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Rogue Algos, Splash Crashes and More Regulation in 2012

One rogue algorithm will do more damage than any human fraud to date, says Progress Software

BEDFORD, Mass.--(BUSINESS WIRE)-- Progress Software Corporation (NASDAQ: PRGS), a leading software provider that enables companies to be operationally responsive, predicts that a rogue algorithm will cost a financial institution a billion dollars or more in 2012.

Dr. John Bates, Chief Technology Officer, Progress Software, said: "Although financial institutions have tightened risk processes to prevent human fraud, particularly after the UBS scandal this year, they are still not adequately monitoring their algorithmic trading. All it takes is one rogue algo to go into an infinite loop and the results could be disastrous."

Progress Software's 2012 outlook forecasts that over-zealous regulations will handicap high frequency trading going forward. Bates noted: "Because financial services firms are not proactive in managing risk and preventing issues such as fat finger errors and flash crashes, regulators will go too far and try to strangle HFT."

Progress Software's Capital Markets Predictions for 2012:

1. Billion Dollar Blunder. At least one financial institution will take a billion dollar (or more) hit when a rogue algorithm goes wild. The algo will go into an infinite loop, taking on an irreversible and un-hedged position, which cannot be shut down. Losses will challenge those by human rogue traders, which banks and financial institutions will prevent from happening next year.

2. Occupy HFT. The public, government and regulators will start the "Occupy HFT" movement -- a popular uprising against the ultimate elite of those making money in this climate. Despite immense financial industry pressure, regulators in both the US and the EU will be panicked by investor and political disapproval of HFT and will rein it in with draconian rules and controls.

3. SEFs Spur Splash Crash. Swaps execution facilities (SEFs) will revolutionize OTC derivatives trading, enabling them to be traded electronically. This, in turn, will lead to increased risk of a cross-asset class swaps "splash crash" which will confound regulators, who have little understanding of these markets.

4. Global Regulation Rocks. Countries will finally realize that regulatory harmonization is a good thing and that individual self-interest is not. Banks and financial services firms will realize that they need to think like regulators, taking control of internal surveillance and compliance before regulators make them do it.

5. RICs Get Smarter. The RICs in BRICs are getting smart order routing and gearing up for an increase in algorithmic trading. This, coupled with looser regulations, will begin to attract regulatory arbitrageurs and Volcker Rule escapees.

6. The Wild East. The West's supremacy in financial markets will further decline as new trading regulations - the Volcker Rule in the US and MiFID in Europe - create a surge of regulatory arbitrage favoring more lightly regulated geographies such as Russia and China. Wall Street and the City of London will lose human and financial capital as a result.

7. Financial Terrorism. An exchange or trading destination will be hacked by financial terrorists intent on manipulating markets for political gain. This will lead exchanges and ECNs to add more stringent monitoring and market surveillance capabilities.

8. Head in the Clouds. Explosive growth in foreign exchange trading and SEFs means that participating firms will require complex hosted solutions. Even the smallest FX broker needs aggregation and pricing services which require a big technology footprint. SEFs present new challenges as swaps markets attract algorithms and require surveillance.

9. Crime & Punishment. Regulators are cracking down hard on financial fraud and market manipulation and they will bring in some big fish in 2012. Prosecutions and punishments will increase in size and in impact.

Progress Software's 2011 predictions proved perspicacious; HFT and algorithmic trading blossomed in Brazil, China and India, algorithms grew smarter and some even began to self-learn. And banks shed proprietary trading desks, which sprang up as new firms or hedge funds elsewhere, in anticipation of the Volcker Rule.

Bates concluded: "Although there are more fraud shocks to come, the good news is that financial firms and regulators are taking regulatory harmonization seriously. One day soon we will have a global set of rules that mandate surveillance and monitoring, thereby proactively preventing fraud and flash crashes."

About Progress Software Corporation

Progress Software Corporation (NASDAQ: PRGS) is an independent enterprise software company that enables businesses to be operationally responsive to changing conditions and customer interactions as they occur — to capitalize on new opportunities, drive greater efficiencies and reduce risk. The company offers a comprehensive portfolio of best-in-class enterprise software spanning event-driven visibility and real-time response, open integration, data access and integration, and application development and deployment — all supporting on-premises and SaaS/Cloud deployments. Progress maximizes the benefits of operational responsiveness while minimizing IT complexity and total cost of ownership. Progress can be reached at www.progress.com or +1-781-280-4000.

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