Consultation Paper on implementation of eligibility criteria for derivatives on Non-Benchmark Indices based on SEBI circular dated May 29, 2025

1. **Objective**:

1.1. SEBI vide circular SEBI/HO/MRD/TPD-1/P/CIR/2025/79 dated May 29, 2025 has stipulated following prudential norms pertaining to Non Benchmark Indices under section 'Eligibility criteria for Derivatives on Non-Benchmark indices':

1.1.1. Minimum of 14 constituents.

1.1.2. Top constituent's weight $\leq$ 20%

1.1.3. Combined weight of the top three constituents $\leq$ 45%

1.1.4. All other constituents' individual weights must be lower than those of the higher-weighted constituents (i.e. a descending weight structure)

1.2. This consultation paper examines approaches evaluated by Stock Exchanges with regard to operationalization of the aforesaid stipulation in case of existing Non-Benchmark Indices already having derivatives contracts on them.

2. **Background**

2.1. The stipulation mentioned at para 1.1 was with an objective to ensure that the Non-Benchmark Indices having derivatives contracts are broad-based and not concentrated with top few constituents.

2.2. As each exchange would have their own Non-Benchmark Indices, the aforesaid stipulation was examined by them individually. The alternatives evaluated by them are as follows:

Alternative A: To introduce a new Non-Benchmark Index which meets the eligibility criteria and offer derivatives on them. The old as well as new indices would remain functional and available.

Alternative B: To adjust the constituent structure in the existing index – in terms of number of constituents and their weights.

2.3. While evaluating the aforesaid alternatives, a key factor is to gauge the quantum of passive funds i.e. ETFs/Index Funds tracking these Non-Benchmark Indices, as the option selected would have impact on the investments / tracking error of these funds. For instance, if Alternative A is opted, there would be no adjustment required for ETF/Passive Funds tracking these indices. On the other hand, for Alternative B, the ETF/Passive Funds will have to adjust their portfolio to track the index with changes in constituents / weights. The proposals of the two exchanges (i.e. BSE and NSE) are summarized below:

2.3.1. BSE has informed that it has one existing Non-Benchmark Index requiring adjustment in line with the stipulation mentioned at para 1.1 (i.e. BANKEX with 10 constituents). However, the said index does not have any passive funds (ETF/index funds or otherwise) tracking the index. Hence, for ease of convenience of market participants, the preference is Alternative B i.e. weight/constituent adjustment in the said index. This could be achieved in one go.

2.3.2. NSE has informed that it has two Non-Benchmark Indices requiring the stipulation mentioned at para 1.1 (i.e. Nifty Bank having 12 constituents and Nifty Financial Services having 20 constituents). Further, as of June 30, 2025, there is tracking of approx. Rs. 34,251 crores and Rs. 511 crores respectively. The weightage of constituents in one index is in the range of around 29% to 2% and in another index is in the range of around 33% to 0.4%

2.4. To evaluate the two alternatives mentioned above, NSE carried out discussions with various market participants including Mutual Funds, AMFI representatives, etc. During the discussions, it was represented by market participants that using existing Non-Benchmark Indices for derivatives over prescribing new indices for them would be beneficial on account of following reasons:

2.4.1. To extend benefits of diversification of a derivatives index to ETF/Index funds.

2.4.2. To preserve liquidity and market-making ecosystems built around these indices

2.4.3. To ensure continuity and avoid disruption in derivative contracts linked to these indices

2.4.4. To minimize investor confusion associated with multiple indices on same sector and maintain the brand identity of indices

2.5. In view of the aforesaid submissions from market participants, the preference of NSE is also Alternative B i.e. weight/constituent adjustment in the existing indices. However, given the existing weights and those stipulated under prudential norms, the adjustment in weights of constituents, if Alternative B is opted, may require a glide path of implementation (explained subsequently)

Points for Deliberation

3. Based on the aforesaid points, following decisions emerge on the prudential norms for constituents and their weights:

3.1. While the SEBI stipulation at para 1.1 was applicable to Non-Benchmark Indices having derivatives contracts on them, stock exchanges have proposed the option of weight adjustment in existing indices. Do you agree with the said approach?

3.2. If answer to the question above is yes, views may be provided on the modalities of weight adjustment process in the existing Non-Benchmark Indices having derivatives and ETF/Index Funds tracking on them:

3.2.1. Modalities of glide path for weight adjustment:

3.2.1.1. As the ETF Asset Under Management (AUM) tracking Nifty Financial Services is around Rs. 511 cr. as of June 30, 2025, should the weight/constituent adjustment be carried out in single tranche?

3.2.1.2. Given the ETF AUM tracking Nifty Bank is significant (i.e. Rs. 34,251 cr. as of June 30, 2025) combined with present weight of constituents highlighted at Para 2.3.2 and the prudential norms specified at Para 1.1, it may be desirable to carry out the weight/constituent adjustment in multiple tranches preferably through four tranches over a period of four months. This would ensure that the inflow/outflow in the constituents on account of the change happens in staggered and orderly manner. The details along with the example are provided below:

3.2.1.2.1. The new constituents would be added in tranche 1. The top 3 constituents will have a target weight at the end of tranche 4. In each adjustment, the weight of top 3 constituents would be checked and if the weights are beyond the prudential norms, the excess would be targeted for reduction equally over the remaining tranches. This is illustrated with an example below.

3.2.1.2.2.Assume the present weight of a constituent at Rank 1 by weight is 28% and the target weight is 20% (i.e. weight adjustment is 8%).

3.2.1.2.3.In the first tranche, the weight would be adjusted by 2% (i.e. 8% divided in 4 tranches) to 26%. At the beginning of the next tranche, weights of all the constituents would be re-evaluated for confirmation with prudential norms. Let's assume that the weight of Rank 1 constituent by weight drifted to 25.5% because of inter tranche price movement of constituents. Now, the remaining weight i.e. 25.5-20 = 5.5% would be adjusted by 1.833% in the instant tranche (i.e. 5.5/3) and so on.

3.2.1.2.4.The iterative process for all tranches is summarized in the table below continuing the same example discussed above:

Month	**Weight at the start of the month/tranche**	**Formula**	**calculation**	**Adjusted weight**
Start of Month 1:	28%	(Actual weight -desired weight)/4	(28-20) = 2%	26%
Start of Month 2:	25.5%	(Actual weight -desired weight)/3	(25.5-20)/3 = 1.83%	23.67%
Start of Month 3:	23%	(Actual weight -desired weight)/2	(23-19*)/2=1.65%	21%
Start of Month 4:	20.9%	(Actual weight -desired weight)	20.9-18.5*=2.4%	18.5%

*It is assumed that based on relative price movement of the constituents and hence their free float market cap, the target weight of the instant constituent changed.

3.2.1.2.5.It may be noted that the example mentioned above is only for illustration purpose and do not represent actual numbers.

3.2.1.2.6. The excess weight after adjustment from the top constituents would be distributed amongst the other constituents as long as they meet the prudential norms mentioned at Para 1.1.

3.3. Whether the aforesaid proposal mentioned at Para 3.2 is in order? If no, suitable recommendations on operationalization of prudential norms may be provided.

4. Accordingly, views of relevant stakeholders are being sought on proposal mentioned at para 3.1 and 3.2 above w.r.t. prudential norms stipulated by SEBI at para 1.1 above for weight adjustment of existing Non-Benchmark Indices having derivatives contracts on them.

5. Invitation for Public Comments

5.1. Public comments are invited on the approach mentioned in this consultation paper. The comments/ suggestions should be submitted latest by **September 8, 2025,** through the online web-based form which can be accessed using the following link: https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes

5.2. The instructions to submit comments on the consultation paper are as under:

1. *Before initiating the process, please read the instructions given on top left of the web form as "Instructions".*
2. *Select the consultation paper you want to comment upon from the dropdown under the tab – "Consultation Paper" after entering the requisite information in the form.*
3. *All fields in the form are mandatory.*
4. *Email ID and phone number cannot be used more than once for providing comments on a particular consultation paper.*
5. *If you represent any organization other than the types mentioned under dropdown in "Organization Type", please select "Others" and mention the type, which suits you best. Similarly, if you do not represent any organization, you may select "Others" and mention "Not Applicable" in the text box. vi. There will be a dropdown*

of Proposals in the form. Please select the proposals one- by-one and for each of the proposal, please record your level of agreement with the selected proposal. Please note that submission of agreement level is mandatory.

6. If you want to provide your comments for the selected proposal, please select

7. "Yes" from the dropdown under "Do you want to comment on the proposal" and use the text boxes provided for the same.

8. After recording your response to the proposal, click on "Submit" button. System will save your response to the selected proposal and prompt you to record your response for the next proposal. Please follow this procedure for all the proposals given in the dropdown.

9. If you do not want to react on any proposal, please select that proposal from the dropdown and click on "Skip this proposal" and move to the next proposal.

10. After recording your response to all the proposals, you may see your draft response to all of proposals by clicking on "Check your response before submitting" just before submitting response to the last proposal in the dropdown. A pdf copy of the response can also be downloaded from the link given in right bottom of the web page. xi. The final comments shall be submitted only after recording your response on all of the proposals in the consultation paper.

5.3. In case of any technical issue in submitting your comment(s) through the web based public comments form, you may email your comment(s) to harshadp@sebi.gov.in and darshilb@sebi.gov.in . While sending the email, kindly mention the subject as "Consultation Paper on implementation of eligibility criteria for derivatives on Non-Benchmark Indices" based on SEBI circular dated May 29, 2025

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