Digital Securities Depository

Understanding DIGIT Access and Settlement



LSEG

Overview

What is the Digital Securities Sandbox (DSS)?

The Digital Securities Sandbox (DSS) is a UK regulatory framework operated jointly by the Bank of England and the Financial Conduct Authority. It enables participating firms to use developing technologies, including distributed ledger technology, to issue, trade and settle securities in a live environment under a temporarily modified legal and regulatory framework. Activities remain subject to regulatory oversight and applicable DSS limits.

What is the purpose of a DSD link?

A DSD link is intended to offer connectivity between two separate DSD platforms, so that investors can access securities issued on one DSD by having access to either platform (either directly themselves or through a custodian). Investors not onboarded directly to either platform should confirm with their broker or intermediary that the custodian their broker or intermediary uses is onboarded to one of the platforms. The UK government's digital gilt instrument (DIGIT) will be the first sovereign digital issuance to support a DSD link between two DSD platforms.

What is a bilateral link?

HSBC and LSEG have created a bilateral link to enable investor access and DSD services between the two DSDs' infrastructures. The DSD link is designed to support multiple securities over time and it will operate in both directions: either DSD can act as the Issuer DSD for securities issued on its platform or as the Investor DSD for securities issued on the other platform.

DIGIT will be the first transaction the link will support, with HSBC Orion UK DSD acting as the Issuer DSD and LSEG DSD as the Investor DSD.

For future issuances, when LSEG DSD acts as the Issuer DSD for fixed income instruments defined in its DSS approval, HSBC Orion UK DSD will be able to act as the Investor DSD for those instruments (if approved in HSBC's SAN).

When will the link between HSBC Orion UK DSD and LSEG DSD be available?

t is intended that the standard DSD link between HSBC Orion UK DSD and LSEG DSD will be operational for the primary issuance of DIGIT.

What is the difference between Issuer DSD vs Investor DSD?

An Issuer DSD is responsible for enabling the issuance of a security, maintaining the integrity of the issuance and the record of legal ownership. It supports settlement and asset servicing for its participants.

An Investor DSD provides access to a security through a link to the Issuer DSD, maintaining the relevant positions for its participants and supports settlement and asset servicing of the beneficial interests in the underlying security for its participants.

For DIGIT, HSBC Orion UK DSD will act as the Issuer DSD, and LSEG DSD will act as the Investor DSD. Investors can access DIGIT through either platform depending on where they are onboarded or their chosen custodian is onboarded. Investors not onboarded directly to either platform should confirm with their

broker or intermediary that the custodian their broker or intermediary uses is onboarded to one of the platforms.

What does it mean to have two DSDs for DIGIT?
In the case of DIGIT, the two DSDs perform complementary roles providing optionality for investors.

HSBC Orion UK DSD acts as the Issuer DSD, maintaining the legal ownership record and enabling investors to access, hold and service DIGIT through the HSBC ecosystem.

LSEG DSD acts as the Investor DSD, maintaining the records of beneficial interests in DIGIT and enabling investors to access, hold and service those beneficial interests through the LSEG ecosystem.

Investors or their custodians can onboard to either platform. The two infrastructures are connected through a standard DSD link (approved by the Bank of England), allowing positions, settlement and asset servicing information to be exchanged between them while providing investors with a choice of access route.

Investors not onboarded directly to either platform should confirm with their broker or intermediary that the custodian their broker or intermediary uses is onboarded to one of the platforms.

As an investor, do I need to have access to both LSEG DSD and HSBC Orion UK DSD platforms to access DIGIT?
No. Investors have the choice to access DIGIT through either HSBC Orion UK DSD or LSEG DSD.

This can be done either by investors directly onboarding to one platform or through their custodian being onboarded to either platform. There is no requirement to connect to both platforms.

Investors not onboarded directly to either platform should confirm with their broker or intermediary that the custodian their broker or intermediary uses is onboarded to one of the platforms.

What is the cash used for DIGIT?
It is expected that HSBC Orion UK DSD will offer settlement with fiat cash, settlement tokens and HSBC Tokenised Deposits.

Subject to regulatory discussions, the LSEG DSD intends to offer the cash-leg settlement via LSEG's DiSH for transactions executed on the LSEG DSD.. Over time, LSEG's vision is to support additional cash settlement options as market demand and the regulatory landscape evolve.

Will both HSBC and LSEG platforms enable Repo transactions?
Yes. Both HSBC DSD and LSEG DSD expect to support repo transactions.

Is DIGIT going to be available in the secondary market?
Yes. DIGIT is expected to be listed and available for secondary market trading, including on the London Stock Exchange.

Regardless of the trading venue (whether on exchange or OTC), settlement of DIGIT will occur through HSBC Orion UK DSD and LSEG DSD depending on which platform the trading counterparties or their custodians have onboarded to. There is no requirement for trading counterparties to onboard to both platforms if their custodian is onboarded to one.

What do investors need to do to be able to participate in DIGIT?
Investors should engage with their custodian either directly or via their intermediary to confirm whether it is onboarded, or intends to onboard, onto either HSBC Orion UK DSD or LSEG DSD and can support access to DIGIT. Investors wishing to become direct participants of either HSBC Orion UK or LSEG DSD should contact their chosen platform to understand the applicable eligibility and onboarding requirements.

LSEG DSD <> HSBC Orion UK DSD Link

What does the standard DSD link between HSBC and LSEG look like?
The standard DSD link connects HSBC Orion UK DSD, as the Issuer DSD for DIGIT, with the LSEG DSD acting as the Investor DSD. Investors will therefore have the optionality to access DIGIT through either DSD.

The concept of linking securities depositories is not new. Securities market infrastructures have long used links to provide access to securities held in another depository and to support settlement and asset servicing across different infrastructures. The DIGIT model applies these established principles within the Digital Securities Sandbox (DSS) using an Issuer DSD and Investor DSD structure.

What is innovative is not the concept of a depository link itself, but its application to a digital sovereign issuance and using Distributed Ledger Technology, giving investors flexibility in how they access DIGIT while supporting connectivity between separate digital market infrastructures.

Is the DSD link used for every single transaction?
The link is used where a transaction settles across the two DSDs and to facilitate asset servicing.

- Scenario 1: Where both counterparties settle through HSBC Orion UK DSD, directly or through their custodians, settlement takes place within HSBC Orion UK DSD. The DSD link is not used in this instance.

- Scenario 2: Where both counterparties settle through LSEG DSD, directly or through their custodians, settlement takes place within LSEG DSD. The DSD link is not used in this instance.

- Scenario 3: Where one counterparty settles through HSBC Orion UK DSD and the other through LSEG DSD, directly or through their respective custodians, the DSD link is used for settlement with one DSD participating in the other's settlement system to facilitate the transfer of securities between the respective counterparties engaging in the trade, regardless of which counterparty is buying or selling.

In all the scenarios, each counterparty, either directly or via their custodians, instructs their DSD using a DvP (Delivery vs Payment) or RvP (Receipt vs Payment) instruction. Instructions can be submitted via User Interface or SWIFT messaging.

How does the DSD link work in practice for cross-DSD Settlement?

The link will support the exchange of settlement instructions, position data, status updates and lifecycle-event information between the two DSDs.

Illustrative example

An Investor holding DIGIT through HSBC Orion UK DSD sells to an investor accessing DIGIT through LSEG DSD. Both investors act through their respective custodians.

Step 1 - Instructions

The Seller's custodian submits a delivery vs payment (DvP) instruction to HSBC Orion UK DSD.

The Buyer's custodian submits a receipt vs payment (RvP) instruction to LSEG DSD.

Step 2 – Link processing

LSEG DSD sends a corresponding receipt vs payment (RvP) instruction through the link to HSBC Orion UK DSD, where matching takes place against the Seller's instruction.

Step 3 – Cash movement

As the Buyer's custodian is a participant in LSEG's system, the LSEG DSD coordinates with LSEG DiSH to make the appropriate funds available on the HSBC Orion UK DSD platform.

Step 4 – HSBC Orion UK DSD Settlement

HSBC Orion UK DSD then settles the securities and cash legs completing DvP on their platform for the Seller's custodian as the participant in the HSBC Orion UK system.

As part of the DvP, HSBC Orion UK DSD transfers the securities from the Seller Custodian's securities account to LSEG DSD's securities account on the HSBC Orion UK platform.

Step 5 – LSEG DSD Settlement

Following receipt of securities in their account, LSEG DSD records the corresponding beneficial-interest holding in the Buyer's custodian's securities account and mints tokens representing the Buyers interest in DIGIT. These tokens will have the same ISIN as the underlying DIGIT instrument. Such tokens are available in the Buyer's or their custodian's wallets. With this step, LSEG DSD completes DvP for its participant.

How are coupons paid for DIGIT?

Step 1. If a coupon is payable HSBC Orion UK DSD will notify all HSBC Orion UK Direct Participants, including LSEG DSD of the coupon event through a SWIFT MT564 corporate-action notification relating to their holding of the relevant debt instrument on the record date.

Step 2. LSEG DSD will then notify its participants accordingly.

Step 3. HSBC Orion UK DSD will calculate the aggregate coupon entitlement based on LSEG DSD's omnibus holding of the relevant debt instrument at the record date.

Step 4. On the payment date, LSEG DSD will receive funds totalling the aggregate coupon payment based on the omnibus holding of LSEG DSD on the HSBC Orion UK DSD platform. All HSBC Orion UK Direct Participants will receive their coupon payments directly from the HSBC Orion UK DSD.

Step 5. LSEG DSD will reconcile the funds received against the corporate-action notifications as received, before allocating and distributing payments to its participants according to their eligible underlying holdings in LSEG DSD.
Investors holding through a custodian or intermediary will receive their payments through that provider subject to their respective agreements with that provider.

What blockchain is used for the link?
The DSD link is a connection between the two DSD platforms and not itself a piece of technology. Both LSEG DSD and HSBC Orion UK DSD use a private permissioned blockchain for record keeping. For the DSD link both HSBC Orion UK DSD and LSEG DSD use SWIFT messaging as a communication layer allowing them to interact across the link. No blockchains, bridges or other related technology is used.

Is there a cyber security risk to the DSD link?
The DSD link between the LSEG DSD and HSBC Orion UK DSD's infrastructure uses the SWIFT network as well as each DSD's respective digital infrastructure. Cyber security and incident management policies and procedures are maintained by both DSDs to mitigate and manage the cyber security of their respective digital infrastructure.

Legal Considerations

What does it mean to have legal ownership recorded in one DSD and beneficial interest recorded in another DSD for DIGIT?
The record of legal ownership of DIGIT is maintained on HSBC Orion UK DSD as the Issuer DSD. Where an investor accesses DIGIT through LSEG DSD, a corresponding position is held by LSEG DSD in an omnibus account on HSBC Orion UK DSD, while the investor's beneficial interest is recorded within LSEG DSD. LSEG DSD holds the DIGIT position on a bare trust for the benefit of its participants on a one for one basis to the underlying DIGIT instrument.

This enables investors to access DIGIT through the LSEG ecosystem while maintaining a clear link to the underlying legal ownership record on HSBC Orion UK DSD.

Does the choice of access route change the economic exposure an investor has to DIGIT?
No, the choice of access route does not change an investor's economic exposure to DIGIT.

What governance and operational arrangements will support the standard DSD link?
The standard DSD link will be supported by contractual and operational arrangements defining the respective rights and responsibilities of HSBC Orion UK DSD and LSEG DSD. These arrangements will include reconciliation, risk management, incident escalation, and settlement and asset-servicing processes.

The DSD link has been approved by the Bank of England and is included in HSBC Orion UK DSD's and LSEG DSD's respective Sandbox Approval Notices (SANs). It will operate under the applicable rules and oversight arrangements of each DSD.

Will transactions on HSBC Orion UK DSD benefit from SFR protection?

HSBC Orion UK DSD intends to provide statutory settlement finality and is working towards such designation from the Bank of England under the UK Settlement Finality Regulations 1999. HSBC expects this to be in place in time for the DIGIT issuance.

Will transactions on LSEG DSD benefit from SFR protection?

LSEG DSD intends to provide contractual settlement finality and is working towards formal SFR designation. LSEG expects the relevant SFR arrangements to be in place for DIGIT, subject to regulatory approval, providing the appropriate statutory settlement finality protections alongside the contractual framework.

HSBC Disclaimer

These FAQs are provided for general informational purposes only and describe HSBC Orion UK DSD's current intended operating model. They do not constitute investment, legal, tax or regulatory advice, an offer or invitation to acquire or dispose of any security, or a representation that any particular service or functionality will be available. Access to HSBC Orion UK DSD and any services described above is subject to applicable law and regulation, regulatory approvals and limits, the HSBC Orion UK DSD Rules and other applicable contractual and operational requirements. Information relating to DIGIT is also subject to the final terms and documentation applicable to the issuance.

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