When both the Regulators are exercising their DSS functions in relation to the same common issue (e.g. assessing the fit and properness of a person who acts in a critical role for both the FCA and Bank-supervised entity/entities), the Regulators will consult one another, recognising that each has distinct objectives and may therefore reach different conclusions.

19. With respect to the exercise of information gathering powers in relation to a sandbox entrant in respect of its DSS activities:

a) when either Regulator proposes to request information from a trading venue operated by a sandbox entrant or a DSD, from a connected person, or from a member or participant of such an entity, it will inform the other where it considers there is a material risk of duplication;
b) when one Regulator proposes to appoint a skilled person or an investigator, it shall notify the other; in such cases the Regulators will, where practicable, consider whether to co-ordinate such investigation jointly and will endeavour to minimise duplication and regulatory burden falling upon the regulated infrastructure or the group as a whole;
c) when either Regulator is appointing a skilled person or an investigator and considers the results of their report or investigation may be materially relevant to the objectives of the other, it shall provide the other with a confidential copy of the results.

<u>Co-ordination in investigations, enforcement and other formal regulatory action</u>

20. Where the Bank and the FCA consider that it would help the other regulator to fulfil its public functions relating to the DSS and there are no overriding reasons not to share such information, the regulators will notify each other of any material investigation it intends to conduct or is conducting into a relevant sandbox entrant (a firm which is regulated by both the FCA and the Bank), or a member of a group which it is aware includes a relevant sandbox entrant or relevant individual (a member of the management body or other person who effectively controls the business of a relevant sandbox entrant) at an early stage, and in any case before enforcement action (including informal action) is taken.

21. Where the matter being considered engages the objectives of both the Bank and the FCA, the Regulators will determine whether any investigation against a relevant sandbox entrant or relevant individual should be carried out by the Bank, by the FCA, or jointly, and how any investigation and subsequent proceedings should be co-ordinated. This includes coordination as between the Bank's Enforcement Decision Making Committee and the FCA's Regulatory Decisions Committee in contested matters concerning both Regulators.

22. Where either the Bank or the FCA carries out any investigation and subsequent proceedings alone, that Regulator will keep the other Regulator regularly updated on material aspects of the progress of the investigation (including unannounced visits, the execution of a search warrant or ahead of any arrests) and subsequent proceedings.

23. As set out in FSMA, each Regulator may issue Warning Notices and Decision Notices. Each Regulator will consult the other when they have reached a view in principle regarding the action they plan to take and before a formal decision to issue a Warning Notice or Decision Notice has been taken.

24. If a decision is made by either Regulator to take action against a subject, the Regulators should consider whether it is possible and would be appropriate to co-ordinate publication of applicable enforcement announcements so that both Regulators publish the outcome of their investigations simultaneously. In any event, the Regulators will endeavour to give the other appropriate notice of any press release or other public statement it intends to make relating to enforcement cases in which the other may have an interest, no later than 24 hours prior to publication unless there are overriding reasons which prevent or delay such notice.

DSS Advisory Panel

25. In addition to on-going working level engagement with respect to policy and supervisory issues and to facilitate information sharing and cooperation for the purposes of the DSS, the Regulators will convene a DSS Advisory Panel (the Panel). The Panel will meet on a regular basis and act as a forum for co-ordinating matters related to the operation of the DSS. The remit of the Panel does not include joint decision-making: no actions taken in the Panel are binding on either Regulator. Instead, any actions arising from a meeting of the Panel must be taken through the appropriate governance process at each respective Regulator and the outcome or update shared at a subsequent meeting.

26. A significant increase in the assessed risk profile of a sandbox entrant may prompt ad hoc discussions between the Regulators at the Panel, or through other fora if necessary. The Regulators will seek to avoid if possible taking regulatory actions that are incompatible or in conflict with the other's statutory objectives (see paragraphs 6-7), and, if conflicts arise and cannot otherwise be resolved at working level, they will escalate the matter through their respective management and governance structures.

Qualifying parent undertakings

27. The DSS Regulations extend the power of the Bank to direct qualifying parent undertakings so as to include parent undertakings of DSDs. Each Regulator will consult the other in relation to any proposal to direct an entity that is a qualifying parent undertaking in respect of a qualifying authorised person or recognised UK investment exchange who is a sandbox entrant (including a DSD), which might be relevant to the other Regulator's DSS functions. Where both Regulators propose to direct such a qualifying parent undertaking, they will in so far as possible coordinate their actions so as to minimise burdens on the group and avoid incompatible requirements.

Other specific areas of supervisory cooperation

28. Under Part 2 of Schedule 17A of FSMA, the Bank may require a DSD (or an entity connected to a DSD) to produce information or documents which the Bank reasonably considers may enable or assist the FCA in discharging functions conferred on the FCA under FSMA (the Part 2 Power). Where the FCA considers that information or documents within the possession or control of a DSD, or a connected person, would be of material assistance to the performance of its functions, the FCA may submit a request to the Bank and, if the Bank reasonably considers this to be the case, it will take steps in accordance with the Part 2 Power to obtain such information or documents on behalf of the FCA.

29. A request by the FCA under that Part 2 in relation to a DSD (or an entity connected to a DSD) may include:

    a) information or documents relevant to assessing the adequacy of clearing or settlement arrangements proposed by a trading venue; and
    b) information or documents relevant to pursuit of its objectives in relation to the detection and deterrence of market abuse or financial crime.

30. When undertaking an assessment of the adequacy of settlement arrangements to be provided to a trading venue by sandbox entrants supervised by the Bank, the FCA will consult the Bank and seek to avoid duplicating work already undertaken by the Bank.

31. In the event of an actual or anticipated default of a user of trading venues and settlement systems in relation to the DSS, the Bank and the FCA, are committed to working closely together, and to communicating effectively and promptly in order to ensure that regulatory actions are coordinated.

Policy and rule-making approach

32. On general policy matters relating to the DSS, the Regulators will, other than in exceptional circumstances (see "emergency action" below), consult each other at an early stage in relation to policy deliberations that might have a material effect on the other's objectives, or the risk borne by settlement systems or trading venues, or their participants. The Regulators will consult each other in advance of making, amending or waiving rules in relation to the DSS that may be materially relevant to the other's objectives.

33. The Regulators will seek to avoid introducing, inadvertently, incompatible requirements or policy positions in these areas. Where there is a serious prospect of conflict between their requirements or policy positions which would materially affect their objectives, and where it has not been possible to resolve this through other fora, for example the DSSAP, the issue will be elevated to the Chief Executive of the FCA and Deputy Governor for Financial Stability at the Bank.

Financial crime

34. Where the Bank, in carrying out its functions referred to in paragraphs 6-7 above, becomes aware of any evidence that it believes may be materially relevant to the FCA's functions in relation to financial crime, it will alert the FCA.

35. The FCA will alert the Bank to any investigation, in respect of financial crime, into an operator of a DSD and which concerns its DSS activities, before commencing or publicly announcing such

investigation; and will inform the Bank of any actual or suspected financial crime in relation to a DSD of which the FCA is aware.

Emergency action

36. It is important that the Regulators have the ability to act quickly where appropriate to advance their respective objectives. In that context, in particular market conditions or other relevant circumstances, the precise arrangements set out in this MoU may not be compatible with one or more of the Regulators advancing its objectives with the urgency required. For example, where justified, action may need to be taken without consultation. In this case, the Regulators will provide the other with notice as soon as practicable of the situation and the action taken, or proposed to be taken.

Confidentiality

37. The Regulators will protect the confidentiality and sensitivity of all unpublished regulatory and other confidential information received from the others.
38. Without prejudice to the obligations which a Regulator may have to use or disclose information in relation to enforcement proceedings or otherwise, each Regulator will endeavour to consult the other, where practicable, before:
    a) passing the information to a third party; and
    b) using the information in the context of enforcement proceedings or other court case where it is likely to become publicly disclosed.

39. It is recognised that it may, over time, become more difficult to identify the source of certain types of information.

40. The Regulators will liaise, where appropriate, on responding to requests made under the Freedom of Information Act and Data Protection Act, and will consult before releasing information received from the others.

Maintaining the MoU

41. The co-chairs of the Panel will be responsible for ensuring that the principles set out in this MoU are upheld on an ongoing basis. The Panel will review and amend the MoU on an ad hoc basis as and when this is necessary. In the case where changes might be needed outside of this cycle, the Panel will review specific sections as appropriate.

Approved by:

Bank of England (September 2024)

Financial Conduct Authority (September 2024)