



EQUITY MARKET

Index funds and ETFs

Two ways to hold a whole index in one scheme, what each costs, and what neither can do

Industry figures as on 31 August 2026

For training and education only. Not investment advice.

A passive fund does not try to beat its index. It tries to match it, less costs.

Nobody picks the shares. The index decides what the fund holds and how much of each. So the fund rises when the index rises and falls when the index falls.

Three terms to get right



Index

A list of securities chosen by a published rule, with a weight for each. The Nifty 50 is one. An index is a calculation. It cannot be bought directly.



Index fund

A mutual fund scheme that holds the index's securities in the index's weights. Units are bought from, and sold back to, the fund house at NAV.



ETF

Exchange traded fund. The same kind of portfolio, but the units are listed. Investors buy and sell them on a stock exchange at a market price.

Both are mutual fund schemes. Each must keep at least 95% of its assets in the securities of its index.

Source: SEBI Master Circular for Mutual Funds, 20 Mar 2026, para 3.8.5 (Index Funds/ETFs: minimum 95% in securities of the index).

Index fund and ETF, side by side

	Index fund	ETF
Where you deal	With the fund house, directly or through a distributor.	On a stock exchange, through a stock broker, in trading hours.
Price you get	The day's NAV, worked out after the market closes. One price a day.	The market price at that moment. It can be above or below the NAV.
Accounts needed	A folio with the fund house. No demat account is needed.	A demat account and a trading account with a broker.
What keeps it in line	The fund house itself issues and cancels units at NAV.	Market makers exchange large blocks, called creation units, with the fund house and quote prices on the exchange.
Costs outside the fund	Stamp duty of 0.005% on purchases. Exit load, if the scheme has one.	Broker's and statutory charges, and the gap between buying and selling quotes.

Source: SEBI Master Circular for Mutual Funds, 20 Mar 2026, paras 4.5.1, 4.5.2 and 4.5.9; stamp duty from Trustner Academy fact sheet, 7 Oct 2026.

Tracking difference: the gap in return

ONE YEAR, ASSUMED

The index, with dividends counted, returns 12.00% in a year.

An index fund tracking it returns 11.55%.

A person holds ₹1,00,000 in the fund at the start.

- 1 Tracking difference = fund return – index return = 11.55% – 12.00% = –0.45 percentage point.
- 2 At the index's return, ₹1,00,000 would have become ₹1,12,000. Nobody can hold the index itself, so this is only a yardstick.
- 3 In the fund it became $₹1,00,000 \times 1.1155 = ₹1,11,550$. The gap is $₹1,12,000 - ₹1,11,550 = ₹450$.
- 4 The gap comes mainly from the fund's expenses, the cash it keeps for redemptions, and the cost and timing of its own trades.

Tracking difference is the fund's return minus the index's. Here it is –0.45 point: 0.45 given up.

Illustration with assumed figures. Not a forecast, and not the return of any index or scheme.

Tracking error: how steady the gap is

FIVE DAYS, ASSUMED

Each day, take the fund's return minus the index's return.

Over five days the differences are +0.02%, -0.02%, +0.02%, -0.02% and 0.00%.

- 1 The average of the five differences is 0.00%. On average the fund kept pace over these days.
- 2 Square each difference and add them up: $4 \times 0.0004 = 0.0016$. Divide by 4, one less than the five days: 0.0004.
- 3 The square root of 0.0004 is 0.02. So the daily standard deviation of the difference is 0.02%.
- 4 To put it on a yearly scale, multiply by the square root of 250 trading days (assumed), about 15.81: $0.02\% \times 15.81 = \text{about } 0.32\%$.

Tracking error measures how much the daily gap wobbles. Lower means a steadier gap, not a smaller one.

Illustration with assumed figures. A real tracking error uses a full year of daily data.

What a passive fund costs



The cap: 0.90%

SEBI caps the base expense ratio of an index fund or ETF at 0.90% a year. A scheme may charge less. Each discloses its own ratio.



On top of the base

Brokerage and transaction costs on the fund's trades, and statutory levies such as GST, are charged on top of it under the 2026 Regulations.



Outside the fund

Index fund: stamp duty of 0.005% on each purchase.
ETF: broker's and statutory charges, and the buy-sell quote gap, on each trade.

Assumed example: at an expense ratio of 0.20%, ₹1,00,000 held for a year bears about ₹200 of expenses.

Sources: SEBI (Mutual Funds) Regulations, 2026, regulations 66-67; Trustner Academy fact sheet (investments), 7 Oct 2026.

What an index fund cannot do



Step aside in a fall

It stays invested. If the index falls 20%, ₹1,00,000 in the fund becomes about ₹80,000, less costs. Nobody moves it to cash.



Beat its index

Its aim is to match. After expenses it usually ends a little behind the index, which is what the tracking difference records.



Choose what it holds

It holds what the index holds, in the index's weights. A narrow or top-heavy index gives a narrow or top-heavy fund.

Passive describes how the securities are chosen. It says nothing about how far their prices can fall.

Where passive assets stand

Index funds and ETFs in India at the end of August 2026. AMFI publishes these figures every month.

PASSIVE AUM, ₹ LAKH CRORE

15.42

17.7% of the industry's ₹87.08 lakh crore. Up 26.5% in one year.

ETFs, ₹ LAKH CRORE

11.97

Includes equity ETFs ₹8.18 lakh crore and gold ETFs ₹1.91 lakh crore.

INDEX FUNDS, ₹ LAKH CRORE

3.45

Equity index funds ₹2.51 lakh crore; debt index funds ₹0.94 lakh crore.

FOLIOS, CRORE

5.55

Folios in index funds and ETFs, of 28.35 crore in all. Not investors.

Source: AMFI Monthly Note, August 2026 (month-end assets and folios; 'passive' means index funds and ETFs). The 17.7% share is computed from the same table.

If you learnt this from older material

What older decks say

- Tracking error is the one number to look at.
- Any large investor can deal with the fund house.
- Authorised participants (old term) supply liquidity.
- Passive funds track share indices or gold.

What holds now

- Tracking error is disclosed daily and tracking difference monthly.
- Only for more than ₹25 crore. Others trade on the exchange.
- Each ETF must have at least two market makers.
- Debt, silver and hybrid index products also exist.

Source: SEBI Master Circular, 20 Mar 2026, paras 4.2 and 4.5.1-4.5.8, citing circulars of 24 Nov 2021, 23 May 2022, 28 Jul and 28 Oct 2022 and 31 Dec 2024.

Four things people get wrong



'Passive means low risk.'

A passive fund carries the full market risk of its index. An index of smaller companies moves like smaller companies.



'An ETF trades at its NAV.'

It trades at a market price. With a NAV of ₹250 and a price of ₹251, the buyer pays a premium of 0.40%.



'An index fund equals the index.'

It usually trails by its costs. Compare the fund with the total return index, which counts dividends as well as prices.



'Two funds on one index are the same.'

Expense ratio, tracking difference and tracking error differ from scheme to scheme. For ETFs, so does trading volume.

Check yourself

Q1

An index returns 9.00% in a year, dividends included. An ETF tracking it returns 8.70% on NAV. What is the tracking difference, and the rupee gap on ₹2,00,000?

Q2

An ETF's NAV is ₹400.00 and its units are trading at ₹398.00. Is that a premium or a discount, and how large?

Q3

A client says: 'I am in an index fund, so I am protected if the market falls.' What would you explain?

Sources and disclaimer

SOURCES FOR THE FIGURES IN THIS DECK

- Passive, ETF, index fund and industry assets and folios, 31 August 2026: AMFI Monthly Note, August 2026.
- 95% minimum in index securities; market makers, creation units, ₹25 crore floor: SEBI Master Circular for Mutual Funds, 20 March 2026, paras 3.8.5 and 4.5.1 to 4.5.3.
- Tracking error and tracking difference, 7-day rebalancing, indicative NAV: same Master Circular, paras 4.5.4, 4.5.5 and 4.5.9.
- Base expense ratio cap of 0.90%: SEBI (Mutual Funds) Regulations, 2026, regulations 66-67, in force 1 April 2026.
- Stamp duty of 0.005%; no demat account for an index fund: Trustner Academy verified fact sheet and scheme-types lesson, 7 October 2026.
- Returns, NAVs, prices and expense ratios in the worked examples are assumed. They do not refer to any real index or scheme.

This material is for training and investor education only. It is not investment, tax or legal advice and is not a recommendation to buy, sell or hold any security or scheme. Examples use assumed figures unless a source and date are shown. Mutual fund investments are subject to market risks; read all scheme related documents carefully. Trustner Asset Services Pvt. Ltd. is an AMFI-registered Mutual Fund Distributor (ARN-286886).