

# Passive funds gain popularity with fresh inflows of Rs 2.13 lakh crore over last 2 years



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In uncertain times worldwide, investors globally have resorted to incrementally investing through passive funds including exchange traded funds (ETFs) and index funds. Globally, assets under management (AUM) of ETFs rose 37.2% to \$12.7 trillion at the end of March 2024 from \$9.3 trillion at the end of December 2022. Since December 2007, AUM in ETFs globally has increased at the rate of 18% per annum re-establishing the fact that passive funds score over their active counterparts in providing investors with low cost access to capital markets.

Interestingly, the trend in India is not very different. While ETFs in India have been present for more than 22 years now, the real ETF story in India started only around 9 years ago with Employees' Provident Fund Organisation (EPFO) starting to invest in equity markets through ETFs. More particularly, the ramp up in asset under management of ETFs during the last 2 financial years has been a dramatic one as it witnessed fresh inflows of about Rs 1.02 lakh crore (Rs 2.13 lakh crore including index funds). The total Asset Under Management (AUM) of passive funds (ETFs and Index Funds) as on March 31, 2024 was Rs 9.08 lakh crore, accounting for about 17% of the total AUM of the mutual fund (MF) industry as on that date. However, if we consider only the AUM of Equity Funds, passive accounts for about 22% of the total Equity Funds AUM of the industry (under the equity category including ELSSs, close ended and interval schemes, equity index funds and Equity ETFs).

The fresh inflows into passive funds have been resilient for few reasons. First, investors benefit from the low-cost nature of passive funds. Investors can get exposure to equity market for as low as 0.05%-0.5% (5-50 basis points) per annum of fund management fee as against upward of 1% (100 basis points) per annum in case of most actively managed funds. Second, as per various studies, majority of the active funds are not able to outperform the corresponding indices consistently. Investors are responding to the above factors by increasing their allocation to passive investments. If this trend continues, which is likely, passive funds are on their way to take a dominant share of overall equity fund AUM.

## Retail exposure to passive products has increased

Investors interest in passive funds – proxied by the increased number of folios in ETFs and Index funds – has been rising steadily. The total number of folios for ETFs and Index funds stood at close to Rs 2.64 crores as at March 31, 2024, out of which about 75% has been added in the last three financial years (FY 21-22, FY 22-23, FY 23-24). Furthermore, retail participation in this increase in passive funds folios has been increasing and retail investors continue to account for upwards of 90% of total folios outstanding. While retail investors (including High Networth Investors) account for about 53% index funds AUM, they account for only 9% of ETF AUM. All stakeholders must work towards increasing awareness of passive products among retail investors to further boost their participation.

## What's finding favour with investors?

The most popular category within equity ETFs has been the traditional market-cap based ETFs. Such ETFs track broad based market cap weighted indices like Nifty 50, Nifty Next 50, Nifty Midcap 150 or Nifty Small Cap 250, where stock selection is largely based on the size of market capitalisation of the stock. This ETF category continues to claim the largest share of the overall AUM in index-based funds in India. Out of the total 413 passive products (206 ETFs and 207 index funds) available in India, as of March 2024 with a total AUM of Rs 9.08 lakh crore, 270 passive funds (150 ETFs and 120 Index funds) with an AUM of Rs 6.67 lakh crore are based on equity indices while 115 funds (28 ETFs and 87 index funds) with an AUM of Rs 2.06 lakh crore are based on debt indices, 16 gold ETFs with an AUM of Rs 26,054 crores and 12 silver ETFs with an AUM of Rs 9,811 crores. Within equity asset class, 65 ETFs and 72 Index funds together claiming an AUM share of 83% (at Rs 5.53 lakh crore) are based on broad-based market cap weighted indices. This also includes 8 funds (6 ETFs and 2 index fund) that track international indices. Out of all broad-based passive funds, Nifty 50 index-based funds lead the race with a total of 18 ETFs and 19 Index Funds with an AUM of Rs 3.3 lakh crore accounting for 49% of the total passive equity AUM as of March 2024. (Refer to table 1 & 2).

ETFs based on sector indices have been another popular category in India. During FY2024, a total of 10 sector ETFs were launched, of which 3 were based on Nifty IT index, 2 on Nifty Bank Index, 2 on Nifty PSU Index and 1 on Nifty Private Bank, Nifty Healthcare and Nifty Realty Index each. With this now, a total of 58 sector based passive funds are available in India with an AUM of Rs 41,320 crores as on March 31, 2024. This also includes one index fund that tracks an international index. Investors wanting to ride their preferred sector wave will find these sector ETFs appealing.

In the thematic ETF category too, winds of change are visible, with investors warming up to the concept of Environmental, Social and Governance (ESG) investing. India's maiden ETF on the ESG theme was launched in FY21, with the Nifty100 ESG Sectors Leaders – a large cap ESG index by NSE Indices as its underlying benchmark. This offers sustainability conscious investors a choice to invest in set of companies doing well on the ESG front.

Investing based on Smart Beta Factor indices continued to see high investor interest. In a Smart Beta Factor index,

selection of stocks is based on a certain factor or some common set of characteristics. Such factor could be high Value, high Quality, high Growth, low Volatility, high Alpha or high Momentum. 9 such passive funds (3 ETFs and 6 index funds) were launched in FY24 – 2 ETFs and 6 index funds were launched on a single factor indices based on Momentum, Quality, Alpha and Value factor and an ETF was launched on a multi factor index - Nifty Smallcap250 Momentum Quality 100 index which combines Momentum and Quality factors. The factor based ETFs fit well as the satellite component within a Core and Satellite investing framework, where the core portfolio comprises of traditional beta trackers (like ETFs based on Nifty 50 or Nifty 100 indices) and the satellite portfolio consists of investments offering potential for outperformance.

The retail investors seek predictability of returns in their fixed income investment portfolios, something that they typically experience in a bank fixed deposit. The launch of Fixed Income passive funds tracking Target Maturity Date based indices have appropriately given such investors a similar investment experience. Unlike, actively managed constant maturity debt funds that do not have a maturity date to it, Target Maturity Date based passive funds have a predefined maturity date when investors will get their money back along with accrued interest. Target Maturity Date passive funds combine the benefits such as high credit quality issuers, low fund management fees, high predictability of returns, and good liquidity as ETFs are traded on exchange and Index funds can directly be redeemed with the MFs. Now that various such target maturity date ETFs are available to investors, each maturing in a different calendar year, investors can select the one that best suits their investment goals and cash flow needs. It is due to such great benefits that target maturity date based ETFs offer, that the Debt ETF AUM has crossed Rs 96,161 crores by March 2024 from Rs 61,256 crores in March 2022.

Passive fund space in India is clearly witnessing a sea change with availability of various innovative indices across equity & debt asset class based on which mutual funds can launch ETFs and index funds. Both number and size of passive funds have increased many folds over the last few years. These ETFs and index funds offer investors low-cost access to equity and debt markets. If the trend of majority of active funds not being able to outperform their indices consistently continues, passive is on its way to become the core component of MF Industry AUM.

**TABLE 1: Year-wise Passive Funds AUM**

Date	AUM (Rs. Crores)						
	Equity		Debt		Commodity		Total ETFs/ Index funds
	ETFs	Index funds	ETFs	Index funds	Gold ETFs	Silver ETFs	
Mar-20	1,29,706	8,089	16,757	-	7,949	-	1,62,501
Mar-21	2,37,903	18,107	37,672	883	14,123	-	3,08,688
Mar-22	3,49,330	39,639	61,256	27,608	19,281	777	4,97,890
Mar-23	3,97,144	55,557	85,345	1,05,219	22,737	1,792	6,67,794
Mar-24	5,63,178	1,03,577	96,161	1,09,995	26,054	9,811	9,05,777

Source: NSE Indices, AMFI. Data as of Mar 31 of the respective years

**TABLE 2: Year-wise Nos. of Passive Funds**

Date	Nos. of products						Total ETFs/ Index funds
	Equity		Debt		Commodity		
	ETFs	Index funds	ETFs	Index funds	Gold ETFs	Silver ETFs	
Mar-20	68	32	8	-	11	-	119
Mar-21	79	41	13	3	11	-	147
Mar-22	104	71	17	22	11	3	228
Mar-23	131	91	22	86	12	7	349
Mar-24	150	120	28	87	16	12	413

Source: NSE Indices, AMFI. Data as of Mar 31 of the respective years