

Trade Life Cycle

Module 2_Lesson 4

What is the Trade Life Cycle ?

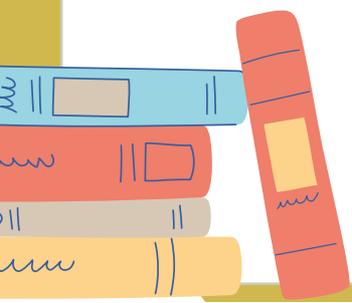
- Trade is the process of buying and selling any financial instrument.
- The life cycle of a trade is the fundamental activity of exchanges, investment banks, hedge funds, pension funds, and many other financial companies.
- All the steps involved in a trade, from the point of order placed and trade execution through to settlement of the trade, are commonly referred to as the trade life cycle.

What are the Types of Trades ?

- It is critical to understand the distinction between the buy-side and the sell-side.
- These two sides comprise the entire picture, the ins and outs of the financial market, and they are mutually dependent:
- **Buy Trade**- The buy-side of the financial market is the side of the market that buys and invests huge amounts of securities for the goal of managing money or funds.
- **Sell Trade** - The sell-side of the financial market is concerned with the creation, promotion, and sale of traded securities to the general public.

Purpose of Equity Investments

- Equities are stakes in a publicly traded corporation.
- Equity is purchased and sold in the form of shares , which are issued by businesses to raise funds.
- When you purchase equity, you are acquiring a little share of the company. Purchasing that asset entitles investors to a portion of the company's profits.
- Dividends and capital growth are the two types of returns from stocks. Dividends are typically paid twice a year and constitute a portion of the company's profit.
- Shareholders can also earn by selling their shares or stocks for more than they paid for them. This allows dealers to build their capital.
- It's vital to understand that share prices can fall as well as rise, which means you might lose money as well as gain money.



- **Trade on Equity-Example**

- Walter Corp had acquired one million shares of metaverse mobility solutions over 15 months ago at 110 rupees a share. Over the period of these fifteen months, metaverse mobility declared dividends of 6.25 rs and 5,75 rs per share. So Walter Corp earned a dividend income of 62,50,000.00 and 57,50,000.00 respectively.
- Finally when the price of metaverse mobility solutions increased to 180 per share Walter Corp instructed its Fund Managers to sell its entire lot of shares of metaverse mobility solutions.
- Through this sell transaction Walter Corp earned Rs. 18,00,00,000.00 leading to a capital gain of Rs. 7,00,00,000.00 (since it had purchased the shares at 11,00,00,000.00 fifteen months ago)

Purpose of Fixed income Investments

- Fixed income trading involves the buying and selling of fixed income securities by fixed income investors.
- The fixed income market has a large, diverse collection of market participants as it consists of low transaction costs & a competitive market structure.
- Institutional investors dominate the fixed income securities market.
- Investors invest in different types of fixed income securities as they have various advantages such as:
 - Tax advantage,
 - Capital appreciation,
 - Safety and
 - Maturity.
- **Fixed-income trade-Example**
 - Mr. Jonathan buys a bond with 5% interest and Rs 10,000 face value and a maturity date of five years. So his initial investment will be Rs 10,000, and he will receive this amount only after the end of five years.

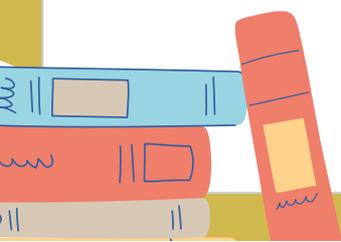
Different Parties involved in Trade Life Cycle

- **Three major roles are involved to execute a successful trade life cycle :**

1. Fund manager
2. Broker
3. Custodian

1. **Fund manager -**

- Their day-to-day job involves selecting the best stocks, bonds, and other financial market instruments which will deliver results to the investors given the fund's objective.
- They give instructions for the purchase/sale of a particular security.



2. Broker -

- The broker accepts this order for execution.
- On successful execution, the broker sends the trade confirmation back to the fund manager & also to the custodian.
- Brokers do a cross verification of whether all the allocation details match the trade details and then prepare the contract notes in the names of the funds in which the fund manager has requested allocation.

3. Custodian -

- The custodian is provided with the name of the securities, the price range, and the number of shares ordered.
- The role of custodian involves Contract Maintenance, Event Processing, Valuation, Payment and Settlement, Collateral Management, Reconciliation, Account Maintenance and Reporting.

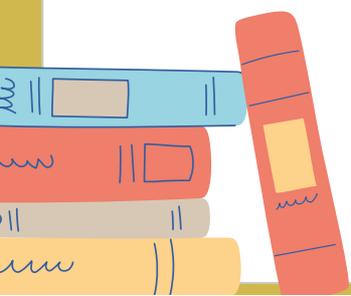
Crucial Stages of Trade Life Cycle

Stage 1. Trade settlement -

- Trade settlement is a two-way process that comes in the final stage of the transaction.
- Once the buyer receives the securities and the seller gets the payment for the same, the trade is said to be settled.
- **There are two broad categories of trade settlements:**
 - a. Spot settlement is that settlement which takes place immediately following the rolling settlement principle of T+2.
 - b. Forward settlement is the settlement that takes place when one agrees to settle the trade at a future date, T+5 or T+7.
- Also knowing the settlement date of a stock is important for investors or strategic traders who are interested in dividend-paying companies because the settlement date can determine which party receives the dividend.
- **Importance** - The trade settlement team plays a vital role in a trade life cycle and is the most important control point to avoid any risks and penalties.

Stage 2. Trade Reconciliation -

- Reconciliation is basically a process in which an accountant compares two separate records and evaluates the accuracy of the agreement.
- It is a verification method to ensure that the process of trading is correct, secure and consistent in practice.
- The frequency of reconciliation depends on the body with regular check frequencies of daily, once in a month or in a year.
- **Importance** - The process of reconciliation is done in order to protect businesses from fraud and illegal activities in trade.



Important Dates in Trade Life Cycle

- **Transaction Date** - It is the date when a purchase is made or cash is withdrawn.
- **Posting Date** - It is when the transaction is received to the account. Interest is charged from the posting date.
- **Booking Date** - It is the date when the expect (initial instruction) receivable comes in
- **Settlement Date** - It is the date when a trade is final, and the buyer must make payment to the seller while the seller delivers the assets to the buyer.
- **Value Date** - It is the same as the settlement date. While the settlement date can only fall on a business day, the value date can fall on any date of the month. Value date refers to the date when an account becomes effective.

Day in a Life: The Trade lifecycle can be divided into two Parts

- **Trade & Operational Activities :**
- Fund manager identifies trade & gives instructions to the broker and the custodian, then the broker executes the trade. this activity is called **a Trade Activity.**
- Fund manager identifies trade & gives instructions to the broker and the custodian, then the custodian performs operations such as trade capture, trade validation, trade confirmation, trade clearing, trade settlement, and trade reconciliation. this activity is called an **Operational activity.**

Trade Activities -

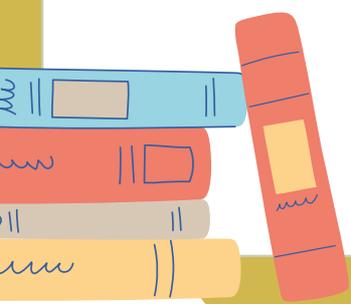
- This activity covers all processes and procedures to identify trade for the client via the front office and enrich that trade so it can be sent ahead for operational activity.
- Trading activities cover the first steps which set the trade life cycle in motion.
- It involves two activities - trade identification, instruction, and trade execution.

1. Trade Identification & Instructions -

- The first step involves Fund managers making decisions on behalf of their clients. The fund manager scopes out potential investment opportunities & discusses them with the client. The fund manager identifies the best stock to invest in and forwards the trade instructions to the Broker & Custodian.

2. Trade Execution -

- After receiving the order from the Fund manager, the broker decides which market to send the order to.
- Once the order is in the market and it gets fulfilled, only then can it be considered that the trade is executed.



Operational Activities -

1. Trade Capture -

- Once the buyer, seller, the price, and quantity have been agreed upon by the parties, the trade capture step begins. The 'front office' captures all the details of the trade order, electronically or manually, and generates a dealing slip or a document showing the record of the trade. This confirmation or notification is then sent to the middle office or the settlement office (internal/external) for the next steps.

2. Trade validation -

- The trade capture is done by the back-office or middle-office teams using the dealing slip or order confirmation document and the additional details are input into the system. This process is called Enrichment. Some firms perform a risk assessment. Once done, the back office confirms trade; they verify the details they have received from the front office and the trade details as per the trade order - this process is called order matching.

3. Trade Confirmation -

- The brokers/broker firms on each side of the trade (buyer and seller) verify the trade, terms, and conditions and confirm the trade. This is important as the settlement details will be clarified and agreed upon at this point. The participants will confirm the securities being traded, the amount of the security, the price, and the settlement term (including the T+n settlement cycle and/or settlement date). The settlement instructions - how and where the funds and securities should be exchanged. Once both parties confirm the details, the trade is sent to the exchange. The exchange also sends the details to the custodian who confirms them with the brokers. The details are recorded in the processing system which also feeds into the client and other reports.

4. Trade Clearing -

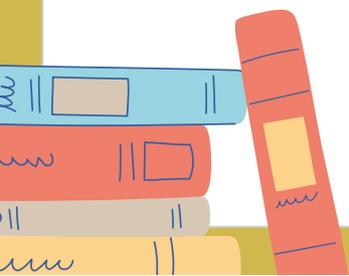
- The cleaning house is involved in this stage of the life cycle. They will calculate the requirements from the buyer and the seller to ensure the trade is honored and informs them of the action that is required. Depending on the settlement terms, the securities and funds will be exchanged. The settlement cycles are usually T+1, T+2, or T+3. T refers to Transaction and +1, +2, and +3 refer to the settlement date. T+1 means that the securities and funds will be exchanged 1 day after the transaction or trade date.

5. Trade Settlement -

- On this date, the funds and securities will be exchanged. This is something that the custodian helps with. They pass the entries to the client account, follow up on the funds or securities, ensure they are accounted for, and perform the reporting.

6. Trade Reconciliation -

- Once the trade is settled, the books of accounts need to be reconciled to reflect the correct status, by the custodian and the broker firm. If the trade went through, the trade entries (the amount transferred, the client account, the securities transferred, etc.) will be recorded in the system. The entries from the buyer or seller's record as well the bank/custodian's books. Once the reconciliation is done, the trade life cycle comes to an end.



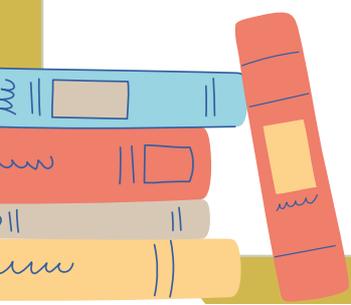
Various Teams involved in Trade Life Cycle

1. Trade & Settlements Team

- They receive instruction from the clients, IMs, or brokers who want to trade. They either want to sell or buy securities. The team will need to get the order in the system, called processing, to ensure that the traders get the order to execute them in the market on time. Since prices fluctuate and markets have cut-offs, the team will need to get the orders processed on time, otherwise, the client could lose money.
- Once the order has been executed in the market by the trader, the team will input all the details of the trade - the terms, amount, security details, other party's details, etc. in the system - like an enrichment of the trade or deal.
- Once the settlement instructions have been determined, the team will work with the counterparty/custodian/bank/IM/client to settle - follow up on the funds or securities to be exchanged, and work with the broker/clearing house to transfer the funds/securities, and credit the clients' accounts with the securities/funds, and process the transactions in the system. The processing of the transactions in the system feeds into the client and other reports.
- **Settlement cutoff timings -**
 - US:
 - The settlement cycle in the US is T+2 for equities, corporate bonds, municipal bonds, unit investment trust (UIT), and T+0 or T+1 for Money Market Instruments and Government Securities.
 - There are several US stock markets, but the most popular are the NYSE and NASDAQ. The New York stock exchange hours are 14:30 to 21:00 UK time (GMT). The NASDAQ trading hours are also 14:30-21:00 UK time.
 - UK:
 - The standard settlement period for equities traded in the UK and Ireland was shortened from T+3 (the trade date plus three business days) to T+2 (the trade date plus two business days).
 - The London Stock Exchange is open Monday through Friday from 8:00 AM to 12:00 PM and 12:02 PM to 4:30 PM British Summer Time (GMT+01:00). Does the London Stock Exchange close for Lunch? Yes, the London Stock Exchange does close for lunch.

2. Reconciliation Team -

- The reconciliation team is required to reconcile the entries in the system and investigate when there are 'breaks' or exceptions. The team receives the bank statements and the feeds from the trade & settlement teams.



- If the bank statements do not match the feeds received from the trade and settlement team, the reconciliations team will check with them on the trade. This can happen if the trade has failed and the entries have not been processed by the trade and settlement system. If there has been a delay in the settlement (exchange of securities/funds), the team will need to enter an explanation in the system for the reason there is a discrepancy between the book and bank entries.
- If the trade has been settled successfully and the entries have been processed correctly, the team will be able to reconcile the book entries (based on the feeds received from the Trade and settlement team) with the bank statement entries. This is the final stage of the trade life cycle.

