

Passive Investing in India: A New Era Under SEBI's MF Lite Framework



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Passive investing in India is moving from the margins to the mainstream. Passive mutual funds now account for roughly 18–19% of India's mutual fund industry assets, a meaningful rise from negligible levels a decade ago, yet still well below the penetration seen in developed markets. In the United States, indexed mutual funds and ETFs account for more than half of long-term fund assets, with indexed assets estimated at approximately US\$20.8 trillion. By comparison, India's passive assets remain much smaller, at around US\$175 billion, underscoring the scale of the growth opportunity.

This gap reflects the stage of market development and the continued appeal of active management in India. Indian investors have historically been willing to pay higher fees in pursuit of alpha, while asset managers have invested heavily in research, stock selection and active portfolio construction. As a result, the Indian mutual fund industry has remained predominantly active-management driven.

For many fund houses, passive products have therefore been viewed as a lower-margin business. At the same time, passive schemes have often been subject to governance, compliance and operational requirements broadly comparable to those applicable to actively managed funds, despite the absence of discretionary investment decision-making. This created a practical challenge: passive products required scale economics, but were expected to operate within a regulatory architecture designed largely for active funds.

The Strategic Shift

SEBI's introduction of the Mutual Fund Lite framework marks a significant regulatory shift. The framework, introduced for passively managed mutual fund schemes and subsequently reflected in the broader SEBI (Mutual Funds) Regulations, 2026, recognize that passive products require a proportionate regulatory model aligned with their rule-based nature.

The framework also acknowledges a broader industry reality. As passive investing gains traction globally, Indian asset managers increasingly need to offer a full spectrum of investment solutions rather than relying solely on active strategies. Investor demand is expanding beyond alpha generation to include:

- Low-cost market exposure
- Core portfolio building blocks
- Asset allocation solutions
- ETF-based investment strategies
- Retirement and long-term wealth accumulation products

MF Lite recognises that while Indian asset managers may continue to compete aggressively through active strategies, the growth of passive investing requires a different economic model—one where regulatory obligations are proportionate to the nature of the product and do not become a barrier to scale.

Importantly, the framework seeks to balance regulatory flexibility with investor protection. By requiring independent oversight through SEBI-registered debenture trustees for specified passive schemes, it introduces a governance mechanism that is more proportionate, while still preserving independent checks on investor interests.

Why Passive Investing Matters

Passive investing seeks to replicate the performance of an underlying index rather than outperform it. Its appeal lies in a simple investment proposition:

- Lower investment costs
- Reduced dependence on fund manager discretion
- Greater portfolio transparency
- Predictable investment outcomes relative to the chosen benchmark
- Efficient access to broad market exposure

As markets become increasingly efficient, many investors are questioning whether paying higher fees for active management consistently delivers superior returns. Passive products offer an attractive alternative by providing diversified market exposure at relatively low cost.

Institutional investors, retirement funds, family offices and retail investors are increasingly incorporating passive strategies as core building blocks within their portfolios. In India, this shift is still at an early stage, but the direction of travel is clear.

SEBI's Evolving Regulatory Approach

SEBI has consistently supported the development of passive funds while strengthening governance standards. Earlier initiatives focused on encouraging product innovation and expanding investor choice. MF Lite takes this approach

further by recognising passive investing as a distinct business model within the mutual fund ecosystem.

A key feature of MF Lite is that it is optional and not a replacement for the existing mutual fund regulatory regime. Asset Management Companies that wish to continue operating under the traditional governance architecture—with trustee structures, board oversight mechanisms and existing compliance requirements—may continue to do so.

Instead, MF Lite provides an alternative regulatory pathway for eligible passive investment products. It allows eligible entities to operate under a lighter-touch governance and compliance framework designed specifically for low-risk, rule-based strategies such as index funds, exchange-traded funds and other specified passive schemes. The objective is to facilitate faster product launches, lower operating costs and greater innovation, while retaining appropriate investor protection mechanisms.

As passive assets continue to grow, trustee oversight may increasingly resemble governance models already familiar in alternative investment funds and debt market structures, where independent fiduciary oversight plays a central role in protecting investors.

The Road Ahead

India remains significantly underpenetrated in passive investing compared with developed markets. As investor awareness increases, digital distribution expands and product choice deepens, passive assets are expected to continue growing at a rapid pace.

SEBI's reforms signal a balanced regulatory philosophy: encouraging innovation and market development while ensuring that investor protection keeps pace with industry expansion.

The use of independent debenture trustees for specified passive schemes reflects the regulator's recognition that scale requires robust governance. Rather than viewing passive funds as inherently low-risk simply because they track an index, the framework acknowledges that operational discipline, transparency and oversight remain essential to maintaining investor confidence.

MF Lite is therefore not merely a regulatory simplification exercise. It is a strategic initiative intended to accelerate the development of India's passive investment ecosystem by aligning regulatory requirements with the lower-risk, rules-based nature of index-tracking products. If implemented effectively, it could help expand investor choice, improve cost efficiency and support the next phase of growth in India's mutual fund industry.