

Index Providers under the purview of SEBI

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What's in today's article?

- **Why in news?**
- **News Summary: Index Providers under the purview of SEBI**
- **Background**
- **Why do indices matter?**
- **What are index funds?**
- **How popular are such funds in India?**
- **How are indices made and what do providers do?**
- **What has SEBI proposed?**
- **Why SEBI wants to regulate index funds?**

Why in News?

- Noting the growing dominance of Index Providers, SEBI has proposed to bring them under its regulatory purview.

News Summary: Index Providers under the purview of SEBI

Background:

- Following a report by Hindenburg Research levelling several allegations against the Adani group, global index providers like MSCI are reviewing some of these stocks' inclusion in its indices that are replicated by many foreign portfolio managers.
 - MSCI (Morgan Stanley Capital International) is a provider of investment decision support tools, including indices, portfolio risk and performance analytics, and governance tools.
- India's National Stock Exchange (NSE), on the other hand, has announced that five Adani group firms' stocks will be added to 14 different indices administered by a subsidiary called NSE Indices.

Why do indices matter?

- Most observers assess a market's general trajectory amid these individual price swings by looking at broader benchmark indices.
 - There are thousands of stocks traded in stock markets around the world and their prices often moving in different directions.
 - This creates confusion among investors.
- For instance, the Sensex represents the 30 largest and most actively traded stocks on the Bombay Stock Exchange (BSE).
- While economists and governments look at market indices' movements as a barometer of the confidence levels in the economy, individual investors and fund managers use them as a gauge to compare their own portfolios' performance.
- Mutual funds and portfolio managers often pitch to prospective investors that their investment strategies have outperformed the Sensex or other relevant benchmarks.

What are index funds?

- An index fund is a fund which tracks the performance of an underlying index, like the Nifty or the Sensex.
- Instead of trying to beat the market by selecting individual stocks, index funds aim to match the performance of the overall market or a specific market segment by investing in all the stocks in that index.
- This means that an index fund will have a portfolio of stocks that closely resembles the composition of the index it tracks.
- When one puts money in an index fund, that cash is then used to invest in all the companies that make up the particular index.
 - This gives investors a more diverse portfolio than if they were buying individual stocks.

- Index investors do not need to actively manage the stocks and bonds investment as closely since the fund is just copying a particular index.
 - This is why index funds are known as passive investing.

How popular are such funds in India?

- While index funds have been an option for Indian investors for about two decades, they have seen an exponential growth in assets since 2015.
- From eight such funds in 2008, there are as many as 200 options now.
- About 16% of the roughly ₹41 lakh crore assets managed by India's mutual funds are parked in index funds and ETFs.

How are indices made and what do providers do?

- Indices could be based on different industry sectors, size of companies (small-cap, mid-cap, etc) and quantitative parameters like liquidity and trading volumes etc.
- The weightage assigned to each stock in an index may vary based on their market capitalisation or other gauges that index providers adopt.
- NSE Indices owns and manages over 350 indices, with 117 ETFs listed in India and 12 ETFs listed abroad using these products as benchmarks.
- MSCI and other global providers build indices that are used by international fund managers to earmark assets to stocks in different markets.
- The methodologies usually provide for a review of the index composition or cessation of specific indices owing to factors such as exceptional circumstances, market disruptions or difficulty in replicating the indices.
- However, they are not regulated by the Securities Exchange Board of India (SEBI).

What has SEBI proposed?

- Noting the growing dominance of Index Providers due to proliferation of passive funds that drive capital flows towards assets that are part of a particular market index, SEBI has proposed to bring them under its regulatory purview.
- The plan, likely to be implemented soon, includes mandating SEBI registration for index providers and subjecting them to norms pertaining to eligibility criterion, compliance, disclosures and periodic audits.
- Penal action is envisaged by SEBI in case of non-compliance and incorrect disclosures, among other things.

Why SEBI wants to regulate index funds?

- While there is an element of transparency in their functioning, SEBI believes it is possible for index makers to exercise discretion.
 - E.g., these index makers can bring changes in methodology resulting in exclusion or inclusion of a stock in the index or change in the weights of the constituent stocks.
 - Their decisions not only impact volumes, liquidity and price of such stocks but also impact index funds' returns to investors.
 - Concerned about possibilities of conflict of interest arising in the governance and administration of indices, SEBI has proposed to introduce an accountability mechanism for them.
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Q1) What is MSCI?

MSCI (Morgan Stanley Capital International) is a provider of investment decision support tools, including indices, portfolio risk and performance analytics, and governance tools. MSCI is best known for its global equity indices, which are widely used by investors to benchmark their portfolios against the overall stock market or specific market segments.

Q2) What are ETFs?

ETFs (Exchange-Traded Funds) are a type of investment fund that trades on stock exchanges like individual stocks. An ETF holds a basket of assets, such as stocks, bonds, or commodities, and its price reflects the performance of the underlying assets.

Source: [Explained | Why are index makers attracting attention from SEBI?](#) | [Investor.gov](#) | [CNBC](#)

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