

Forecasting clearer skies: SFC clarifies approach to external electronic and cloud storage

Executive summary:

- This bulletin considers the external data storage framework set out in the SFC’s 31 October 2019 *Circular on the use of external electronic data storage*, following clarifications made in its *EDSP FAQs* published on 10 December 2020.
- The Circular sets out the requirements expected of licensed corporations using external data storage or processing services for regulatory records and/or client data and information relevant to the operation of their business.
- The EDSP FAQs clarify the scope of the Circular including the expectations as to records held by a licensed corporation’s affiliates.
- Significantly, the SFC has confirmed that it will begin approving overseas premises for record-keeping purposes. This means that licensed corporations will need to start applying for approval where regulatory records are kept *exclusively* with external data storage providers or affiliates. As part of the application for approval, the SFC will require certain confirmations – for example an “MIC/RO Undertaking” – to ensure that it will be able to access regulatory records upon demand.
- The Circular also sets out general requirements to implement the control and risk measures which apply to all licensed corporations using external data service providers or affiliates.
- Licensed corporations should take action now to ascertain whether (and the extent to which) the requirements apply, and determine the appropriate way in which to comply.

Introduction

The use of electronic data storage as a means to store information and documents is increasingly prevalent – generally and among licensed corporations. However, regulatory requirements around the keeping of records have historically been restrictive. While respecting the legitimate need for firms to be able to store records in an efficient manner, the Hong Kong regulators have responded on a number of fronts expressing their need and concern that they have continued power to access such records as necessary to fulfil their regulatory obligations irrespective of where the records are held.

Against this backdrop, on 31 October 2019, the Securities and Futures Commission (SFC) issued the [Circular on the use of external electronic data storage](#) (the **Circular**) formally setting out its requirements and expectations in relation to the use of external electronic data storage providers (**EDSPs**), such as external providers of public and private cloud services, servers or devices for data storage at conventional data centres, other forms of virtual storage of electronic information, and technology storage services. The primary purpose of the Circular, [as noted by the SFC](#), is to enable firms to store their regulatory records using EDSPs in a way which complies with key regulatory

objectives and requirements. In particular, one of the key aims of the SFC is to be able to obtain regulatory records (properly preserved from tampering) as needed, even if held outside Hong Kong.

However, as recognised in Ashley Alder’s [speech at the SFC Compliance Forum](#), there have been a number of concerns around the practical difficulties in complying with the Circular. In particular, the industry has requested that the SFC: (i) clarifies a number of aspects including (but not limited to) the application of the Circular to records held by affiliates; (ii) addresses the unwillingness of major EDSPs to sign the notices and undertakings required by the SFC; (iii) provides the scope for a variation of the requirement to designate multiple Managers-in-

Charge based in Hong Kong (noting that smaller licensed corporations, for example, might not have the appropriate resource in Hong Kong); and (iv) confirms the scope of the “audit trail” requirements.

Therefore, to assist the market, on 10 December 2020 the SFC issued [EDSP FAQs \(EDSP FAQs\)](#) to address these concerns, clarify certain matters in the Circular and further set out its expectations for where records are kept with group companies and overseas affiliates (**affiliates**) (which the Circular did not address). The SFC has also [revised its existing FAQs](#) in respect of premises for business and record keeping.

This bulletin explores the requirements in respect of external data storage as it currently stands.

Application

The Circular and EDSP FAQs apply to two major categories of licensed corporations:

Category	Relevant requirements and expectations
Licensed corporations who use EDSPs or affiliates to <i>exclusively</i> keep Regulatory Records (as defined in the Circular).	See Section 3 – Framework for exclusive storage of Regulatory Records and Section 4 – Section E of the Circular: General obligations for all licensed corporations storing data with EDSPs or affiliates.
Licensed corporations who use external data storage or processing services for Regulatory Records and/or client data and information relevant to the operation of the business (whether or not these records/documents are kept <i>exclusively</i> by EDSPs or affiliates).	See Section 4 – Section E of the Circular: General obligations for all licensed corporations storing data with EDSPs or affiliates.

Regulatory Records are defined in the Circular and mean the records required to be kept by licensed corporations under the Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong) (**SFO**) (and its subsidiary legislation) or the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615, Laws of Hong Kong) (**AMLO**). Not all records held by a licensed corporation will be Regulatory Records. The licensed corporation may have other client data and information relevant to the operation of the business stored or processed by EDSPs or affiliates which will fall outside of the definition of Regulatory Records but will still need to comply with the Circular.

A licensed corporation will be considered as storing data **exclusively** with EDSPs or affiliates unless it contemporaneously keeps its own full set of Regulatory Records at its Hong Kong-approved premises (and records held by EDSPs or affiliates are only for data back-up or computation and analytics purposes).

Statutory requirements are not changed by the Circular. Licensed corporations will need to continue to comply with all the applicable record-keeping rules, including as set out in the Securities and Futures (Keeping of Records) Rules (Cap. 571O, Laws of Hong Kong) or the AMLO. Any physical Regulatory Records are still required to be kept in Hong Kong at approved premises.



Framework for *exclusive* storage of Regulatory Records

If Regulatory Records are kept *exclusively* with an EDSP or an affiliate, then further requirements may apply depending on how such records are held. The table below provides a high-level summary of the key designation, approval and documentary requirements (with text in **bold** further explained below):

Method	Obligations
<p>Regulatory Records kept <i>exclusively</i> with a Hong Kong EDSP*</p> <p>* A Hong Kong EDSP is an EDSP which is a Hong Kong incorporated company or non-Hong Kong company registered under the Companies Ordinance with personnel in Hong Kong storing the licensed corporation's data at a Hong Kong data centre</p>	<p>The onshore data storage premises have been approved by the SFC before the date of the Circular</p> <ol style="list-style-type: none"> 1. Comply with the MIC Requirement and provide the SFC's Licensing Department with confirmation that all the Regulatory Records of the licensed corporation kept with the EDSP are fully accessible upon demand by the SFC at the licensed corporation's principal place of business. 2. Comply with Sections C – E of the Circular. See Section 4 – Section E of the Circular: General obligations for all licensed corporations storing data with EDSPs or affiliates. 3. <i>As soon as practicable</i>, provide the SFC with: <ol style="list-style-type: none"> (a) confirmation that the EDSP is a Hong Kong EDSP; (b) a copy of the EDSP Notice (countersigned by the EDSP) OR an MIC/RO Undertaking (including the Access Map); and (c) confirmation that other requirements in the Circular have been complied with.
	<p>The onshore data storage premises have not been approved by the SFC before the date of the Circular</p> <ol style="list-style-type: none"> 1. <i>Without undue delay</i>, notify the SFC's Licensing Department. 2. Comply with Sections C – E of the Circular. See Section 4 – Section E of the Circular: General obligations for all licensed corporations storing data with EDSPs or affiliates. 3. Comply with the MIC Requirement. 4. <i>As soon as practicable</i>, apply for Section 130 Approval for the data storage premises, with the application accompanied by: <ol style="list-style-type: none"> (a) confirmation that the EDSP is a Hong Kong EDSP; and (b) a copy of the EDSP Notice (countersigned by the EDSP) OR an MIC/RO Undertaking (including the Access Map).
<p>Regulatory Records are kept <i>exclusively</i> with a non-Hong Kong EDSP who has not been approved before the date of the Circular</p>	<ol style="list-style-type: none"> 1. <i>Without undue delay</i>, notify the SFC's Licensing Department. 2. Comply with Sections C – E of the Circular. See Section 4 – Section E of the Circular: General obligations for all licensed corporations storing data with EDSPs or affiliates. 3. Comply with the MIC Requirement. 4. <i>As soon as practicable</i>, apply for Section 130 Approval for the data storage premises, with the application accompanied by: <ol style="list-style-type: none"> (a) copies of the EDSP Notice and the EDSP Undertaking; or (b) an MIC/RO Undertaking (including the Access Map).
<p>Regulatory Records are kept <i>exclusively</i> with an affiliate (whether in or outside Hong Kong)</p>	<ol style="list-style-type: none"> 1. <i>Without undue delay</i>, notify the SFC's Licensing Department. 2. Comply with Paragraphs 7(d) – (h) and 8 of the Circular (and references to EDSPs include the affiliates). <ol style="list-style-type: none"> (a) (Where the affiliate uses an EDSP itself) Comply with Section E (other than Paragraph 21) of the Circular. See Section 4 – Section E of the Circular: General obligations for all licensed corporations storing data with EDSPs or affiliates. 3. Comply with the MIC Requirement. 4. <i>As soon as practicable</i>, apply for Section 130 Approval for the data storage premises, with the application accompanied by an MIC/RO Undertaking (including the Access Map).

Although the SFC has specified the template notices and/or undertakings which should be used, the SFC has intimated in the EDSP FAQs that licensed corporations may approach the SFC to propose or discuss alternative forms which may satisfy the SFC's regulatory objectives and requirements (eg a "bilateral addendum" between the EDSP/affiliate and the licensed corporation).

Where a licensed corporation keeps records *exclusively* with EDSPs or affiliates, it will also be required to ensure that (i) all the Regulatory Records are fully accessible upon demand by the SFC without undue delay, and can be reproduced in a legible form from its approved Hong Kong premises and (ii) the Regulatory Records are kept in a manner that does not impair or result in undue delay to the SFC's effective access to the Regulatory Records.

In addition, the Circular requires a licensed corporation to ensure that (i) it can provide detailed audit trail information (at a minimum, information on timestamp, affected file, type of event, user ID and user location (such as IP address)) in a legible form regarding any access to the Regulatory Records (including read, write and modify) and (ii) the audit trail is a complete record of any access by the licensed corporation to Regulatory Records.

Following feedback from some market participants who had noted that their systems did not capture users who only read (without writing or modifying) Regulatory Records (eg a read access log), the EDSP FAQs clarify that the key will be an audit trail that enables the licensed corporation and the SFC "*with reasonable expediency, to identify each user responsible for the creation, modification or deletion of electronic Regulatory Records*" (our emphasis). However, if the licensed corporation maintains an audit trail under any other legal or regulatory requirement which necessitates read access logs, then these should be maintained.

A. Section 130 approval

In Hong Kong, Section 130 of the SFO requires licensed corporations to seek approval from the SFC for premises to be used for the storage of Regulatory Records.

Historically, it has not been the SFC's practice to approve premises outside Hong Kong for the keeping of Regulatory Records. This is because the SFC requires that it be able to access all of the Regulatory Records at any time, and its statutory powers preclude it from entering premises to inspect records where these are held outside of Hong Kong.

Pursuant to the Circular, the SFC will approve overseas premises (wherever located) which *exclusively* keep the licensed corporation's Regulatory Records and where certain conditions are met. With the application for approval, the licensed corporation will need to demonstrate that it has complied with the requirements of the Circular, such as the MIC Requirement, the Notice

or the EDSP Undertaking, or the MIC/RO Undertaking (as applicable).

Addresses of the relevant data centres do not need to be provided to the SFC if the licensed corporation is unable to obtain this (and the SFC is aware that EDSPs and affiliates may not provide such information for security reasons). Nevertheless, licensed corporations will be expected to provide the jurisdictions in which the data centres are located (for EDSPs) and the addresses of the premises used by affiliates, as applicable.

B. MIC Requirement

Where the MIC Requirement applies, the starting point is that a licensed corporation must designate two managers-in-charge (**MICs**) *in Hong Kong* with the appropriate knowledge, expertise and authority to ensure compliance with the Circular and provide assistance so that the SFC can promptly gain access to all Regulatory Records. The EDSP FAQs have clarified that this means the MIC (or responsible officer (**RO**) – see below) should have the ability to gain possession of or procure all relevant digital certificates, keys, passwords and tokens to facilitate access to the Regulatory Records.

The EDSP FAQs acknowledge that it may not be feasible to have two MICs ordinarily resident in Hong Kong. Therefore, on a case-by-case basis, the SFC may consent to a licensed corporation having only one MIC ordinarily resident in Hong Kong; the EDSP FAQs indicate this is most likely to be the MIC for Overall Management and Oversight, unless the licensed corporation satisfies the SFC that another MIC ordinarily resident in Hong Kong is in a better position to assume this role. Furthermore, the SFC may consider consenting to an RO ordinarily resident in Hong Kong if there are no suitable MICs. There should also be a delegate ordinarily resident in Hong Kong, for situations when the MIC/RO is unavailable.

Where applicable, the MIC/RO will be required to give the MIC/RO Undertaking. In selecting the MIC/RO, the licensed corporation (particularly its board and MIC/RO) will need to ensure that the MIC/RO has the appropriate authority to give effect to and secure the discharge of the MIC/RO's responsibilities under the MIC/RO Undertaking (see below).

The SFC is not creating a new core function under the MIC regime. Licensed corporations will however need to assess which of their existing MIC(s) in Hong Kong can fulfill the requirements of the Circular. Other than the MIC for Overall Management and Oversight, we expect licensed corporations to also look at whether the MIC for Information Technology (who will have responsibility for designing, developing, operating and maintaining computer systems) may be a suitable candidate given the technical nature of some of the requirements.

While not specifically noted in the Circular, licensed corporations should update the management structure paper to reflect the additional roles, responsibilities, accountability and reporting lines that might arise when applying the Circular. The licensed corporation's board should sign off on the changes.

C. MIC/RO Undertaking

An MIC/RO Undertaking is an undertaking substantially in the form of [Appendix 1 to the EDSP FAQs](#) that is given by the MIC/RO designated under the MIC Requirement. Under the MIC/RO Undertaking, the MIC/RO undertakes that all Regulatory Records will be readily accessible to the SFC and kept in a way which safeguards and ensures their accuracy. The MIC/RO is required to confirm that it has *"authority to give effect to, secure the full compliance of and discharge of responsibilities"* under the MIC/RO Undertaking and the Circular – and shall (among other things):

- ensure that all electronic Regulatory Records are securely kept and stored by the EDSPs and affiliates – and not kept or stored in any jurisdiction with restrictions on cross-border data flow that would hinder disclosure to the SFC
- ensure that the licensed corporation is able to access all the electronic Regulatory Records from its approved premises
- ensure that the EDSPs and affiliates maintain audit trails
- put in place all necessary policies, procedures and internal controls to ensure that the SFC has full access to all electronic Regulatory Records upon demand without undue delay
- ensure an Access Map is maintained in accordance with the SFC's requirements
- ensure proper operational resilience of the electronic data storage arrangements and maintain daily back-up of certain information (ie client transactions, outstanding client positions, client assets held by the licensed corporation or its associated entity)
- provide all reasonable assistance to the SFC

The MIC/RO must ensure that they understand and can comply with the required undertakings. This will necessitate the MIC/RO having the requisite knowledge, understanding and familiarity with the relevant internal and external stakeholders (including the EDSPs and affiliates) – and the requisite authority.

Given the breadth, the MIC/RO may not, in the ordinary course, have the appropriate authority to give such

undertakings and these powers may rest with the licensed corporation's board (of which the MIC/RO may not be a part). We would expect a licensed corporation to empower their MIC/RO to give such undertakings through board approval. Senior management should also be fully conversant of the requirements as the MIC/RO will depend upon all personnel properly complying with the undertakings given.

The licensed corporation will be required to keep an **Access Map** (see below) which provides an overview of how all the electronic Regulatory Records are stored with EDSPs and affiliates which can be provided to the SFC upon request.

Where relevant, the licensed corporation may wish to seek a legal opinion from local counsel in the relevant jurisdiction to ensure that there are no restrictions on cross-border data flow that would restrict or inhibit the licensed corporation or the SFC from accessing the data at all times.

D. Access Map

As part of the MIC/RO Undertaking, the licensed corporation will be required to maintain a document which provides an overview of how electronic Regulatory Records are stored exclusively with EDSPs and/or affiliates (the **Access Map**). The Access Map should set out the types of electronic Regulatory Records that are stored *exclusively* with each EDSP or affiliate, and the physical locations (ie the jurisdictions or, if such information is available to the licensed corporation, the addresses) of the relevant data centres or other premises where the electronic Regulatory Records are stored.

The licensed corporation will be required to ensure the Access Map is accurate, up-to-date and available for the SFC's review within two business days upon request.

E. EDSP Undertaking

The EDSP Undertaking is an undertaking substantially in the form of [Appendix 1 to the Circular](#) required to be given by a non-Hong Kong EDSP with whom data is stored *exclusively*. The EDSP Undertaking provides (among others) that the non-Hong Kong EDSP undertakes to provide all necessary assistance to the SFC, including the provision of any of the licensed corporation's data, and without the obligation to notify the licensed corporation. The definition of 'company data' under the EDSP Undertaking is very broad; it does not appear to only include Regulatory Records, but all data the non-Hong Kong EDSP holds on behalf of the licensed corporation.

A number of concerns have been raised in respect of the form of EDSP Undertaking because in it the non-Hong Kong EDSP undertakes to directly provide the requested data to the SFC. It is unclear how protections such as legal professional privilege will apply. The EDSP Undertaking also puts the onus on the non-Hong Kong EDSP to potentially assume responsibility and liability for compliance with Hong Kong law, with which it may not be familiar. Therefore, there has been hesitation on the part of the major EDSP players to provide this undertaking.

Section E of the Circular: General obligations for all licensed corporations storing data with EDSPs or affiliates

Section E of the Circular sets out general obligations for all licensed corporations using EDSPs or affiliates (regardless of whether the data is stored *exclusively* or *non-exclusively*). The data included in this section covers not only Regulatory Records, but also client data and information relevant to the operation of the business. The intention is for licensed corporations to implement practices that properly manage cyber and other operational risk by adopting certain control measures.

The general obligations applicable to data outsourcing set out in the Circular are not new; they can be seen in previous SFC circulars and guidelines issued over the years. However, some are worth highlighting:

- before engaging in a contract, due diligence should be conducted; there must be regular monitoring over the performance of the service provider and the risks associated with the outsourced activity

Next steps

All licensed corporations should immediately proceed to finalise their review of their external data storage arrangements to ascertain the extent to which the Circular will apply, and in particular to answer key threshold questions such as:

- whether data is stored with EDSPs or affiliates;
- whether such data is stored *exclusively*;
- the extent to which data is caught by the Circular; and
- the appropriate way in which to comply with the Circular.

Where any licensed corporation's electronic Regulatory Records are kept *exclusively* with an EDSP or an affiliate which has not been approved by the SFC, the licensed

F. Notice to the EDSP

An EDSP Notice is a notice substantially in the form of [Appendix 2 to the Circular](#) required to be given by the licensed corporation to the EDSPs providing exclusive storage services. In a case where the EDSP is a Hong Kong EDSP, the Hong Kong EDSP will be required to countersign the Notice. The SFC will expect to see a copy of the Notice.

The scope of and considerations concerning the EDSP Notice are similar to the considerations listed above in relation to the EDSP Undertaking.

- a legally binding service agreement should clearly set out contractual liabilities and obligations of the service provider (if applicable)
- contingency planning should be maintained – a licensed corporation is required to have in place an exit strategy such that the termination of an arrangement with the service provider does not materially disrupt the applications of a licensed corporation
- an effective governance process must be in place for the use of software applications and to ensure security and timely availability of the relevant information
- policies and procedures should be put in place in respect of cybersecurity management, such as user access rights, security automation and the proper allocation of responsibilities

corporation should “*without undue delay*” notify the SFC's Licensing Department of the Intermediaries Division and apply for Section 130 Approval in respect of the premises “*as soon as practicable*”.

Further, licensed corporations will need to review the terms entered into with the EDSPs and affiliates, especially to ensure that none of the terms obstruct or restrict the licensed corporation from being able to comply with the MIC/RO Undertaking, so that the SFC has access to the Regulatory Records at all times.

Internally, licensed corporations should consider having their board sanction the MIC/RO's authority to comply with the Circular and the MIC/RO Undertaking as a matter of good corporate governance; senior



management should also be familiar with the obligations and requirements imposed by the Circular. Staff training should be given to ensure that all relevant personnel understand their compliance obligations under the new framework.

Licensed corporations will need to have appropriate policies and procedures in place to ensure compliance with the Circular; in particular, policies and procedures

around record keeping and outsourcing (not least to support the Access Map), on-going notification obligations, business continuity and senior management responsibility.

This bulletin does not provide exhaustive coverage of the requirements in the Circular. We would be happy to discuss and advise in more detail.

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