

RISK FACTORS

Scheme specific risk factors

Risk factors associated with investing in Fixed Income Securities

Subject to the stated investment objective, the Scheme proposes to invest in debt and related instruments and the risk factors pertinent to the same are:

- The performance of Scheme may be affected by changes in Government policies, general levels of interest rates and risks associated with trading volumes, liquidity and settlement systems.
- Investments in different types of securities are subject to different levels and kinds of risk. Accordingly, the Scheme's risk may increase or decrease depending upon its investment pattern.

E.g. investments in corporate bonds carry a higher level of risk than investments in Government securities. Further, even among corporate bonds, bonds which have a higher rating are comparatively less risky than bonds which have a lower rating.

- **Price-Risk or Interest Rate Risk:** As with all debt securities, changes in interest rates may affect the NAV of the Scheme as the prices of securities increase as interest rates decline and decrease as interest rates rise. Prices of long-term securities generally fluctuate more in response to interest rate changes than do short term securities. Indian debt markets can be volatile leading to the possibility of price movements up or down in fixed income securities and thereby to possible movements in the NAV.
- The change in value of a security, for a given change in yield, is higher for a security with higher duration and vice versa. Hence portfolios with higher duration will have higher volatility which leads to duration risk.
- Government securities do carry price risk depending upon the general level of interest rates prevailing from time to time. The extent of fall or rise in the prices is a function of the coupon rate, days to maturity and the increase or decrease in the level of interest rates. The price of the Government securities (existing and new) is influenced only by movements in interest rates in financial systems.
- In the case of floating rate instruments, an additional risk could be due to the change in the spreads of floating rate instruments. If the spreads on floating rate papers rise, then there could be a price loss on these instruments. Secondly in the case of fixed rate instruments that have been swapped for floating rates, any adverse movement in the fixed rate yields vis-à-vis swap rates could result in losses. However, floating rate debt instruments which have periodical interest rate reset, carry a lower interest rate risk as compared to fixed rate debt instruments. In a falling interest rate scenario, the returns on floating rate debt instruments may not be better than those on fixed rate debt instruments. In case of a floating rate instrument, this risk is lower as a result of periodic reset of the coupon. During the life of floating rate security or a swap the underlying benchmark index may become less active and may not capture the actual movement in the interest rates or at times the benchmark may cease to exist. These types of events may result in loss of value in the portfolio.

Liquidity Risk: This refers to the ease with which a security can be sold at or near to its valuation yield-to-maturity (YTM). The primary measure of liquidity risk is the spread between the bid price and the offer price quoted by a dealer. Liquidity risk is today characteristic of the Indian fixed income market.

This represents the possibility that the realised price from selling the security might be lesser than the valuation price as a result of illiquid market. If a large outflow from the Scheme is funded by selling some of the illiquid securities, the NAV could fall even if there is no change in interest rates. Illiquid securities are typically quoted at a higher yield than the liquid securities and have higher bid offer spreads. Investment in illiquid securities results in higher current yield for the portfolio. In addition, money market securities, while fairly liquid, lack a well-developed secondary market, which may restrict the selling ability of the Scheme and may lead to the Scheme incurring losses till the security is finally sold.

The corporate debt market is relatively illiquid vis-a-vis the government securities market. Even though the government securities market is more liquid compared to that of other debt instruments, on occasions, there could be difficulties in transacting in the market due to extreme volatility or unusual constriction in market volumes or on occasions when an unusually large transaction has to be put through.

Liquidity Risk for all Open-Ended Debt Schemes is measured and addressed through the below mentioned liquidity management tools.

Liquidity Management Tools	Brief Description
Potential Risk Matrix (PRC) and Risk-o-meter (RoM)	All debt schemes are bucketed in terms of Potential Risk Class matrix (PRC) based on maximum interest rate risk and credit risk parameters. PRC defines the maximum risk that a scheme will run as per design and RoM is the measurement of that risk on a regular basis. Remedial measures are in place in case any of the design boundaries are breached.
Maintenance of minimum liquid assets in all open ended debt schemes and monitoring liquid assets through LRRaR and LR-CRaR framework provided by AMFI.	All open ended debt schemes (except Overnight fund, Liquid fund, Gilt fund and Gilt Fund with 10-year constant duration) shall hold at least 10% of their net assets in liquid assets or liquidity ratio computed basis LR-RaR and LR-CRaR, whichever is higher. Similarly, liquid funds shall comply with the requirement of maintaining liquid assets at 20% of their net assets or liquidity ratio computed basis LR-RaR and LR-CRaR, whichever is higher. The Liquidity Risk Management framework defines the Liquidity Risk arising from liability side of the portfolio and covers all potential liquidity risk scenarios upto 99% confidence interval. The AMC measures and monitors liquidity risk on a monthly basis and has laid down action plan in case there is difference between actual outcome and projected outcome.
Stress Testing	Stress Testing is carried out for all open ended debt schemes (except overnight scheme) on a monthly basis as required by SEBI. The stress testing addresses the asset side risk taking into account the Interest Rate risk, Credit risk and Liquidity risk at an aggregate portfolio level and its impact on NAV. This asset side stress testing complements the liability side stress testing conducted through LR-RaR and CR-CRaR framework. The result of Stress Testing is reported to AMFI, Board of AMC and Trustee Company on an ongoing basis.
Asset Liability Management	Asset Liability Management covers monitoring of liquidity risk addressing asset liability mismatch upto a period of 90 days. The 90-day liability ratio is calculated taking into account investor behavior based on size of their investments and historic redemptions at an industry level. The 90-day liability ratio is compared with the Portfolio Liquidity ratio to ascertain if any asset liability mismatch exists.
Borrowing	A fund may borrow to meet redemption requirements up to the limit allowed by the regulator from time to time

- **Credit Risk:** Credit risk or default risk refers to the risk that an issuer of a fixed income security may default (i.e. will be unable to make timely principal and interest payments on the security). A sovereign security carries no default risk since Government raises money to meet its capital and revenue expenditure by issuing these debt or discounted securities. As the payment of interest and principal amount has a sovereign status implying no default, such securities are popularly known as “risk-free security” or “Zero Risk security”. Thus Zero-Risk is the lowest risk, even lower than a security with “AAA” rating and hence commands a yield, which is lower than a yield on “AAA” security. Normally, the value of a fixed income security will fluctuate depending upon the changes in the perceived level of credit risk as well as any actual event of default. The greater the credit risk, the greater the yield required for someone to be compensated for the increased risk. Because of this risk, corporate debentures are sold at a yield above those offered on Government Securities, which are sovereign obligations.
- **Reinvestment Risk:** This risk refers to the interest rate levels at which cash flows received from the securities in the Scheme are reinvested. The additional income from reinvestment is the “interest on interest” component. The risk is that the rate at which interim cash flows can be reinvested may be lower than that originally assumed. However, declining interest rates normally lead to increase in bond prices which may help cushion the impact of reinvestment risk to some extent.

- **Benchmark Risk:** The floating rate segment of the domestic debt market is not very developed. Currently, majority of the issuance of floating rate papers is linked to NSE MIBOR. As the floating rate segment develops further, more benchmark rates for floating papers may be available in future. The fewer number of benchmark rates could result in limited diversification of the benchmark risk.
- **Prepayment Risk:** The risk associated with the early unscheduled return of principal on a fixed- income security. The early unscheduled return of principal may result in reinvestment risk.
- **Settlement risk:** Different segments of Indian financial markets have different settlement periods and such periods may be extended significantly by unforeseen circumstances. Delays or other problems in settlement of transactions could result in temporary periods when the assets of the Scheme are uninvested and no return is earned thereon. The inability of the Scheme to make intended securities purchases, due to settlement problems, could cause the Scheme, to miss certain investment opportunities. Similarly, the inability to sell securities held in the Scheme's portfolio, due to the absence of a well-developed and liquid secondary market for debt securities, may result at times in potential losses to the Scheme in the event of a subsequent decline in the value of securities held in the portfolio of the Scheme.
- **Market risk:** Lower rated or unrated securities are more likely to react to developments affecting the market and the credit risk than the highly rated securities which react primarily to movements in the general level of interest rates. Lower rated or unrated securities also tend to be more sensitive to economic conditions than higher rated securities.
- In addition to the factors that affect the values of securities, the NAV of Units of the Scheme will fluctuate with the movement in the broader fixed income market, money market and derivatives market and may be influenced by factors influencing such markets in general including but not limited to economic conditions, changes in interest rates, price and volume volatility in the bond and stock markets, changes in taxation, currency exchange rates, foreign investments, political, economic or other developments and closure of the stock exchanges.

Risk Factors associated with investments in Money Market instruments

- Investments in money market instruments would involve a moderate credit risk i.e. risk of an issuer's liability to meet the principal payments. Additionally, money market securities, while fairly liquid, lack a well-developed secondary market, which may restrict the selling ability of the Scheme and may lead to the Scheme incurring losses till the security is finally sold.
- Money market instruments may also be subject to price volatility due to factors such as changes in interest rates (when interest rates in the market rise, the value of a portfolio of money market instruments can be expected to decline), general level of market liquidity and market perception of credit worthiness of the issuer of such instruments and risks associated with settlement of transactions and reinvestment of intermediate cash flows. The NAV of the Scheme's Units, to the extent that the Scheme is invested in money market instruments, will consequently be affected by the aforesaid factors. The AMC endeavours to manage such risk by the use of in-house credit analysis.
- The NAV of the Scheme's Units, to the extent that the corpus of the Scheme is invested in money market instruments, will be affected by the changes in the level of interest rates. When interest rates in the market rise, the value of a portfolio of money market instruments can be expected to decline.

Risks pertaining to Interest Rate Futures

- **Performance risk:** Hedging interest rate duration risk in a falling interest rate environment could limit the profits on the bond portfolio if interest rate call of the fund manager goes wrong.
- **Default Risk:** This is the risk that losses will be incurred due to default by counter party. This is also referred to as counterparty risk. However, this risk is negligible if the trades are cash settled through a Clearing Corporation.
- **Price Risk:** Despite the risk mitigation provided by various derivative instruments, there remains an inherent price risk which may result in losses exceeding actual underlying.
- **Basis Risk:** This risk arises when the derivative instrument used to hedge the underlying asset does not match the movement of the underlying being hedged for e.g. mismatch between the maturity date of the futures and the actual selling date of the asset.
- **Liquidity risk:** This risk pertains to how saleable a security is in the market. All securities/instruments may be exposed to liquidity risk (when the sellers outnumber buyers) which may impact returns while exiting opportunities.

Risks associated with investing in securitised debt

Securitised Debt: Securitised debt papers carry credit risk of the Obligors and are dependent on the servicing of the PTC / Contributions etc. However these are offset suitably by appropriate pool selection as well as credit enhancements specified by Rating Agencies. In cases where the underlying facilities are linked to benchmark rates, the securitised debt papers may be adversely impacted by adverse movements in benchmark rates. However this risk is mitigated to an extent by appropriate credit enhancement specified by rating agencies. Securitised debt papers also carry the risks of prepayment by the obligors. In case of prepayments of securities debt papers, it may result in reduced actual duration as compared to the expected duration of the paper at the time of purchase, which may adversely impact the portfolio yield. These papers also carry risk associated with the collection agent who is responsible for collection of receivables and depositing them. The Investment team evaluates the risks associated with such investments before making an investment decision.

The underlying assets in the case of investment in securitised debt could be mortgages or other assets like credit card receivables, automobile / vehicle / personal / commercial / corporate loans and any other receivables / loans / debt.

The risks associated with the underlying assets can be described as under:

Credit card receivables are unsecured. Automobile / vehicle loan receivables are usually secured by the underlying automobile / vehicle and sometimes by a guarantor. Mortgages are secured by the underlying property. Personal loans are usually unsecured. Corporate loans could be unsecured or secured by a charge on fixed assets / receivables of the company or a letter of comfort from the parent company or a guarantee from a bank / financial institution. As a rule of thumb, underlying assets which are secured by a physical asset / guarantor are perceived to be less risky than those which are unsecured. By virtue of this, the risk and therefore the yield in descending order of magnitude would be credit card receivables, personal loans, vehicle / automobile loans, mortgages and corporate loans assuming the same rating.

Risk factor associated with legal, tax and regulatory Risk

The Schemes could be exposed to changes in legal, tax and regulatory regime which may adversely affect it and / or the investors. Such changes could also have retrospective effect and could lead to additional taxation imposed on the Schemes which was not contemplated either when investments were made, valued or disposed off.

Risks associated with investing in Derivatives

The Fund may use derivative instruments like interest rate swaps, forward rate agreements or other derivative instruments as permitted under the Regulations and guidelines.

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 specialised 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. Thus, 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.

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 perused by the fund manager 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. 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.

Risk associated with short selling and securities lending by Scheme

Short Selling Risk: The risk associated with upward movement in market price of security sold short may result in loss. The losses on short position may be unlimited as there is no upper limit on rise in price of a security.

Securities Lending: The risks in lending portfolio securities, as with other extensions of credit, consist of the failure of another party, in this case the approved intermediary, to comply with the terms of agreement entered into between the lender of securities i.e., the Scheme and the approved intermediary. Such failure to comply can result in the possible loss of rights in the collateral put up by the borrower of the securities, the inability of the approved intermediary to return the securities deposited by the lender and the possible loss of any corporate benefits accruing to the lender from the securities deposited with the approved intermediary. The Mutual Fund may not be able to sell such lent securities and this can lead to temporary illiquidity.

Risks associated with investments in Repo transactions in Corporate Bonds

In repo transactions, also known as a repo or sale repurchase agreement, securities are sold with the seller agreeing to buy them back at later date. The repurchase price should be greater than the original sale price, the difference effectively representing interest. A repo is economically similar to a secured loan, with the buyer receiving corporate debt securities as collateral to protect against default. The Scheme may invest in repo of corporate debt securities which are subject to the following risks:

- **Counterparty Risk:** This refers to the inability of the seller to meet the obligation to buy back securities at the contracted price on the contracted date. The Investment Manager will endeavour to manage counterparty risk by dealing only with counterparties, having strong credit profiles, approved by our credit risk analysis team. The exposure to each counterparty will be within the overall approved credit limits. Also, the counterparty risk is to an extent mitigated by taking collateral equivalent in value to the transaction after knocking off a minimum haircut on the intrinsic value of the collateral. In the event of default by the repo counterparty, the scheme shall have recourse to the corporate debt securities.
- **Collateral Risk:** Collateral risk arises when the market value of the securities is inadequate to meet the repo obligations. This risk is mitigated by restricting participation in repo transactions with collateral bearing a minimum rating as prescribed by the regulators (currently AA or equivalent and above rated money market and corporate debt securities). Any rating

downgrade will tantamount to either an early termination of the repo agreement or a call for fresh margin to meet the minimum haircut requirement. In addition, the Investment manager may apply a higher haircut on the underlying security than mentioned above to adjust for the illiquidity and interest rate risk on the underlying instrument. The adequacy of the collateral will be monitored on a daily basis by considering the daily market value & applying the prescribed haircut. In the event of shortfall in the collateral, the counterparty shall be asked to replenish the same. If the counterparty is not able to top-up either in form of cash/collateral, it shall tantamount to early termination of the repo agreement

- **Settlement Risk:** Corporate Bond Repo shall be settled between two counterparties in the OTC segment unlike in the case of Government securities repo transactions where CCIL stands as central counterparty on all transactions which neutralizes the settlement risk. However, the settlement risk pertaining to CDRs shall be mitigated through Delivery versus Payment (DvP) mechanism which is followed by all clearing members.

Risks associated with transaction in Units through Stock Exchange mechanism

- In respect of transactions in Units of the Scheme routed through the BSE StAR MF platform or any other recognised stock exchange platform as intimated by the AMC, allotment and redemption of Units on any Business Day will depend upon the order processing/settlement by BSE, or such other exchange and their respective clearing corporations on which the Fund has no control. Further, transactions conducted through the stock exchange mechanism shall be governed by the operating guidelines and directives issued by BSE or such other recognised exchange in this regard.

Risks associated with Segregated Portfolio

- **Liquidity risk** - Segregated Portfolio is created to separate debt and money market instruments affected by a Credit Event from the Main Portfolio of the Scheme. The Fund will not permit redemption of the Segregated Portfolio units, but the units will be listed on a recognized stock exchange. The Fund is not assuring any liquidity of such units on the stock exchange. Further, trading price of units on the stock exchange may be significantly lower than the prevailing NAV. Investors can continue to transact (subscribe/redeem) from the Main Portfolio.
- **Credit risk** - While the AMC will put in sincere efforts to recover the securities in the Segregated Portfolio and distribute the same to unit holders, it is likely that such securities may not realize any value leading to losses to investors.

Backstop facility in form of investment in Corporate Debt Market Development Fund (CDMDF):

CDMDF is set up as a scheme of the Trust registered as an Alternative Investment Fund ('AIF') in accordance with the SEBI (Alternative Investment Funds) Regulations, 2012 ("AIF Regulations") which is launched as a closed-ended scheme with an initial tenure of 15 years (extendable) from the date of its initial closing. The Investment Manager-cum-Sponsor of CDMDF shall be SBI Funds Management Ltd., the asset management company of SBI Mutual Fund. The objective of the CDMDF is to help to develop the corporate debt market by providing backstop facility to instill confidence amongst the market participants in the corporate debt/bond market during times of market dislocation and to enhance the secondary market liquidity. In times of market dislocation, CDMDF shall purchase and hold eligible corporate debt securities from the participating investors (i.e., specified debt-oriented MF schemes to begin with) and sell as markets recover. The CDMDF will thus act as a key enabler for facilitating liquidity in the corporate debt market and to respond quickly in times of market dislocation. The trigger and period for which the backstop facility will be open shall be as decided by SEBI. Thus, this backstop facility will help fund managers of the aforementioned Schemes to better generate liquidity during market dislocation to help the schemes fulfill liquidity obligations under stress situation.

In accordance with the requirement of regulation 43A of SEBI (Mutual Funds) Regulations, 1996 read with SEBI circular no. SEBI/HO/IMD / PoD2/P/CIR/2023/129 dated July 27, 2023 on Investment by Mutual Fund Schemes in units of Corporate Debt Market Development Fund, the aforementioned schemes shall invest 25 bps of its AUM as on December 31, 2022 in the units of the Corporate Debt Market Development Fund ('CDMDF'). An incremental contribution to CDMDF shall be made every six months to ensure 25 bps of scheme AUM is invested in units of CDMDF. However, if AUM decreases there shall be no return or redemption from CDMDF. Contribution made to CDMDF, including the appreciations on the same, if any, shall be locked-in till winding up of the CDMDF.

We would further like to bring to the notice of the investors that investments in CDMDF units shall not be considered as violation while considering maturity restriction as applicable for various purposes (including applicable Investment limits) and the calculations of Potential Risk Class (PRC) Matrix, Risk-o-meter, Stress testing and Duration for various purposes shall be done after excluding investments in units of CDMDF. Contribution by the Specified open-ended Debt- Oriented Schemes shall be treated as an investment and not an expense, and hence shall form part of Net Asset Value (NAV) of the Specified open ended Debt-Oriented Schemes.

Investors are requested to read disclosure on investment of the schemes in the CDMDF as listed in Part II - "How will the Scheme Allocate its Assets and "Where will the Scheme Invest?"