IDFC
IDFC MUTUAL FUND

Notice - Cum - Addendum No. 31 of 2018

Addendum to the Scheme Information Document and Key Information Memorandum of IDFC Asset Allocation Fund of Fund

NOTICE is hereby given of the following changes in the features of IDFC Asset Allocation Fund of Fund ("the Scheme") with effect from **Monday, May 28, 2018** ("Effective Date"):

A) Type / Category :

Existing	Revised (proposed)
An Open ended Fund of Funds Scheme	An open ended fund of fund scheme investing in schemes of IDFC Mutual Fund - equity funds and debt funds excluding Gold ETF.

B) Change in Investment Objective of the Scheme:

The Investment objective of the Scheme shall stand modified as follows from the Effective Date:

Existing	Revised (proposed)
The primary objective of Scheme is to generate capital appreciation through investment in different mutual fund schemes primarily local funds based on a defined asset allocation model. However, there can be no assurance that the investment objective of the scheme will be realized.	The investment objective of the scheme is to provide diversification across asset classes and generate a mix of capital appreciation and income predominantly through investment in equity funds and debt funds of IDFC Mutual Fund based on a defined asset allocation model.

C) Change in Asset Allocation pattern of the Scheme:

The Asset Allocation pattern of the Scheme shall stand modified as follows from the Effective Date:

Asset Allocation Pattern (existing)

Standard Matrix	Conservative Plan	Moderate Plan	Aggressive Plan
Equity Funds (including Offshore equity)	10%-15%	25%-30%	45%-50%
Debt Funds (including Liquid)	0%-90%	0%-70%	0%-45%
Alternate (including Gold / Commodity based funds)	0%	5%-10%	10%-15%
Money Market Securities	0%-15%	0%-15%	0%-15%

Asset Allocation Pattern (proposed/revised)

Particulars	Conservative Plan	Moderate Plan	Aggressive Plan
Equity Funds (including Offshore equity)	10%-30%	25%-55%	40%-80%
Debt Funds and/or Arbitrage funds (including Liquid fund)	35%-90%	10%-75%	0%-40%
Alternate (including Gold/ Commodity based funds)	0%-30%	0%-30%	0%-30%
Debt and Money Market Securities	0%-5%	0%-5%	0%-5%

Exposure in Derivatives - up to 5% of total assets

D) Change in Investment Strategy of the Scheme:

Existing Strategy	Revised Strategy (proposed)
a) The primary objective of Scheme is to generate capital appreciation through investment in different mutual fund schemes based on a defined asset allocation model covering both local and offshore assets. The shortlist will be created in two steps. First from the universe of local fund managers, a shortlist of qualifying fund managers will be selected whose schemes will be taken up for detailed review. The selection of mutual funds will be based on the quality of sponsors, stability of business, assets under management and performance across different asset classes. Secondly from the short-listed fund managers, the fund manager will carry out a review of different schemes in each asset class that have investment philosophy in line with the scheme's objectives and that are open for subscription. The fund manager will shortlist a series of schemes based on parameters such as performance of the scheme, investment objectives, investment strategy and assets under management. The list will also include ETFs wherever available. Higher consideration will be given for stable performance over medium term than near term out-performance. The shortlist will be reviewed and modified on an on-going basis. Final investments will only be made to schemes that are a part of this shortlist. b) Decide the tactical asset allocation: Within the asset allocations mentioned above, the fund manager can carry out a tactical allocation by underweighting/ overweighting any of the asset classes. This will be based on the view of individual asset market and risk-return considerations. It can also happen on an ongoing basis due to mark-to-market movements in any of the asset classes. The fund will maintain asset allocation within +/- 5% of the target allocation of that portfolio. The scheme can thus be overweight, neutral or underweight in any of the asset classes. The asset allocation will be reviewed on a quarterly basis or in case mark-to-market movements take the allocations to beyond the permissible bands. c) Select schemes from the shortlist to invest: The fund manager will aim to create a portfolio through investments that are complementary to each other and enables it to diversify. The portfolio will be multi-manager in nature i.e. it will look to invest in schemes from different sponsors. The fund will select schemes from its shortlist. Selection of funds will be based on quantitative and qualitative factors. The fund manager will have detailed discussions with each of the short-listed fund managers to understand their fund management approach. The quantitative factors considered by the fund manager will include risk-adjusted return, information ratio and stability of performance relative to peer group. Multi-manager here indicates that the fund of fund proposes to invest in the schemes of different fund managers depending on the investment objective and performance of individual schemes in nature. d) Monitor performance of funds: The fund manager will carry out detailed on-going review of the short-listed schemes and fund managers. This will include meetings with the fund managers to understand the background to their performance and to understand their portfolio positioning. The scheme will target stable allocations to fund managers that are offering consistency in performance with respect to benchmark and peer groups. **Debt** The domestic debt markets are maturing rapidly with liquidity emerging in various debt segments through the introduction of new instruments and investors. The actual percentage of investment in various fixed income schemes will be decided after considering the prevailing political conditions, the economic environment (including interest rates and inflation), the performance of the corporate sector and general liquidity and other considerations in the economy and markets. The Fund has put in place detailed Investment manual defining the prudential and concentration limits for the portfolio limits. The investment management team is allowed full discretion to make sale and purchase decisions within the limits established.	The objective of the scheme is to provide diversification across asset classes and generate a mix of capital appreciation and income predominantly through investment in various schemes of IDFC Mutual Fund based on a defined asset allocation model. Asset allocation across various asset classes will be based on the view of individual asset market and risk-return considerations. For equity, schemes selected will be basis fund manager's view on the macro economy and opportunities available across market cap and sector. For fixed income, schemes will be selected basis fund manager's view on the macro economy, interest rates, credit spreads and other such parameters. The schemes will be reviewed and modified on an ongoing basis.

E) Change in Benchmark of the scheme:

Existing	Revised (proposed)
Conservative Plan: CRISIL MIP Blended Index **Moderate Plan:** CRISIL MIP Blended Index **Aggressive Plan:** CRISIL Balanced Fund - Aggressive Index	**Conservative Plan:** 15% S&P BSE 200 + 80% Crisil Short Term Index + 5% Gold Prices **Moderate Plan:** 40% S&P BSE 200 + 55% Crisil Short Term Index + 5% Gold Prices **Aggressive Plan:** 65% S&P BSE 200 + 30% Crisil Short Term Index + 5% Gold Prices Each plan is benchmarked to a customised index comprising of S&P BSE 200, Crisil Short Term Bond Fund Index and INR prices of gold with the weightages in line with the intended allocation of the respective plan. S&P BSE 200 being a diversified index is a suitable index for equity portion, Crisil Short Term Bond Fund Index is appropriate index to track the performance of the debt portion and the price of gold is the benchmark for gold allocation.

F) The following disclosures are being inserted in the Scheme Information Document of the Scheme from the Effective Date:

Risks associated with Investing in Derivatives (inserted under the section "Risk Factors"):

Derivative products are leveraged instruments and can provide disproportionate gains as well as disproportionate losses to the investor. Execution of such strategies depends upon the ability of the fund manager to identify such opportunities. Identification and execution of the strategies to be pursued by the fund manager involve uncertainty and decision of fund manager may not always be profitable. No assurance can be given that the fund manager will be able to identify or execute such strategies. The risks associated with the use of derivatives are different from or possibly greater than, the risks associated with investing directly in securities and other traditional investments. As and when the Scheme trade in the derivatives market there are risk factors and issues concerning the use of derivatives that investors should understand. Derivative products are specialized instruments that require investment techniques and risk analyses different from those associated with Money Market Instruments bonds. The use of a derivative requires an understanding not only of the underlying instrument but of the derivative itself. Derivatives require the maintenance of adequate controls to monitor the transactions entered into, the ability to assess the risk that a derivative adds to the portfolio and the ability to forecast price or interest rate movements correctly. There is the possibility that a loss may be sustained by the portfolio as a result of the failure of another party (usually referred to as the "counter party") to comply with the terms of the derivatives contract. Other risks in using derivatives include the risk of mispricing or improper valuation of derivatives and the inability of derivatives to correlate perfectly with underlying assets, rates and indices.

Derivatives are highly leveraged instruments. Even a small price movement in the underlying security could have a large impact on their value. Also, the market for derivative instruments is nascent in India.

The risks associated with the use of derivatives are different from or possibly greater than the risks associated with investing directly in securities and other traditional investments.

The specific risk factors arising out of a derivative strategy used by the Fund Manager may be as below:

- Lack of opportunity available in the market.
- The risk of mispricing or improper valuation and the inability of derivatives to correlate perfectly with underlying assets, rates and indices.

Risk associated with Interest Rate Future

1. Market Risk - Derivatives carry the risk of adverse changes in the market price.
2. Liquidity Risk - This occurs where the derivatives cannot be sold (unwound) at prices that reflect the underlying assets, rates and indices.
3. Model Risk - The risk of mispricing or improper valuation of derivatives.
4. Basis Risk - This risk arises when the instrument used as a hedge does not match the movement in the instrument/ underlying asset being hedged. The risks may be inter-related also; for e.g. interest rate movements can affect equity prices, which could influence specific issuer/industry assets.
5. Risk associated with imperfect hedge due to use of IRF are - 'Basis Risk' is the risk that arises when the instrument used as a hedge does not match the movement in the instrument/ underlying asset being hedged. This could result into potential gains or losses from the strategy.

Risk Management Strategies

Risk Description	Risk Management
As and when the Scheme trades in the derivatives market there are risk factors and issues concerning the use of derivatives that Investors should understand. Derivative products are specialized instruments that require investment techniques and risk analyses different from those associated with stocks and bonds. The use of a derivative requires an understanding not only of the underlying instrument but also of the derivative itself. Derivatives require the maintenance of adequate controls to monitor the transactions entered into, the ability to assess the risk that a derivative adds to the portfolio and the ability to forecast price or interest rate movements correctly. There is the possibility that a loss may be sustained by the portfolio as a result of the failure of another party (usually referred to as the "counter party") to comply with the terms of the derivatives contract. Other risks in using derivatives include the risk of mispricing or improper valuation of derivatives and the inability of derivatives to correlate perfectly with underlying assets, rates and indices.	The fund has provision for using derivative instruments in the manner permitted by SEBI from time to time. Interest Rate Swaps will be done with approved counter parties under pre-approved ISDA agreements. Mark to Market of swaps, netting off of cash flow and default provision clauses will be provided as per international best practice on a reciprocal basis. Interest rate swaps and other derivative instruments will be used as per local (RBI and SEBI) regulatory guidelines.

Note on investment in Derivatives (inserted under the Section "Information about the scheme")

The following information provides a basic idea as to the nature of the derivative instruments proposed to be used by the Scheme and the risks attached there with.

Advantages of Derivatives:

The volatility in Indian markets both in debt and equity has increased over last few months. Derivatives provide unique flexibility to the Scheme to hedge part of its portfolio. Some of the advantages of specific derivatives are as under:

Derivatives Strategy:

The Scheme may use derivatives instruments like Interest Rate Swaps, Forward Rate Agreements, Interest Rate Futures or such other derivative instruments as may be introduced from time to time and in the manner permitted by SEBI/RBI from time to time, within a permissible limit of 5% of the total assets. The cumulative gross exposure through investments in debt oriented mutual fund schemes, debt and money market instruments and derivatives shall not exceed 100% of the net assets of the Scheme.

Interest Rate Swaps (IRS)

An IRS is an agreement between two parties to exchange stated interest obligations for an agreed period in respect of a notional principal amount. The most common form is a fixed to floating rate swap where one party receives a fixed (pre-determined) rate of interest while the other receives a floating (variable) rate of interest.

In terms of SEBI circular no. Cir/IMD/DF/11/2010 dated August 18, 2010, Mutual Funds may enter into plain vanilla interest rate swaps for hedging purposes. The counter party in such transactions has to be an entity recognized as a market maker by RBI. Further, the value of the notional principal in such cases must not exceed the value of respective existing assets being hedged by the scheme. Exposure to a single counterparty in such transactions should not exceed 5% of the total assets of the scheme.

Basic Structure of a Swap:

Bank A has a 6 month Rs 10 crore liability, currently being deployed in call. Bank B has a Rs 10 crore 6 month asset, being funded through call. Both banks are running an interest rate risk.

To hedge this interest rate risk, they can enter into a 6 month MIBOR (Mumbai Inter Bank Offered Rate) swap. Through this swap, A will receive a fixed pre-agreed rate (say 7%) and pay "call" on the NSE MIBOR ("the benchmark rate"). Bank A's paying at "call" on the benchmark rate will neutralise the interest rate risk of lending in call. B will pay 7% and receive interest at the benchmark rate. Bank A's receiving of "call" on the benchmark rate will neutralise his interest rate risk arising from his call borrowing.

The mechanism is as follows:

- Assume the swap is for Rs.10 crore from March 1, 2017 to September 1, 2017. A is a fixed rate receiver at 7% and B is a floating rate receiver at the overnight compounded rate.
- On March 1, 2017 A and B will exchange only an agreement of having entered this swap. This documentation would be as per International Swaps and Derivatives Association (ISDA).
- On a daily basis, the benchmark rate fixed by NSE will be tracked by them.

On September 01, 2017 they will calculate the following:

- A is entitled to receive interest on Rs.10 crore at 7% for 184 days i.e. Rs. 35.28 lakh, (this amount is known at the time the swap was concluded) and will pay the compounded benchmark rate.
- B is entitled to receive daily compounded call rate for 184 days & pay 7% fixed.
- On September 1, 2017, if the total interest on the daily overnight compounded benchmark rate is higher than Rs. 35.28 lakhs, A will pay B the difference. If the daily compounded benchmark rate is lower, then B will pay A the difference.
- Effectively Bank A earns interest at the rate of 7% p.a. for six months without lending money for 6 months fixed, while Bank B pays interest @ 7% p.a. for 6 months on Rs. 10 crore, without borrowing for 6 months fixed.
- The AMC retains the right to enter into such derivative transactions as may be permitted by the applicable regulations from time to time.

Forward Rate Agreement (FRA)

A FRA is basically a forward starting IRS. It is an agreement between two parties to pay or receive the difference between an agreed fixed rate (the FRA rate) and the interest rate (reference rate) prevailing on a stipulated future date, based on a notional principal amount for an agreed period. The only cash flow is the difference between the FRA rate and the reference rate. As is the case with IRS, the notional amounts are not exchanged in FRAs.

Interest Rate Future (IRF)

Interest Rate Futures means a standardized interest rate derivative contract traded on a recognized stock exchange to buy or sell a notional security or any other interest bearing instrument or an index of such instruments or interest rates at a specified future date, at a price determined at the time of the contract.

Exchange traded IRFs are standardized contracts based on a notional coupon bearing Government of India (GOI) security.

As there is an inverse relationship between interest rate movement and underlying bond prices and the futures price also moves in tandem with the underlying bond prices. If the Fund Manager has a view that interest rates will rise in the near future and intends to hedge the risk from rise in interest rates; the Fund Manager can do so by selling the IRF contracts to hedge the interest rate risk on the underlying portfolio.

If the Fund Manager is of the view that the interest rates will go down the Fund Manager will buy IRF to participate in appreciation.

Example:

The scheme holds cash & cash equivalent and expects that the interest rate will go down and intends to take directional position. Accordingly, the fund manager shall buy IRF –

- Trade Date - January 1, 2018.
- Futures Delivery date - April 1, 2018.
- Current Futures Price - Rs. 102.00.
- Futures Bond Yield- 8.85%.
- Trader buys 200 contracts of the April 2018 10 Year futures contract of face value of Rs.1000 on NSE on January 1, 2018 at Rs. 102.00.

Closing out the Position

- Date: January 7, 2018

Size : 329 (w) x 500 (h) cm

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- Futures market Price - Rs. 105.00.
- Trader sells 200 contracts of April 2018 10 year futures contract of face value of Rs.1000 at Rs. 105 and squares off his position.
- Therefore total profit for trader 200*1000*(105 – 102) is Rs.6,00,000.

Pursuant to SEBI circular no. CIR/MRD/DRMNP/11/2015 dated June 12, 2015, the following position limits shall be applicable to mutual funds in for IRF contracts:

a) Scheme of Mutual Fund Level - The gross open positions across all contracts within the respective maturity bucket shall not exceed 3% of the total open interest in the respective maturity bucket or INR 200 crore, whichever is higher.

b) Mutual Fund Level - The gross open positions across all contracts within the respective maturity bucket shall not exceed 10% of the total open interest in the respective maturity bucket or INR 600 crore, whichever is higher.

Hedging

Debt securities are exposed to the risk of rising interest rates, which in turn results in the reduction in the value and such impact can be seen in the value of the portfolio of the scheme. Under such circumstances, in order to hedge the fall in the value of the portfolio of the scheme due to falling bond prices, the fund manager may sell IRF contracts.

Example:

Date: January 01, 2018
Spot price of Security: Rs 101.80
Futures price of IRF Contract: Rs 102.00

On January 01, 2018, the Fund Manager bought 2000 GOI securities from spot market at Rs 101.80. The Fund Manager anticipates that the interest rate will rise in near future, therefore to hedge the exposure in underlying security the Fund Manager sells March 2018, Interest Rate Futures contracts at Rs 102.00.

On March 01, 2018 due to increase in interest rate:

Spot price of Security: Rs 100.80
Futures Price of IRF Contract: Rs 101.10

Loss in underlying market will be (101.80 - 100.80)*2000 = Rs 2000
Profit in the Futures market will be (101.10 – 102.00)*2000 = Rs 1800

Imperfect Hedging

The Scheme may use Interest Rate Futures (IRF) in accordance with SEBI guidelines and may imperfectly hedge its portfolio or part of its portfolio using IRFs. Use of IRF may result in imperfect hedging when the IRF used for hedging the interest rate risk has different underlying security(s) than the existing position being hedged.

Example of imperfect hedge due to use of IRF:

Date: January 1, 2018
Spot price of 8 year GOI Security: Rs.101.80
Futures price of IRF Contract (underlying is 10 year GOI): Rs.102.00

On January 1, 2018, the Fund Manager bought 2000 GOI securities from spot market at Rs.101.80. The Fund Manager anticipates that the interest rate will rise in near future, therefore to hedge the exposure in underlying security the Fund Manager sells March 2018, Interest Rate Futures contracts at Rs.102.00.

On March 1, 2018 due to increase in interest rate:

Spot price of 8 year GOI Security: Rs.100.80
Futures Price of IRF Contract (underlying is 10 year GOI): Rs.101.10

Loss in underlying market will be (101.80 - 100.80)*2000 = Rs 2000
Profit in the Futures market will be (101.10 – 102.00)*2000 = Rs 1800

Because of imperfect hedging strategy, the profit in futures market is Rs.1800 while the loss in the cash market is Rs.2000, resulting in a net loss of Rs. 200.

The change in investment objective, asset allocation pattern, investment strategy and enabling use of derivatives in the scheme being changes in the fundamental attributes of the Scheme, in terms of regulation 18(15A) of SEBI (Mutual Funds) Regulations, investors in the Scheme are given an option to exit (redeem / switch-out) at the prevailing Net Asset Value without any exit load, in case they do not wish to continue in the Scheme in view of the proposed change in the Scheme's features. The period of this no load exit offer is valid for a period of 30 days from **Wednesday, April 25, 2018** to **Friday, May 25, 2018** (both days inclusive). The normal redemption / switch request form may be used for this purpose and submitted at any of the IDFC AMC / CAMS ISCs. The no load exit option will be available only to those investments in the Scheme made prior to **Wednesday, April 25, 2018.**

Such exit option will not be available to unitholders whose units have been pledged or encumbered their units in the Scheme and Mutual Fund has been instructed to mark a pledge/lien on such units, unless the release of the pledge/ lien is obtained and appropriately communicated to AMC / Mutual Fund prior to applying for redemption/switch-out.

Unitholders who do not exercise the exit option on or before **Friday, May 25, 2018** would be deemed to have consented to the proposed change. It may be noted that the offer to exit is merely an option and is not compulsory.

The above changes in the scheme features have been approved by the Board of Directors of the AMC and the Trustee Company.

All other features, terms and conditions of the Scheme, as stated in the Scheme Information Document (SID) & the Key Information Memorandum (KIM) of the Scheme, read with the addenda issued from time to time, remain unchanged.

As regards the unitholders who redeem their investments during the Exit Option Period, the tax consequences as set forth in the Statement of Additional Information of IDFC Mutual Fund and Scheme Information Document of the Scheme would apply. In view of individual nature of tax consequences, unitholders are advised to consult their financial / tax advisor for detailed tax advice.

The Notice - Cum - Addendum forms an integral part of the SID and KIM of the Scheme, read with the addenda.

Date: April 23, 2018