Trading Up-On Someone Else's Software and Servers

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Marlon Weems is a managing director for equity sales and trading at CastleOak Securities, a 40-person, New York-based, boutique investment bank.

He firmly believes his firm is saving money, serving clients better and becoming far more efficient-by not investing in technology to be maintained on-site.

Instead, CastleOak is now renting a combination of software services-referred to by the provider as "hosted" services-that sit off-site on hardware provided and managed externally by an outside firm, thus allowing CastleOak to avoid having to build, manage or update the trading hardware or software itself.

"It's a great service, allowing me to focus on my main mission-to trade effectively and efficiently for my clients," says Weems.

The firm uses one hosted service to trade in individual stocks, another to swiftly trade hundreds or "large baskets" of equities in an automated fashion and yet another to provide a range of algorithms to their customers which can be customized when required.

Specifically, as of February, CastleOak has switched from using a single hosted trading software platform to a suite of Fidessa Group services that not only execute individual trades but also automate middle and back office functions, allow for the simultaneous execution of large quantities of trades and provide about a dozen algorithms that can now be offered to CastleOak's trading customers and customized by Fidessa for CastleOak's clients upon request.

The Fidessa services go by the names the U.S. Trading Platform (USTP) order management system (OMS), the Basket Execution And Management (BEAM) tool and BlueBox algorithmic trading service.

"As a small firm, it makes a lot of economic sense to outsource our software and server maintenance operations," said Weems adding that, "The trick is to find the right hosted service provider," to meet one's specific needs such as his firm's desire to outsource the algorithm provision and update function.

In expanding its use of hosted technology, CastleOak represents a growing number of smaller trading firms and startup broker dealers who are trying to get the most possible bang for their bucks. Evidence includes vendor observations-"Due to broader acceptance, we're seeing firms now willing to work with not just one, but a convergence of hosted services," said David Polen, a senior vice president of hosted products at Fidessa.

Aite Group estimates that 15 to 20 percent of trading firms are currently using hosted systems with the number now leaning toward 20 percent; Citisoft, a consulting firm, puts the current number at closer to 30 percent; and a Microsoft survey released in March of small and midsize businesses reports that in a drive for lower IT costs, 65 percent of such firms now use hosted software, an increase of 40 percent over the last five years. In addition, market analyst IDC estimates that usage of software as a service among businesses at large will grow 35 percent a year until 2013. At that point, it will represent 20 percent of all IT spending worldwide.

The hosted services go by many names, including cloud computing, software-as-a-service (SaaS) or as application services from application service providers. "Hosted software, time-sharing software and cloud computing: they are different names for the same thing," insists Vikram Mehta, CEO of Blade Network Technologies.

Whatever the current moniker, the use of hosted software services involves working with a vendor who provides online access to software that is created and maintained off-site by an online vendor and received on a pay-for-usage model, allowing users to scale usage down or up as needed. The software and the data it acts upon is stored or hosted on servers managed by the vendor. In turn, the vendor handles all software updates and data backups.

Jonathan Cohn, a consultant in the strategic IT and operations practice at advisory firm Oliver Wyman, defines the current crop of financial service users of hosted software as leveraging technology services that are outside their enterprise, spanning applications, processes, storage and networking activities.

"If clients are leveraging technology outside the enterprise, they are doing so in a hosted services fashion," Cohn says.

What's different is that today, financial services firms have far more options than they did ten years ago.

Cohn points out that users have the ability today to either access little pieces of technology-a hosted risk analytics service, for example-or can access a suite of hosted services or combine several hosted services into a more comprehensive, outsourced service. "They are also more likely to be able to fine tune these services or to turn them on or off," he said. An example would be the custom algo services available to CastleOak via Fidessa.

The benefits are faster ramp-up at lower cost. "The hosted route has allowed us to get up to speed quickly, keep our cost margins under control and lets us hand over the maintenance of the technology over to someone else," says Weems, whose operations no longer require the presence of five or six technology specialists on-site.

In addition, Fidessa provides technology upgrades approximately every three months and quick adjustments, when needed, related to regulatory changes such as new short-sell rules or regulations that may require brokers to conduct a pre-trade review of the risks.

"We're seeing more regulation these days, and quite frequently, this means more technology or technology adjustments to account for the new regulations," said Fidessa's Polen.

With hosted trading software gaining acceptance among buy side firms, new types of hosted services have popped up. According to Denise Valentine, a senior analyst at Aite Group, the online services can include portfolio management systems, risk analytics, performance analytics, asset valuation and pricing systems, client reporting systems, compliance maintenance and reporting systems, clearing and settlement services.

"There are hosted systems today for pretty much every sector," said Valentine.

Of course, hosted software solutions are not for everyone.

Paul Migliore, CEO at Citisoft, a strategy, operations and technology adviser to buy side firms, notes that for firms that are highly secretive and concerned about protecting their strategies and client data from prying eyes, hosting solutions are not the answer.

"They will say, I need my privacy; You can tell me that it's a select server that no one else will see, but I just don't trust it. The fact is, not everyone is going to feel comfortable if their information is being stored outside of their own technology environment, no matter how secure," he says.

This will be in spite of the fact that the security systems employed by many hosted providers-particularly those that have been providing services consistently for ten years are more-are very reliable, he notes.

Consistently reliable and innovative providers have certainly helped win converts to the model over the past two decades. "People have become far more accepting of the security arrangements with many of the hosted offerings; but tightening budgets and firms trying to cut bottom lines has also encouraged wider acceptance" notes Matt Samelson, a founder of Woodbine Advisers and consultant to trading firms.

Sungard Data Systems for example, has been providing hosted solutions for over 15 years. "Our customers have long relied on us to provide hosted solutions that automate their transaction process and trading environment so that they stay lean and competitive," says Pamela Marnell, Sungard's head of product management.

Marnell notes that Sungard's early and better known offerings in the hosted arena include Brass OMS, an integrated trade and order management solution for sell side firms. Over the years, the firm's hosted offerings have expanded to include risk management, collateral management and risk analytics. Also online are a consolidated ticker plant and a full suite of liquidity services including algorithmic trading.

More recent trends include an uptick of interest in hosted middle office capabilities and in hosted platforms to serve the burgeoning number of independent wealth advisers. "We now have a SaaS-based offering called WealthStation on Demand, where you can go to a Web site, swipe your credit card and get a suite of functions that you used to only get at a large wire house," she said.

Somewhat related to the hosted offerings from the exchanges, is a new type of service-some call it infrastructure-as-a-service and others refer to it as a kind of double hosting or "hosted squared" type service. Providers of such services have leased space at data centers located as close as possible to exchange matching engines and have built out ultra, high-speed, network infrastructure capabilities with related financial application hosting capabilities suited to this environment-a hardware based market data accelerator service for example-which they will then offer as a hosted service that is optimized to meet the needs of high frequency, low latency traders.

Options IT is one such firm, providing what it calls a fully-managed, high-speed technology infrastructure for trading firms. It works with more than 150 hardware or software based application providers that span front, middle and back office activities. High frequency traders can simply drop in their proprietary or third-party trading applications and the infrastructure-as-a-service structure takes care of everything else on the hardware, market data and hardware side.

According to Patrick Ruppe, marketing director at Options IT, "High frequency trading firms are increasingly opting to put their resources into developing their trade logic rather than in technology development and as a result, there is less incentive to invest in infrastructure."

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