

Consultation on revision in stock selection methodology of the Nifty Next 50 index

Background:

The Nifty Next 50 index represents the balance 50 companies from Nifty 100 index after excluding the Nifty 50 companies. The review of the Nifty Next 50 index is undertaken semi-annually in February and August based on data for six months ending January and July respectively. The replacement of stocks in Nifty Next 50 index is implemented from the last trading day of March and September. The weight of each stock in the index is based on its free-float market capitalization. The cumulative weight of the non-F&O stocks is presently capped at 10% and are individually capped at 4.5% each on a quarterly basis in March, June, September, and December.

For detailed methodology of the Nifty Next 50 index refer

https://www.niftyindices.com/Methodology/Method_NIFTY_Equity_Indices.pdf

Challenges in the existing approach:

Currently, there are 20 passive funds tracking the Nifty Next 50 index with a total AUM of ~Rs. 11,600 Cr as on March 31, 2023 (7 ETFs with AUM of ~Rs. 5,560 Cr and 13 Index funds with AUM of ~Rs. 6,040 Cr).

With the number and asset size of passive funds tracking the Nifty Next 50 index increasing, ensuring index constituents liquidity and ease of index replication by passive funds gains more importance.

Presently out of 50 there are 11 stocks with a cumulative weight of 9.05%[^] as on May 16th, 2023, are not available in the derivative segment. The exposure of the index to such non-F&O stocks (that are being included in/ excluded from indices) frequently hitting the price bands, lowers the ability to replicate the index portfolio efficiently and thus increases the tracking error.

[^] The Nifty Next 50 index was last rebalanced on March 31, 2023; Thus, the stock weights can be higher or lower than the capping limits due to movement in stock prices between the two rebalancing period.

Proposed change to the stock selection methodology of the Nifty Next 50 index:

One way to resolve this issue of index replication is to only include those stocks into the Nifty Next 50 index that are available for F&O trading. Stocks that are available for F&O trading are typically more liquid and accessible than other stocks that are not available for F&O trading. Having only those stocks that are available for F&O trading into the Nifty Next 50 index shall improve the ease of replication of the index by passive funds. The below table summarizes the proposed changes in the index criteria for Nifty Next 50.

Parameter	Existing Methodology	Proposed Methodology
Universe	Nifty 100	Nifty 100 and Nifty Midcap 50
Eligibility criteria	Stock should not form part of the Nifty 50 index	<ul style="list-style-type: none"> - Stock should not form part of the Nifty 50 index - Stock should be available for trading NSE's Futures & Options segment (F&O) as on the review date
Stock Selection criteria	Balance 50 companies from Nifty 100 index after excluding the Nifty 50 companies	<p>Step 1: Eligible stocks from Nifty 100</p> <p>Step 2: Deficit no. of stocks from Nifty Midcap 50 based on 6 month avg. full market capitalization</p>
Compulsory Inclusion criteria	Stock included in the Nifty 100 index but not part of the Nifty 50 index	<p>Step 1: All F&O stocks in Nifty 100 excluding the stocks of Nifty 50 will compulsorily be part of the Nifty Next 50 index.</p> <p>Step 2: Further, deficit number of stocks (if any) shall be included from Nifty Midcap 50 if its 6 month Avg. Full Market Capitalization is at least 1.5 times of the existing smallest index constituents (other than the stocks identified in step 1 above) at the time of review</p>
Compulsory exclusion criteria	<ul style="list-style-type: none"> - Stock moves out of Nifty 100 index - Stock moved to the Nifty 50 index 	<ul style="list-style-type: none"> - Stock moves out or going to move out of the Nifty 100 or Nifty Midcap 50 - Stock is no longer available for trading NSE's Futures & Options segment (F&O) as on the review date
Capping Limit	<ul style="list-style-type: none"> - Cumulative weight of Non- F&O stocks is capped at 10% - Weight of non-F&O stocks are individually capped at 4.5% 	<ul style="list-style-type: none"> - Weight of each stock in the index is capped at 23% - Aggregate weight of top 3 stocks is capped at 62%
Additional Adhoc rebalancing/review	Index constituent undergoes any corporate action (scheme of arrangement, delisting etc.) or suspension by the exchange etc.	<ul style="list-style-type: none"> - Index constituent undergoes any corporate action (scheme of arrangement, delisting etc.) or suspension by the exchange etc. - Is no longer available for trading on NSE's F&O segment

Proposed implementation plan

In order to smoothly transit to the above proposed approach for the Nifty Next 50 index, we plan to implement the changes in two phases as described below:

Phase 1: - Reduce the cumulative weight of Non- F&O stocks in Nifty Next 50 index from the existing 10% to 5%. This is proposed to be effective June 30, 2023 (close of June 29, 2023). Effectively, cumulative weight of F&O stocks in the Nifty Next 50 index would be 95% and that of Non-F&O stocks would be 5% as on the effective date.

Phase 2: - Implement the proposed changes to the stock selection methodology of the Nifty Next 50 index as described above w.e.f. September 29, 2023 (close of September 28, 2023). Effectively only those stocks that are available for trading in NSE's Futures & Options segment shall be eligible to be the part of the Nifty Next 50 index.

For better clarity, below is the summary of changes along with effective dates, if the above plan is implemented:

Parameter	Existing Methodology	Phase 1	Phase 2
		Proposed Methodology w.e.f. June 30, 2023	Proposed Methodology w.e.f. September 29, 2023
Universe	Nifty 100	Nifty 100	Nifty 100 and Nifty Midcap 50
Eligibility criteria	Stock should not form part of the Nifty 50 index	Stock should not form part of the Nifty 50 index	<ul style="list-style-type: none"> - Stock should not form part of the Nifty 50 index - Stock should be available for trading NSE's Futures & Options segment (F&O) as on the review date
Stock Selection criteria	Balance 50 companies from Nifty 100 index after excluding the Nifty 50 companies	Balance 50 companies from Nifty 100 index after excluding the Nifty 50 companies	<p>Step 1: Eligible stocks from Nifty 100</p> <p>Step 2: Deficit no. of stocks from Nifty Midcap 50 based on 6 month avg. full market capitalization</p>
Compulsory Inclusion criteria	Stock included in the Nifty 100 index but not part of the Nifty 50 index	Stock included in the Nifty 100 index but not part of the Nifty 50 index	<p>Step 1: All F&O stocks in Nifty 100 excluding the stocks of Nifty 50 will compulsorily be part of the Nifty Next 50 index.</p> <p>Step 2: Further, deficit no. of stocks (if any) shall be included from Nifty Midcap 50 if its 6 month Avg. Full Market Capitalization is at</p>

Parameter	Existing Methodology	Phase 1	Phase 2
		Proposed Methodology w.e.f. June 30, 2023	Proposed Methodology w.e.f. September 29, 2023
			least 1.5 times of the existing smallest index constituents (other than the stocks identified in step 1 above) at the time of review
Compulsory exclusion criteria	<ul style="list-style-type: none"> - Stock moves out of Nifty 100 index - Stock moved to the Nifty 50 index 	<ul style="list-style-type: none"> - Stock moves out of Nifty 100 index - Stock moved to the Nifty 50 index 	<ul style="list-style-type: none"> - Stock moves out or going to move out of the Nifty 100 or Nifty Midcap 50 - Stock is no longer available for trading NSE's Futures & Options segment (F&O) as on the review date
Capping Limit	<ul style="list-style-type: none"> - Cumulative weight of Non- F&O stocks is capped at 10% - Weight of non-F&O stocks are individually capped at 4.5% 	<ul style="list-style-type: none"> - Cumulative weight of Non- F&O stocks is capped at 5% - Weight of non-F&O stocks are individually capped at 4.5% 	<ul style="list-style-type: none"> - Weight of each stock in the index is capped at 23% - Aggregate weight of top 3 stocks is capped at 62%
Additional Adhoc rebalancing/review	Index constituent undergoes any corporate action (scheme of arrangement, delisting etc.) or suspension by the exchange etc.	<ul style="list-style-type: none"> - Index constituent undergoes any corporate action (scheme of arrangement, delisting etc.) or suspension by the exchange etc. 	<ul style="list-style-type: none"> - Index constituent undergoes any corporate action (scheme of arrangement, delisting etc.) or suspension by the exchange etc. - Is no longer available for trading on NSE's F&O segment

Feedback for proposed changes to the methodology of the Nifty Next 50 index

Name of the respondent	Organization name	Email ID	Phone number

Sr. No.	Consultation Point	Agree/ Disagree	Rationale	Suggestions (if any)
1	To implement the proposed changes to the stock selection methodology of the Nifty Next 50 index			

Feedback from market participants is invited on the proposal contained in this paper. The feedback should reach NSE Indices latest by June 10, 2023

It may be noted that the feedback received from this consultation will be reviewed and considered by the Index Maintenance Sub-Committee (Equity). In case of any revision, a formal announcement shall be made through a press release. The consultation may or may not lead to the implementation of any or all of the proposed changes in Nifty indices.

Comments as per aforesaid format may be sent to the following, latest by June 10, 2023, in any of the following manner:

- a) By email to: index-consultation@nse.co.in; or
- b) By participating through '[Online survey](#)'; or
- c) By post to the following address

NSE Indices Limited

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Date: May 29, 2023