

Client Alert

25 November 2015

Cloud Computing in the Financial Services Sector – the UK FCA Gets On-Message

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It's been a long wait but the UK's financial services regulator, the Financial Conduct Authority (FCA), has published proposed guidance for UK-regulated financial services firms when using cloud computing solutions to implement technology services or operations. Although the proposed guidance raises as many questions as it answers, the main take-away for regulated firms ought to be that some form of guidance as a framework for cloud adoption is better than nothing.

The FCA's consultation follows its 2014 guidance on the use of third party off-the-shelf technology to support operations (see our client alert [here](#)) and is the first time the FCA has issued guidance specifically directed at cloud services. In the United States, the federal financial regulatory agencies published [guidance](#) over three years ago.

The "cloud" has come to be used as a collective term to describe a range of IT services provided in various formats over the Internet, including, for example, private, public or hybrid cloud, as well as Infrastructure as a Service (IaaS), Platform as a Service (PaaS), and Software as a Service (SaaS). Cloud services are constantly evolving and the market has burgeoned over recent years, and turned from a growth market to a mainstream channel for delivery of technology requirements.

But as many industry surveys have highlighted, potential users in regulated sectors such as financial services and health care have been slower to adopt cloud solutions than organizations in other sectors – in large part due to the absence of clear regulatory guidance. So, to that extent, the FCA's announcement ought to be welcomed by the financial services sector.

GUIDANCE 15/6

The FCA's aim in issuing its draft Guidance consultation 15/6 is to avoid imposing inappropriate barriers on regulated firms' ability to adopt cloud-based solutions, while ensuring that risks are appropriately identified and managed. The FCA has recognized that, from a regulatory perspective, there is no fundamental reason why cloud services (including public cloud services) cannot be implemented in a manner that complies with its rules. The FCA also acknowledges that, although different requirements may apply to different types of firms and different types of cloud-based services, the outcome that all regulated firms are expected to demonstrate is the same.

In the UK, the FCA and its predecessors have created longstanding guidance on outsourcing for regulated firms. The principles applicable to outsourcing require firms to appropriately identify and manage the operational risks associated with its use of third parties, including undertaking due diligence before making a decision on outsourcing. The approach is risk-based and proportionate, taking into account the nature, scale and complexity of a firm's operations. Financial institutions with UK-regulated operations are already geared up to consider and

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address the risks of technology outsourcing according to whether the functions being outsourced are considered critical or important, whether they constitute material outsourcing, or whether they relate to important operational functions. Regulated firms retain full responsibility and accountability for discharging all of their regulatory responsibilities. Firms cannot delegate any part of these responsibilities to a third party.

Guidance 15/6 builds on the existing approach to outsourcing. The FCA identifies three risks that are specific to cloud-based solutions over-and-above “normal” outsourced technology services delivery methods:

- a. cloud customers may have less scope to tailor the service provided;
- b. cloud providers may move customer data around with less visibility and control for the data owner; and
- c. cloud providers may also contract out part of the service provided to other cloud providers, again without visibility for the customer.

The proposed guidance lists a number of areas of interest that regulated firms should consider when using cloud-based services, including how they should discharge their oversight obligations:

1. Legal and Regulatory Considerations
2. Risk Management
3. International Standards
4. Oversight of Service Provider
5. Data Security
6. Data Protection Act 1998
7. Effective Access to Data
8. Access to Business Premises
9. Relationships Among Service Providers
10. Change Management
11. Continuity and Business Planning
12. Resolution (*i.e.*, treatment during a dissolution or insolvency event)
13. Exit Plan

Each category is accompanied by a list of bullet points for consideration and, helpfully, the guidance offers a number of clear statements detailing what the FCA expects in terms of access to data (access for regulated firms, auditors and the FCA to a wide category of data including firm data, personal data, transaction data, HR data and audit logs), access to premises and exit planning (including documented and regularly rehearsed exit plans and obligations on the outsourced service provider to co-operate fully to ensure a successful transition).

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A GLASS HALF-FULL

It has taken a long time for the FCA to get off the fence on cloud computing. While it's hard to date precisely the origins of the massive growth of cloud computing as a technology phenomenon, one could look back to milestones such as the delivery of enterprise applications via simple websites in the late 1990s, the launch of Amazon Web Services to provide a suite of cloud-based services in 2002, or the entry of Microsoft and Google into the cloud market in 2008 and 2009. Whatever date you prefer, the point is that cloud computing is not a new technology delivery channel, and millions of businesses have been spending billions of dollars on cloud services for many years now. So the FCA's guidance is long overdue.

Any regulated financial institution looking to the draft guidance as a complete road-map for a planned adoption of cloud services will be disappointed. The paper does not lay out what cloud services can be safely adopted, what a firm should look for in its contract with a cloud services provider, or what mandatory audit requirements exist over cloud services. But that's not really the FCA's job, and to expect otherwise would be unrealistic. The draft guidance is relatively high-level and risk-based – as are most of the FCA's guidance notes.

One could quibble with the FCA's view that certain risk areas are specific to outsourcing to the cloud – because many risks and areas of interest are equally applicable to other types of outsourcing arrangement, and are issues that businesses would seek to address in any outsourcing arrangement.

But criticism of the lateness of the guidance, or the fact that it is high-level and risk-based, misses the point. What's important is that the FCA has finally produced something to fill the vacuum left by its previous silence on cloud computing issues. The proposed guidance gives regulated firms assurances that, as long as they comply with the FCA's rules and guidelines, outsourcing to the cloud is permissible. Coupled with the FCA's guidance in summer 2014 on the use of third party technology solutions, at least regulated UK firms now have a framework that can be used as a structure to guide compliance with the FCA's rules when adopting cloud-based services.

The challenge for regulated firms will be to use the draft guidance – due to be published in final form in 2016 – to create an appropriate framework for assessing cloud-based risks, determining which services can be sourced via the cloud while still ensuring compliance, and making key decisions on what risk mitigation factors are necessary to counteract any gaps between the FCA's expectations and what cloud providers might offer as part of their solutions.

Cloud providers themselves will, one hopes, focus on the FCA's guidance as an expression of their regulated financial services customers' compliance requirements and begin to create offerings tailored to ensure compliance. Already there are signs of positive steps in some areas, such as the creation of graduated customer audit rights, offered as a series of scaled payable options to suit customers' needs. The financial services industry as a whole would welcome such commercial innovation from a segment of the technology industry that has shown such extensive technical innovation in cloud services for over 15 years now.

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