**L&T Mutual Fund**
6th Floor, Brindavan, Plot No. 177
C. S. T. Road, Kalina
Santacruz (East), Mumbai 400 098

**call** 1800 2000 400
**email** investor.line@lntmf.co.in
**www**.ltfs.com

**L&T Financial Services**
*Mutual Fund*

# Notice-Cum-Addendum (No. 37 of F.Y. 2020 – 2021)

**Change in fundamental attribute of L&T Equity Fund:**

Notice is hereby given that effective February 09, 2021, there shall be a change to the fundamental attributes of L&T Equity Fund as stated below. These changes will be applicable on a prospective basis.

| Particulars | Existing | Proposed |
|---|---|---|
| Scheme name | L&T Equity Fund | L&T Flexicap Fund |
| Scheme category | Multi Cap Fund | Flexi Cap Fund |
| Scheme Type | An open ended equity scheme investing across large cap, mid cap, small cap stocks | An open ended dynamic equity scheme investing across large cap, mid cap, small cap stocks |
| Benchmark | S&P BSE 500 TRI | S&P BSE 500 TRI |
| Investment objective | The investment objective of the Scheme is to generate long-term capital growth from a diversified portfolio of predominantly equity and equity-related securities.<br>There is no assurance that the objective of the Scheme will be realised and the Scheme does not assure or guarantee any returns. For defensive considerations and/or managing liquidity, the Scheme may also invest in money market instruments.<br>The Scheme does not intend to and shall not invest in derivative instruments of any kind | The investment objective of the Scheme is to generate long-term capital growth from a diversified portfolio of predominantly equity and equity-related securities.<br>There is no assurance that the objective of the Scheme will be realised and the Scheme does not assure or guarantee any returns. For defensive considerations and/or managing liquidity, the Scheme may also invest in Debt & money market instruments. |

**Asset Allocation**

*Existing*

| Instruments | Indicative allocations (% of net assets) | | Normal Allocations (% of netassets) | Risk Profile |
|---|---|---|---|---|
| | Maximum | Minimum | | |
| Equity and Equity related securities* | 100% | 80% | 95% | High |
| Money market instruments | 20% | 0% | 5% | Low to Medium |

*Includes investments in offshore securities, ADRs and GDRs not exceeding 10% of the net assets of the Scheme subject to SEBI Guidelines.

Due to market conditions, the AMC may invest beyond the range set out above. Such deviations shall normally be for a short term purpose only, for defensive considerations and the intention being at all times to protect the interests of the Unit Holders. In the event of deviations, rebalancing will be carried out within 10 Business Days.

The Scheme does not intend to and shall not invest in derivative instruments of any kind. The Scheme does not intend to invest in securitized debt.

For details regarding % investment under scrip lending please refer paragraph "Scrip Lending by the Mutual Fund".

*Proposed*

| Instruments | Indicative allocations (% of net assets) | | Risk Profile |
|---|---|---|---|
| | Maximum | Minimum | |
| Equity and Equity related securities | 100% | 65% | High |
| Debt & Money market instruments* | 35% | 0% | Low to Medium |
| Units Issued by REITs & InvITs | 10% | 0% | Medium to High |

*Investment in Securitized debt if undertaken, would not exceed 35% of the net assets of the Scheme.
The Scheme may undertake (i) repo / reverse repo transactions in Corporate Debt Securities; (ii) Interest Rate Swaps; and (iii) Short Selling.

ADR/GDR/Foreign securities/Overseas ETFs up to 35% of the Net Assets. Investments in ADR/GDR and foreign securities would be as per SEBI Circular dated September 26, 2007 as may be amended from time to time.

The investment in Derivatives instruments will be up to 50% of the Net Assets.

For details regarding % investment under scrip lending please refer paragraph "Scrip Lending by the Mutual Fund".

The gross exposure to repo transactions in corporate debt securities shall not be more than 10% of the net assets of the concerned scheme.

The Fund will participate in repo transactions only in AA and above rated corporate debt securities.

In terms of Regulation 44 (2) of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, the fund will borrow through repo transactions only if the tenor of the transaction does not exceed a period of six months.

The cumulative gross exposure through equity, debt, derivative positions and REITs & InvITs should not exceed 100% of the net assets of the scheme.

The Scheme may invest in debt instruments having Structured obligations and Credit enhancement in line with the SEBI (Mutual Fund) Regulation, 1996 and circular dated October 01, 2019.

The Scheme's investment in the following instrument shall not exceed 10% of the debt portfolio of the schemes and the group exposure in such instruments shall not exceed 5% of the debt portfolio of the schemes:

a. Unsupported rating of debt instruments (i.e. without factoring-in credit enhancements) is below investment grade and
b. Supported rating of debt instruments (i.e. after factoring-in credit enhancement) is above investment grade.

For the purpose of this provision, 'Group' shall have the same meaning as defined in paragraph B(3)(b) of SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/35 dated February 15, 2016.

**Investment restriction relating to Scrip lending**

*Existing*

**Scrip Lending by the Mutual Fund:**

If permitted by SEBI under extant Regulations/guidelines, the Scheme may also engage in scrip lending. The AMC shall comply with all reporting requirements and the Trustee shall carry out periodic review as required by SEBI guidelines. Scrip lending means the lending of stock to another person or entity for a fixed period of time, at a negotiated compensation. The securities lent will be returned by the borrower on expiry of the stipulated period.

The Investment Manager will apply the following limits, should it desire to engage in scrip lending:
i) not more than 20% of the net assets of the Scheme can generally be deployed in scrip lending; and
ii) Not more than 5% of the net assets of the Scheme can generally be deployed in scrip lending to any single counter-party.

Various risks associated with scrip lending, such as counter-party risks, liquidity and other market risks, are described in paragraph "Risk associated with short selling and securities/scrip lending".

*Proposed*

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**Where will the Scheme invest?**

*Existing*

The Scheme will invest predominantly in equity and equity-related securities. Equity related securities include equity warrants and compulsorily convertible instruments.

Investments in Offshore securities shall be made in accordance with the requirements stipulated by SEBI/RBI from time to time.

**Money market instruments and Mutual Fund Units:**

Investments other than in equity will be made for managing liquidity. The preferred instruments will be money market instruments.

Money market instruments include commercial papers, commercial bills, treasury bills, Government securities having an unexpired maturity upto one year, call or notice money, certificate of deposit, usance bills and any other like instruments as specified by Reserve Bank of India from time to time.

For the purpose of further diversification and liquidity, the Scheme may invest in another equity scheme managed by the same AMC or by the AMC of any other mutual fund without charging any fees on such investments, provided that aggregate inter-scheme investment made by all schemes managed by the same AMC or by the AMC of any other mutual fund shall not exceed 5% of the net asset value of the Mutual Fund.

*Proposed*

The Scheme shall predominantly invest in equity and equity related instruments (including equity derivatives), debt and money market instruments. Subject to the Regulations, the corpus of the Scheme may be invested in all or any of the following securities:

i) Equity and equity related securities including equity warrants and compulsorily convertible instruments.
ii) Derivatives (which includes but is not limited to stock and index futures or such other derivatives as are or may be permitted under the Regulations and/or RBI from time to time).
iii) Securities issued or guaranteed by Central Government, State Government's or local governments and/or repos/reverse repos/ ready forward contracts in such government securities as are or may be permitted under the Regulations and/or RBI from time to time (including but not limited to coupon bearing bonds, zero coupon bonds and treasury bills)
iv) Securities issued (including debt issuances) by domestic government agencies and statutory bodies, which may or may not be guaranteed by Central or State Government
v) Corporate bonds of public sector or private sector undertakings
vi) Debt issuances of banks (public or private sector) and financial institutions
vii) Money market instruments (which includes but is not limited to commercial papers, commercial bills, treasury bills, usance bills, government securities having unexpired maturity up to one year, certificates of deposit, bills rediscounting, TREP, repo, call money and any other like instruments as are or may be permitted under the Regulations and RBI from time to time.)
viii) Securitized debt (instruments as may be prevailing and permissible under the Regulations from time to time.)
ix) Convertible debentures
x) ADRs / GDRs / Foreign Securities as permitted by Reserve Bank of India and Securities and Exchange Board of India.
xi Units of Real Estate Investment Trust ('REITs') & Infrastructure Investment Trust ('InvITs')
xii) Deposits of scheduled commercial banks as permitted under the extant Regulations.
xiii) Any other security as may be permitted by SEBI.

For the purpose of further diversification and liquidity, the Scheme may invest in other schemes managed by the same AMC or by the asset management company of any other mutual fund without charging any fees on such investments, provided that aggregate inter-scheme investment made in all schemes managed by the same AMC or in schemes managed by the AMC of any other mutual fund shall not exceed 5% of the net asset value of the Mutual Fund and all norms, as may, from time to time be laid down by SEBI in this regard, are complied with. Such investments must also be commensurate with the investment objective as set out in paragraph "Investment Objective"

**Investment strategy**

*Existing*

**Investments in equity and equity related instruments:**

The investment approach is bottom-up stock picking. The Scheme seeks to add the best opportunities that the market presents, without any sector/cap bias.

The key features of the Mutual Fund's investment strategy include:
- Diversification: The Scheme will be well diversified across sectors in about 60 to 80 stocks. The Scheme is likely to be fully invested in equity at all times.
- Bottom-up stock picking: The Scheme focuses on bottom-up stock picking (i.e. focusing solely on prospects of individual stocks) as opposed to a top-down approach (i.e. predicting macro-economic and political trends and taking investment decisions based on them).
- No cap bias: It will seek to identify the best stocks at a point in time, regardless of any market cap bias.
  Investments in equity and equity related securities and debt securities carry various risks such as inability to sell securities, trading volumes and settlement periods, interest rate risk, liquidity risk, default risk, reinvestment risk etc. Whilst such risks cannot be eliminated, they may be mitigated by diversification and hedging.

Further, the portfolio of the Scheme will be constructed in accordance with the investment restrictions specified under the Regulations which would help in mitigating certain risks relating to investments in securities market.

For portfolio turnover policy, please refer paragraph "Portfolio Turnover".

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For portfolio turnover policy, please refer paragraph "Portfolio Turnover".

The following provisions shall be added in the Scheme Information Document (SID) and Key Information Memorandum of L&T Equity Fund under relevant section:

It is further proposed to enable the Scheme to write call options:

## I. 'COVERED CALL OPTION' STRATEGY:

A call option gives the holder (buyer) the right but not the obligation to buy an asset by a certain date for a certain price. Covered calls are an options strategy where a person holds a long position in an asset and writes (sells) call options on that same asset.

**Rationale of using Covered Call strategy in Mutual Funds:** The covered call strategy can be followed by the Fund Manager in order to hedge risk thereby resulting in better risk adjusted returns of the Scheme. The strategy offers the following benefits:

a) Hedge against market risk - Since the fund manager sells a call option on a stock already owned by the mutual fund scheme, the downside from fall in the stock price would be lower to the extent of the premium earned from the call option.
b) Generating additional returns in the form of option premium in a range bound market. Thus, a covered call strategy involves gains for unit holders in case the strategy plays out in the right direction.

**Investment Restrictions for Covered Call strategy:** Mutual Fund schemes (excluding ETFs and Index funds) can write Call options under a covered strategy for constituent stocks of NIFTY 50 and BSE SENSEX subject to the following:

a) The total notional value (taking into account strike price as well as premium value) of call options written by a scheme shall not exceed 15% of the total market value of equity shares held in that scheme.
b) The total number of shares underlying the call options written shall not exceed 30% of the unencumbered shares of a particular company held in the scheme. The unencumbered shares in a scheme shall mean shares that are not part of Securities Lending and Borrowing Mechanism (SLBM), margin or any other kind of encumbrances.
c) At all points of time the Mutual Fund scheme shall comply with the provisions at points (a) and (b) above. In case of any passive breach of the requirement at paragraph (a) above, the respective scheme shall have 7 trading days to rebalance the portfolio. During the rebalancing period, no additional call options can be written in the said scheme.
d) In case a Mutual Fund scheme needs to sell securities on which a call option is written under a covered call strategy, it must ensure compliance with paragraphs (a) and (b) above while selling the securities.
e) In no case, a scheme shall write a call option without holding the underlying equity shares. A call option can be written only on shares which are not hedged using other derivative contracts.
f) The premium received shall be within the requirements prescribed in terms of SEBI circular dated August 18, 2010 i.e. the total gross exposure related to option premium paid and received must not exceed 20% of the net assets of the scheme.
g) The exposure on account of the call option written under the covered call strategy shall not be considered as exposure in terms of paragraph 3 of SEBI Circular no. Cir/IMD/DF/11/2010, dated August 18, 2010.
h) The call option written shall be marked to market daily and the respective gains or losses factored into the daily NAV of the respective scheme(s) until the position is closed or expired.

**Illustration for Covered Call Option –**

Suppose, a fund buys equity stock of ABC Ltd. for Rs. 1000 and simultaneously sells a call option on the same stock at a strike price of Rs. 1100. The scheme earns a premium of say, Rs. 50. Here, the fund manager does not think that the stock price will exceed Rs. 1100.

**Scenario 1:** Stock price exceeds Rs. 1100, the call option will get exercised and the fund manager will sell the stock to settle his obligation on the call at Rs. 1100 (earning a return of 10% on the stock purchase price). Also, the scheme has earned a premium of Rs. 50 which reduced the purchase cost of the stock, thus increasing its investment Profits (Rs. 1000 – Rs. 50 = Rs. 950). Net Gain – Rs. 150

**Scenario 2:** Stock prices stays below Rs. 1100, the call option will not get exercised and will expire worthless. The premium earned on call option will generate alpha for the scheme. Net Gain – Rs. 50.

## II. Risk Factors:

**Risk Factors of covered call option strategy**

**Volatility risk:** Volatility risk arises when market more volatile than the Fund Manager's estimation. The investment manager holds view of range bound market and the market volatility breaches these limits, thereby increasing risk to the portfolio. This risk is mitigated as we have covered with the stocks we hold.

**Opportunity loss:** Selling call option means investment manager are obligated to deliver the stock at predetermined price. In case when the stock price move above the predetermine price the upside opportunity is lost on the stock, because we have sold call option.

Writing call options are highly specialized activities and entail higher than ordinary investment risks. In such investment strategy, the profits from call option writing is capped at the option premium, however the downside depends upon the increase in value of the underlying equity shares.

**Risks associated with investing in securitised debt**

- The underlying assets in securitised debt may assume different forms and the general types of receivables include auto finance, credit cards, home loans or any such receipts. Credit risks relating to such receivables depend upon various factors, including macroeconomic factors of these industries and economies. Further, specific factors like the nature and adequacy of property mortgaged against these borrowings, the nature of loan agreement/mortgage deed in case of home loans, adequacy of documentation in case of auto finance and home loans, capacity of a borrower to meet his obligations on borrowings in case of credit cards and intentions of the borrower also influence the risks relating to asset borrowings underlying securitised debt. Additionally, the nature of the asset borrowings underlying the securitised debt also influences the underlying risk, for instance while residential mortgages tend to have lower default rates, repossession and recovery is easier in case of commercial vehicles. Credit rating agencies take into account a series of such factors and follow an elaborate system involving stipulation of margins, over-collateralisation and guarantees to provide a rating for securitised debt.
- In case of securitised debt, changes in market interest rates and pre-payments may not change the absolute amount of receivables for the investors but may have an impact on the reinvestment of the periodic cash flows that an investor receives on securitised papers.
- **Tenor risk:** While building the planned amortization schedule for a PTC, there can be a clause stating a minimum percentage of receivable by the issue to stick to the initial cash flows. If the receivables are less than the minimum stated receivables then the tenor of the PTC can get elongated or vice versa.
- **Risk due to prepayment:** Asset securitization is a process whereby commercial or consumer credits are packaged and sold in the form of financial instruments. In the event of pre-payment of the underlying debt, investors may be exposed to changes in tenor and yield.
- **Liquidity Risk:** Presently, despite recent legal developments permitting the listing of securitised debt instruments, the secondary market for securitised debt in India is not very liquid. Even if a more liquid market develops in the future, secondary transactions in such instruments may be at a discount to initial issue price due to changes in the interest rate structure.
- **Limited Recourse and Credit Risk:** Certificates issued on investment in securitised debt represent a beneficial interest in the underlying receivables and there is no obligation on the issuer, seller or the originator in that regard. Defaults on the underlying loan can adversely affect the pay outs to the investors (i.e. the Schemes) and thereby, adversely affect the NAV of the Schemes. While it is possible to repossess and sell the underlying asset, various factors can delay or prevent repossession and the price obtained on sale of such assets may be low.
- **Bankruptcy Risk:** If the originator of securitised debt instruments in which the Schemes invest is subject to bankruptcy proceedings and the court in such proceedings concludes that the sale of the assets from originator to the trust was not a 'true sale', then the Schemes could experience losses or delays in the payments due. Normally, care is taken in structuring the securitization transaction so as to minimize the risk of the sale to the trust not being construed as a 'true sale'.
- **Risk of Co-mingling:** Servicers in a securitization transaction normally deposit all payments received from the obligors into a collection account. However, there could be a time gap between collection by a servicer and depositing the same into the collection account. In this interim period, collections from the loan agreements by the servicer may not be segregated from other funds of the servicer. If the servicer fails to remit such funds due to investors, investors in the schemes may be exposed to a potential loss.

**Risks associated with investing in derivatives**

- The Scheme may invest in derivative products in accordance with and to the extent permitted under the Regulations and by RBI. Derivative products are specialized instruments that require investment techniques and risk analysis different from those associated with stocks and bonds. The use of a derivative requires an understanding not only of the underlying instrument but of the derivative itself. Trading in derivatives carries a high degree of risk although they are traded at a relatively small amount of margin which provides the possibility of great profit or loss in comparison with the principal investment amount. Thus, derivatives are highly leveraged instruments. Even a small price movement in the underlying security could have an impact on their value and consequently, on the NAV of the Units of the Scheme.
- The derivatives market in India is nascent and does not have the volumes that may be seen in other developed markets, which may result in volatility to the values.
- Investment in derivatives also requires 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. Even a small price movement in the underlying security could have an impact on their value and consequently, on the NAV of the Units of the Scheme.
- The Scheme may face execution risk, whereby the rates seen on the screen may not be the rate at which the ultimate execution of the derivative transaction takes place.
- The Scheme may find it difficult or impossible to execute derivative transactions in certain circumstances. For example, when there are insufficient bids or suspension of trading due to price limit or circuit breakers, the scheme may face a liquidity issue.
- The options buyer's risk is limited to the premium paid, while the risk of an options writer is unlimited. However the gains of an options writer are limited to the premiums earned. Since in case of the scheme all option positions will have underlying assets, all losses due to price – movement beyond the strike price will actually be an opportunity loss.
- The exchange may impose restrictions on exercise of options and may also restrict the exercise of options at certain times in specified circumstances and this could impact the value of the portfolio.
- Investments in index futures face the same risk as the investments in a portfolio of shares representing an index. The extent of loss is the same as in the underlying stocks.
- The Scheme bears a risk that it may not be able to correctly forecast future market trends or the value of assets, indices or other financial or economic factors in establishing derivative positions for the Scheme.
- The risk of loss in trading futures contracts can be substantial, because of the low margin deposits required, the extremely high degree of leverage involved in futures pricing and the potential high volatility of the futures markets.
- 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 "counterparty") 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.
- Derivative products are leveraged instruments and can provide disproportionate gains as well as disproportionate losses to the investor.
- Execution of investment strategies depends upon the ability of the fund manager(s) to identify such opportunities which may not be available at all times. Identification and execution of the strategies to be pursued by the fund manager(s) involve uncertainty and decision of fund manager(s) may not always be profitable. No assurance can be given that the fund manager(s) will be able to identify or execute such strategies.
- Interest Rate Swaps (IRS) are highly specialized instruments that require investment technique and risk analysis different from those associated with equity shares and other traditional securities. The use of an Interest Rate Swap (IRS) requires not only an understanding of the referenced asset, reference rate or index but also of the swap itself, without the benefit of observing the performance of the swap under all possible market conditions. Swap agreements are also subject to liquidity risk, which exists when a particular swap is difficult to purchase or sell. Swap agreements may be subject to pricing risk, which exists when a particular swap becomes extraordinarily expensive (or cheap) relative to historical prices or the prices of corresponding cash market instruments. IRS agreements are also subject to counterparty risk on account of insolvency or bankruptcy or failure of the counterparty to make required payments or otherwise comply with the terms of the agreement. 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.