EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2023 (DIGITAL SECURITIES SANDBOX) (AMENDMENT) REGULATIONS 2025

2025 No. 93

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of His Majesty.

2. Declaration

2.1 Emma Reynolds MP, Economic Secretary to the Treasury at HM Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 Tom Duggan, Deputy Director for Securities and Markets, at HM Treasury confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 The email fmipolicybranch@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument amends the Financial Services and Markets Act 2023 (Digital Securities Sandbox) Regulations 2023 ("the DSS Regulations"). It modifies the effect of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 ("MLRs") and makes other minor amendments to the DSS Regulations.

4.2 Specifically, it temporarily disapplies the provisions of the MLRs that apply to cryptoassets (and other related concepts as defined in regulation 14A of the MLRs) for activities in scope of the Digital Securities Sandbox ("DSS"). It does this by inserting a fifth table into the schedule to the DSS Regulations.

4.3 The MLRs would continue to apply to firms outside of the DSS as appropriate.

Where does the legislation extend to, and apply?

4.4 The extent of this instrument (that is, the jurisdictions in which the instrument forms part of the law) is England and Wales, Scotland, and Northern Ireland.

4.5 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England and Wales, Scotland, and Northern Ireland.

5. Policy Context

What is being done and why?

DSS modifications of the MLRs

5.1 To facilitate activity in the DSS these regulations disapply provisions of the MLRs that would otherwise apply to activity in the DSS, whilst maintaining all other anti-money laundering (AML) obligations.

5.2 The MLRs require relevant persons, including financial institutions and other regulated sectors to comply with AML obligations, such as customer due diligence and suspicious transaction reporting, in line with the international AML standards set by the Financial Action Task Force (FATF).

5.3 Most conventional financial market actors who fall in scope of the MLRs are already authorised with the Financial Conduct Authority ("the FCA") under the Financial Services and Markets Act 2000 ("FSMA 2000") and will be subject to FCA AML rules.

5.4 Currently, where distributed ledger technology ("DLT") is used in relation to activity connected with the DSS, that activity could be defined as a cryptoasset service under regulation 14A of the MLRs. Without changes to existing legislation, firms already registered or authorised with the FCA for other activities, and subject to the MLR requirements, would need to register separately with the FCA as a cryptoasset business to undertake DSS activities.

5.5 The government does not believe that this approach is proportionate. It would also impose obligations on firms in a way that goes beyond current market practice for the traditional regulated securities markets that DSS activity involves. This instrument therefore temporarily exempts activity in the DSS from the MLRs cryptoasset regime.

5.6 AML risks will continue to be mitigated within the DSS with the exemption in place, given all conventional non-cryptoasset related AML requirements would continue to apply, and due to activity in the DSS being regulated and supervised. Permitted activity in the DSS is limited to particular regulated financial instruments as defined in in the Regulated Activities Order set out in FSMA 2000. Instruments such as unbacked cryptoassets are not in scope of the DSS.

5.7 The DSS also provides an extensive regulatory tool kit (such as the ability for the regulators to change rules flexibly, modify approval notices to impose conditions on participants, and set volume limits).

5.8 Since applications to participate in the DSS opened on 30 September 2024, ClearToken CSD Limited, Montis Digital UK Limited and BPX Markets Limited have successfully completed the approvals process, as set out by the Bank of England ("the Bank") and the FCA and have passed through Gate 1 of the DSS. More information is available at the following webpage https://www.bankofengland.co.uk/financial-stability/digital-securities-sandbox/digital-securities-sandbox-dashboard.

Reporting of infringements

5.9 To avoid a regulatory and supervisory gap in enforcement actions and whistleblowing provisions within the DSS, this instrument reinstates article 65 of Regulation No. 909/2014 ("UK CSDR") within the temporarily modified version of CSDR as set out in the DSS Regulations and extends the reporting requirements to include reporting infringements, potential or otherwise.

Ancillary FMI activities

5.10 These Regulations provide the Bank and the FCA with the power to regulate and supervise ancillary FMI activities in the DSS where appropriate. Given the experimental nature of the DSS, this will ensure that where activity in the DSS involves certain ancillary activities that are beyond those that are directly in scope, that the regulators have the appropriate regulatory and supervisory tools if they are needed. Those activities are referred to in regulation 3(6) of the DSS Regulations.

Section 20 of FSMA 2000

5.11 S20 of FSMA 2000 requires an authorised person to hold the necessary Part 4A permissions for any regulated activities they carry out. These Regulations disapply the section in so far as it applies to an authorised person who is a sandbox entrant carrying on regulated activities in connection with any of the FMI activities in regulation 3(5)(b) of the DSS Regulations (notary, maintenance, or settlement), or ancillary FMI activities (as defined in the DSS Regulations) for which it has approval in its Sandbox Approval Notice.

What was the previous policy, how is this different?

5.12 FMIs provide essential services for financial markets, such as the clearing, settlement and, recording of financial instruments. They are important from a financial stability perspective and are subject to strict regulation both domestically and internationally. It is also important that FMIs continue to innovate and be able to trial the adoption of new technologies to remain competitive, lower operating costs and enhance performance.

5.13 This could include DLT, which could make markets more efficient, resilient, and transparent. It has the potential to radically change the way markets operate for example the potential combining of functions currently performed by separate entities into single digital FMIs, 24/7 operation and the instantaneous settlement of market transactions.

5.14 Regulatory sandboxes were cited by industry as an effective way to understand how the law needs to change, in order to best support FMIs in adopting and using new technologies and practices. HM Treasury subsequently established the DSS in December 2023, via the DSS Regulations.

5.15 Temporary changes to the MLRs were not originally in scope of the DSS. However, engagement and consultation with the regulators and industry suggested that applying the MLRs in the current form to firms participating in or interacting with the DSS would disincentivise participation, given the requirements on firms to register with the FCA despite having already undertaken AML obligations as part of their prior authorisation.

5.16 The issues regarding the application of the cryptoasset regime in the MLRs to DSS activity were raised in response to HMT's consultation on the DSS in 2023 and the Bank and the FCA's joint consultation on the DSS in 2024. After careful consideration HMT, the Bank and the FCA concluded that it is appropriate to provide a temporary exemption from the cryptoasset regime in the MLRs, to prevent its application to DSS activity constituting a barrier to entry into, or engagement with, the DSS.

6. Legislative and Legal Context

How has the law changed?

6.1 The Financial Services and Markets Act 2023 ("FSMA 2023") provided HM Treasury with powers to modify, apply, or disapply elements of existing legislation as well as the ability to confer powers on to the Bank and the FCA to operate and supervise an FMI sandbox. Specifically, this is provided for through Sections 13 and 17 of and Schedule 4 to FSMA 2023.

6.2 Through the DSS Regulations which were laid before Parliament in December 2023, HM Treasury established the UK's first FMI sandbox, the DSS.

6.3 The temporary changes made by those regulations enable participating firms to engage in activity in a way that is not practicable under current legislation.

6.4 The legislation that has been temporarily applied, disapplied and modified includes the Financial Services Markets Act 2000, Companies Act 2006, the Uncertified Securities Regulations 2001, and the UK Central Securities Depositories Regulation 2014.

6.5 The Financial Services and Markets Act 2023 (Addition of Relevant Enactments) Regulations 2024 added more legislation, including the MLRs, to the list of enactments in FSMA 2023 that HM Treasury is able to modify in an FMI sandbox.

Why was this approach taken to change the law?

6.6 The powers set out in FSMA 2023 (as amended) enable HMT to make further changes to the DSS via statutory instrument. These modifications to the MLRs and other modifications are consistent with this approach.

7. Consultation

Summary of consultation outcome and methodology

7.1 The consultation on the DSS closed on 22 August 2023. The Bank and the FCA joint DSS consultation closed on 29 May 2024.

7.2 A consultation was not undertaken for this instrument specifically, as the changes are based on stakeholder feedback received from other consultations.

8. Applicable Guidance

8.1 HM Treasury does not propose to provide any guidance in relation to this instrument.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because the impact of this SI is small (the cost to businesses is <£5m per year). A de minimis impact assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

Impact on businesses, charities, and voluntary bodies

9.2 There is no, or no significant, impact on business, charities, or voluntary bodies because participation in the DSS is voluntary.

9.3 The legislation does not impact small or micro businesses.

9.4 There is no, or no significant, impact on the public sector because participation is voluntary, and is aimed at understanding how new technology and practices can improve markets.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The instrument does not include a statutory review clause, and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, the Economic Secretary to the Treasury (Emma Reynolds MP) has made the following statement:

"It is not proportionate to include a review clause in this instrument because the estimated annual net direct cost to business is less than £5 million and the number of small businesses in scope is very low."

For each FMI Sandbox the government is required to report to Parliament, setting out the activity that has taken place and outlining what permanent changes it intends to make under the powers set out at Section 14 FSMA 2023.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Financial Services and Markets Act 2023 (Digital Securities Sandbox) (Amendment) Regulations 2025 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.