IDFC
IDFC MUTUAL FUND

Notice - Cum - Addendum No. 33 of 2018

Addendum to the Scheme Information Document and Key Information Memorandum of IDFC Government Securities Fund

Reposition Short Term Plan of the Scheme as Constant Maturity Plan:

NOTICE is hereby given that pursuant to SEBI circular dated October 6, 2017 on categorization and rationalization of mutual fund schemes, the features of IDFC Government Securities Fund - Short Term Plan ("G-Sec-ST") shall stand modified with effect from **Monday, May 28, 2018** ("Effective Date"):

The Short term Plan of the Scheme shall be repositioned as Constant Maturity Plan and accordingly, the features of the Plan shall stand modified as follows from the Effective Date:

Type / Category

Existing	Proposed
An Open ended gilt scheme	An open ended debt scheme investing in government securities having a constant maturity of 10 years.

Investment objective

Existing	Proposed
To generate optimal returns with high liquidity by investing in Government Securities	The scheme seeks to generate optimal returns with high liquidity by investing in Government Securities such that weighted average portfolio maturity of around 10 years.

Asset Allocation Pattern (existing)

Asset Class	Indicative allocation (as % of net assets)
Government Securities and Treasury Bills	0% – 100%

The Scheme may invest in repos / reverse repos in Government Securities and may invest in money at call and short notice or such alternatives as may be provided under applicable regulations for meeting liquidity requirements. On introduction of cheque writing facility by RBI / such other authority, the AMC may introduce the same under the scheme.

Asset Allocation Pattern (proposed/revised)

Asset Class	Indicative allocation (as % of total assets)
Government Securities and Treasury Bills / Cash Management Bills such that weighted average portfolio maturity of around 10 years (in the range of 8-13 years)	0% – 100%

The Scheme may invest in repos / reverse repos in Government Securities and may invest in CBLO or money at call and short notice or such alternatives as may be provided under applicable regulations for meeting liquidity requirements.
Investment in Foreign securities - up to 50% of total assets.
Investment in Securities lending - up to 20% of the total assets with maximum single party exposure restricted to 5% of the total assets.
Exposure in Derivatives - up to 100% of total assets.
The Scheme may engage in short selling of securities in accordance with the applicable guidelines / regulations.
The cumulative gross exposure through derivatives along with debt and money market instruments shall not exceed 100% of the net assets of the Scheme.

Investment Strategy

Existing	Proposed
The domestic debt markets are maturing rapidly with liquidity emerging in various debt segments through the introduction of new instruments and investors. The aim of the Investment Manager will be to allocate the assets of the Scheme between various treasury bills or money at call and short notice and gilt securities with the objective of achieving optimal returns with a highly liquid portfolio. The actual percentage of investment in various gilt securities 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 Discretion Guidelines defining the prudential and concentration limits for the portfolio and setting dealer limits. The investment management team is allowed full discretion to make sale and purchase decisions within the limits established.	The Scheme proposes to invest substantially in government securities (including T-Bill/CMB) with the aim of generating optimal returns with high liquidity such that weighted average portfolio maturity of around 10 years. The aim of the Investment Manager will be to allocate the assets of the Scheme amongst various government securities (including T-Bill/CMB) or money at call and short notice with the objective of optimizing returns. The actual percentage of investment in various securities from time to time will be decided basis the prevailing macro-economic environment (including interest rates and inflation), market conditions, general liquidity, and fund manager views.

Benchmark Index

Existing	Proposed
I-Sec Si-Bex Index	**Crisil 10 year Gilt Index** Crisil 10 year Gilt Index is an index that tracks the performance of the 10 year benchmark government security which is in line with the schemes portfolio post re-positioning

Consequent to the change in asset allocation as stated above, the Short Term Plan under the Scheme shall be renamed as **Constant Maturity Plan** from the Effective Date.

Subsequent to the proposed changes in features of G-Sec-ST, the Investment Plan and the Short Term Plan (to be renamed as Constant Maturity Plan) of the Scheme will continue to have separate portfolios.

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.

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 10% of the net 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

Size : 24 (w) x 50 (h) cm

Notice - Cum - Addendum No. 33 of 2018 *(Contd.)*

Addendum to the Scheme Information Document and Key Information Memorandum of IDFC Government Securities Fund

Example: *(Contd.)*

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 - *(Contd.)*

- 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
- 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 above changes in the G-Sec-ST being changes in the fundamental attributes of the G-Sec-ST, in terms of regulation 18(15A) of SEBI (Mutual Funds) Regulations, investors in G-Sec-ST 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 G-Sec-ST in view of the proposed changes 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

MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY.

Size : 24 (w) x 25 (h) cm