भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

Consultation paper on review of regulatory framework for Angel Funds in AIF Regulations

Objective

Angel Funds, a type of Category I AIFs - Venture Capital Funds, provide capital to start-ups from Angel Investors. Interest in this asset class has been growing, as seen in the rise of registered Angel Funds and their investments.

However, a review of the current regulatory framework indicates gaps in operational clarity and concerns about offering investment opportunities to a wide range of investors, some of whom may not have commensurate risk appetite. The existing prudential norms and investment conditions also require revision to provide more flexibility and ease of operations. Considering these issues and the recent Budget announcement of abolishing Angel Tax, a question arises on whether Angel Funds structure should continue to be regulated at all, under the SEBI (Alternative Investment Funds) Regulations, 2012 ('AIF Regulations').

This paper aims to seek views from public on the need for channelizing capital from Angel investor pools through a regulated structure. If the need for a regulatory environment for Angel Funds is acknowledged, this paper also aims to seek views on proposals to streamline regulatory framework for Angel Funds to –

(i) rationalise their fundraising processes,
(ii) strengthen disclosure and governance requirements, and,
(iii) provide operational clarity and investment flexibility.

These proposals aim to, *inter-alia,* restrict Angel Funds to investors with commensurate risk appetite and ability to evaluate investment proposals, while also enhancing the ease of doing business in this space.

Background

1. Angel Funds, a sub-category of AIF Regulations, play an important role in channelizing investments to start-ups. As of March 31, 2024, there are 82 Angel Funds registered with SEBI under the AIF Regulations, with a total of INR 7,053 Crore in commitments and INR 3,343 Crore in investments. Details of Angel Funds' activity over the past five years is as under:

Year	No. of registered Angel Funds	Commitments raised (in INR Cr)	Investments made (in INR Cr)
As on March 31, 2019	9	170	89
As on March 31, 2020	15	489	351
As on March 31, 2021	22	910	577
As on March 31, 2022	39	3,480	1,727
As on March 31, 2023	64	5,663	3,166
As on March 31, 2024	82	7,053	3,343

The Angel Fund industry has experienced significant growth over the past five years, with a compound annual growth rate (CAGR) of 106% in investments.

2. The regulatory framework for Angel Funds was introduced in the AIF Regulations in 2013 following the Budget announcement for FY 2013-14. The goal was to establish requirements for angel investor pools to be recognized as Category I AIF - VCFs, thereby encouraging angel investments and providing an exemption from the "Angel Tax" provisions under Section 56(2)(vii) of the Income Tax Act, 1961.

3. Angel Funds must raise capital from eligible Angel Investors and invest in start-ups as defined by the Department for Promotion of Industry and Internal Trade (DPIIT), Ministry of Commerce and Industry, Government of India. Before making any investment, the manager of an Angel Fund is required to obtain approval from investors on a deal-by-deal basis. This requirement distinguishes these Funds from other AIFs under the AIF Regulations. Additional differences are outlined in **Annexure A**.

4. Due to these unique features of Angel Funds, certain requirements (such as the use of a template PPM, auditing of PPM terms, and reporting to performance benchmarking agencies, etc.) were not initially made applicable to Angel Funds when the regulatory framework was introduced. These aspects were deferred for further examination.

5. Recently, SEBI has been in receipt of requests from AIF industry associations seeking a review of the regulatory provisions with respect to Angel Funds, including increasing the investment limit in start-ups, extending the investment horizon for angel investors, and removing the lock-in period.

6. Additionally, SEBI has observed inconsistencies in the operational practices of Angel Funds, such as commitment periods, closing procedures, and the offering of investment opportunities, due to a lack of explicit clarity in the current regulatory framework. This has led to frequent requests from industry stakeholders for clarifications and informal guidance.

7. In response, SEBI decided to conduct a comprehensive review of the regulatory framework for Angel Funds. A Working Group (WG) was established in July 2022, consisting mainly of Angel Fund managers and other stakeholders, to provide recommendations on this matter.

Consultation with Stakeholders

8. The WG submitted its recommendations on various provisions of Angel Fund framework. In its Report, WG also highlighted the existence of two types of Angel Fund structures within the AIF Industry:

   a) *One type of investment vehicle structurally resembles a VCF in terms of a defined corpus size, defined life of fund and so on, more like close ended Angel Funds (referred as 'traditional Angel Funds');*

   b) *The other type of vehicles are the angel networks that do not have a defined life or corpus size most of the time. Investors join when they feel the need to invest and leave the network when they do not wish to be part of network any longer (referred as 'platform Angel Funds').*

9. The WG noted that the existence of these two distinct types of Angel Funds pose challenges in linking fund milestones to metrics like corpus or establishing finite timelines tied to the fund's life and performance. The WG further suggested that its recommendations be viewed taking the same into account.

10. It was also observed that the current Angel Fund regulatory framework does not explicitly account for factors that enable "platform Angel Funds," which brings in complexities in implementation and monitoring of prudential norms and investment conditions.

11. While the recommendations of the WG and the issues in the extant regulatory framework for Angel Funds were being examined, the Government in its Budget Announcement for FY 2024 – 25, abolished Angel Tax for all classes of investors, to bolster the Indian start-up eco-system, boost the entrepreneurial spirit and support innovation. The merits in continuing to regulate Angel Funds while the Government has removed the Angel Tax, which was the primary objective for establishment of Angel Funds, needs to be analyzed. The issues highlighted above and proposals of WG to review the regulatory framework for Angel Funds were discussed in the meeting of SEBI's Alternative Investment Policy Advisory Committee (AIPAC) held on November 07, 2024. Based on the recommendations of the WG, AIPAC, and internal deliberations, the review of regulatory framework for Angel Funds is outlined in detail below.

Review of existence of Angel Funds as a regulated structure:

12. Due to removal of Angel Tax, the incentive for registration as an Angel Fund vis-a-vis direct investment by Angel Investors in start-ups, may need to be reviewed afresh. Hence, a fundamental question on regulating Angel Funds and thereby subjecting them to supervision and compliance costs associated with regulatory framework has arisen. There is an argument that the removal of taxation has incentivised Angel Investors to make direct investment in start-ups based on their own due diligence, which is expected to boost the entrepreneurial spirit and support innovation. On the other hand, Angel Fund framework provides Angel Investors an opportunity to avail expertise of experienced, professional fund managers in accessing and managing investments in start-ups along with discretion to invest in start-ups of their liking. Further, the investment is made and managed in the name of Angel Fund which offers ease of operation for start-ups and Angel Investors and bolsters the start-up ecosystem in the country.

13. Considering the need to weigh both the perspectives mentioned at Paras 13 and 14 above, an agenda was presented to AIPAC, seeking their comments and views on the matter –

    a) Need to continue with the Angel Fund framework, particularly since Angel Funds is a type of AIF without a blind pool of investment, and is a deal by deal investment based on investor consent; and,

    b) If AIPAC recommends continuation of a regulatory framework for Angel Funds, proposals to streamline and rationalize the same to-
        (i) Address the concerns in the current framework;
        (ii) Provide explicit clarity on various aspects of the framework,

(iii) Strengthen the governance and disclosure related norms, and,
(iv) Provide flexibility for making investments.

14. After discussions, the AIPAC recommended maintaining Angel Funds as a regulated structure, recognizing their importance in professionally managing Angel Investors' capital and their critical role in funding start-ups. AIPAC members also highlighted that besides AIFs, there may not be any other legitimate avenues for pooling funds to invest in start-ups.

Proposals for consideration:	
Proposal 1.	Should investments by Angel Investor pools through Angel Funds continue to be regulated by SEBI under AIF Regulations? Kindly provide your views with rationale for the same.

15. Considering AIPAC's recommendation on continuing with Angel Funds as a regulated structure, the proposals for reviewing the extant regulatory framework for Angel Funds were also discussed during the meeting. AIPAC endorsed the proposed framework, with suggestions for certain modifications, which have been discussed below.

Issues for consideration and proposals:

16. <u>Fund Raising by Angel Funds and Concept of Private Placement</u>

a) Angel investor is defined in the Regulations as any person who proposes to invest in an Angel Fund and satisfies one of the following conditions:
- Individual investor with net tangible assets of at least INR 2 Cr. excluding value of his principal residence and who (a) has early-stage investment experience; or, (b) has experience as a serial entrepreneur; or, (c) is a senior management professional with at least 10 years of experience.
- Body corporate with net worth at least INR 10 Cr.
- AIF registered under the AIF Regulations or VCF under the VCF Regulations.

b) To incentivise participation from various pools of capital, the WG recommended -
- expanding the scope of Angel Investors to include HUFs, family trusts, sole proprietorships, trusts, accredited investors,
- reducing net-worth criteria for body corporates, and,
- considering individuals with a 5 years' experience and a professional qualification as Angel Investor.

c) **Third-Party Verification of Investors' Eligibility**: Since investments in start-ups are highly risky and investor consent is required for each investment, Angel Investors must have the necessary risk appetite and be well-informed about the risks involved. SEBI observed during its supervision processes that Angel Fund managers often rely on self-declarations and social media profiles to verify investor eligibility. There is a need for third-party verification to ensure that investors meet the required criteria.

Also, the net worth requirement for Angel Investors, set in 2013, is no longer sufficient to assess risk appetite, leading to the on-boarding of investors who may not have the necessary understanding or risk tolerance.

d) **Platform Angel Funds**: Reg. 19E(2) limits Angel Funds to no more than 200 investors contributing to a specific investment. However, there is no cap on the total number of investors that can be offered an investment opportunity. Some Angel Funds, known as 'platform Angel Funds,' have long tenures and use web-based platforms to onboard large numbers of investors. These funds may offer investment opportunities to more than 200 investors but restrict contributions to 200.

e) When the Angel Fund framework was introduced, the number of investors was initially capped at 49 to ensure that investment in a company is not akin to public offerings. This limit was later raised to 200, in line with changes in the Companies Act. However, the 200-investor limit in the Companies Act is tied to invitation to subscribe or offer, not just allotment. This is a key distinction in the context of Angel Funds. Offering investment opportunities to a large number of investors, while restricting contributions to 200, raises concerns that this could be seen as a public issue, undermining the original intent of the Angel Fund regulations in limiting the number of investors to 200 in an investment. The said concern, combined with those regarding veracity of angel investors being on-boarded, exacerbates the issues with the existing eligibility criteria for angel investors.

f) **Proposed Eligibility Criteria**: To ensure that Angel Funds only on-board investors with the necessary risk appetite, it is proposed to allow only "Accredited Investors" to invest in Angel Funds. Accredited Investors are required to meet commensurate net-worth criteria, which will be verified by a third-party accreditation agency. The eligibility criteria for Accredited Investors and modalities for accreditation are given here. It is expected that the eligibility criteria for Accredited Investors would allay concerns regarding investors without the necessary risk appetite, evaluating and making investments in start-ups through Angel Funds. Further, considering this proposal, certain flexibility in operations may be extended to Angel Funds while strengthening their disclosure and governance requirements.

g) If only Accredited Investors are allowed to invest, there may be no need for a cap on the total number of investors who may be on-boarded to an Angel Fund. However, the 200-investor limit per company of Angel Fund will remain, applicable annually, and excluding Qualified Institutional Buyers (QIBs) as defined under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

h) **Investments by Manager/Employee**: The WG further recommended allowing employees, directors, advisors, and full-time consultants of Angel Funds or their managers to invest with a minimum of INR 5 lakhs. Allow employees and directors of Angel Fund and its manager to invest in Angel Funds with a specified minimum investment amount, would align with the flexibility given in other AIFs, enhancing the "skin in the game" for managers and related entities.

AIPAC noted that these proposals aim to strengthen the regulatory framework for Angel Funds, ensuring that they attract investors with the appropriate risk appetite and align with the intended private placement nature of the funds. After discussions, AIPAC recommended these proposals along with a simplification of the accreditation process. They also suggested providing a transition period for existing Angel Funds to adapt to this new framework.

Proposals for consideration:	
Proposal 2.	To replace the existing eligibility criteria for Angel Investors with allowing only Accredited Investors to be on-boarded as investors to Angel Funds.
Proposal 3.	The number of investors who can contribute for investment in a particular investee company of an Angel Fund shall not exceed 200 during a Financial Year, excluding investors who are Qualified Institutional Buyers.
Proposal 4.	To allow employees and directors of Angel Fund and its manager to invest in Angel Fund with minimum investment amount of INR 5 lakh.

17. <u>Minimum Investment Amount and Commitment Period for Investment</u>

(a) **Commitment Period for drawing down capital**: Reg. 19(D)(3) of AIF Regulations provides that "*Angel funds shall accept, up to a maximum period of 5 years, an investment of not less than INR 25 lakhs from an angel investor*". The WG suggested clarifying that this 5-year period applies to each individual angel investor, not to the Angel Fund as a whole. This would imply that the 5-year period refers to the maximum duration an Angel Fund can accept investments from each investor, rather than the total duration for the entire fund to onboard investors and draw down capital.

(b) The regulatory intent here is to limit how long Angel Funds can accept capital from an investor. Further, it is possible that an investor's commitment is not fully drawn down of within the 5-year period may not have happened due to various factors like limited investment opportunities, mismatched interests, or lack of investor approval for certain opportunities, etc. Additionally, an investor might be willing to wait for future opportunities beyond the 5 years.
Given that only Accredited Investors are allowed to invest in Angel Funds, and there is no minimum investment requirement for such investors in AIFs, it is proposed to remove Regulation 19(D)(3) of AIF Regulations.

(c) **Removal of Minimum Corpus Requirement**: Reg. 19D(2) of AIF Regulations requires Angel Funds to have a minimum corpus of INR 5 crore, which is defined as the total funds committed by investors to the fund. However, since only Accredited Investors is proposed to be allowed to invest, there will be no minimum commitment requirement for them. The concept of calculating Angel Fund's corpus based on investor commitments, hence becomes irrelevant.

(d) Therefore, it is proposed to remove the minimum corpus requirement for Angel Funds. However, to ensure sufficient investor interest prior to starting to make investments, Angel Funds would need to onboard at least a minimum number of Accredited Investors before conducting the first close. AIPAC recommended a threshold of 5 Accredited Investors for conducting first close.

(e) Since the concept of "corpus" becomes irrelevant under the proposed framework, other limits in the current regulatory framework (such as the permissible limit for overseas investment or the continuing interest of sponsors/managers) may be linked to the total investments made by the Angel Fund, rather than its corpus.

AIPAC noted that these proposals aim to simplify and align the regulatory framework with the shift towards Accredited Investors, removing outdated requirements while ensuring Angel Funds remain adequately capitalized and operationally efficient. After deliberations, AIPAC recommended the same.

Proposals for consideration:	
Proposal 5.	To remove Regulation 19(D)(3) of AIF Regulations specifying minimum investment amount and commitment period for angel investors.
Proposal 6.	To replace the requirement of minimum corpus of the Angel Fund of INR 5 Crore with requirement that Angel Fund shall start investing only after on-boarding minimum 5 Accredited Investors.
Proposal 7.	All the existing conditions linked to corpus/investable funds of Angel Fund may instead be linked to the total amount contributed by all the angel investors in the investments of the Angel Funds subject to their consent/approval.

18. <u>Limits for investments by Angel Funds in start-ups -</u>

(a) **Investment Limits:** Reg 19F(2) of AIF Regulations provides that the investment by an Angel Fund in a start-up shall not be less than INR 25 lakh and shall not exceed INR 10 Crore. The WG recommended that the minimum investment limit be reduced to INR 10 lakh and that the maximum investment limit be increased to INR 25 crore. This change is to reflect the growth of the angel ecosystem and the increasing interest in angel investments as an asset class.

(b) In 2017, the minimum investment requirement was lowered from INR 50 lakh to INR 25 lakh, and in 2018, the maximum investment limit was increased from INR 5 crore to INR 10 crore. Before the recent abolishment of the Angel Tax provisions, the eligibility for start-ups to qualify for the exemption was based on a paid-up share capital and share premium amount of INR 25 Cr. (raised from INR 10 Cr., in 2019). This proposal further aligns with these previous changes, considering the evolving market dynamics. It is therefore proposed to reduce the lower limit for investment in a start-up to INR 10 lakhs and increase the upper limit to INR 25 crore.

(c) **Diversification Requirement:** Reg 19F(5) of AIF Regulations currently mandates that no more than 25% of the total investments under all schemes of an Angel Fund can be made in a single venture capital undertaking, provided that the compliance to this regulation shall be ensured by the Angel Fund at the end of its tenure. However, adhering to this requirement at the end of the fund's tenure has been found to be neither feasible for Angel Funds nor easily verifiable by the regulator. Further, meeting the diversification requirement only at the end of the fund's life cycle does not adequately mitigate investment concentration risks.

Given that only Accredited Investors will be allowed to invest and that investor consent is required for each investment, it is proposed to remove the diversification norm for Angel Funds.

(d) However, to prevent Angel Funds from becoming vehicles for single-investor or single-investment structures, it is proposed that each investment made by an Angel Fund must involve contributions from at least three investors (excluding the manager/sponsor). This requirement ensures broader participation in each investment.

(e) The proposal also includes mandating disclosure to investors when an Angel Fund proposes to invest in a group company or a related party of an existing investee company. This disclosure would be made at the time of obtaining investor consent for the investment, ensuring transparency.

AIPAC noted that these proposals aim to refine and update the regulatory framework for Angel Funds, ensuring that they remain effective, transparent, and aligned with the growing angel investment landscape while mitigating potential risks. After deliberations, AIPAC recommended these proposals.

Proposals for consideration:	
Proposal 8.	Investment by an Angel Fund in any start-up shall not be less than INR 10 Lakhs and shall not exceed INR 25 Crore.
Proposal 9.	To remove 25% diversification limit for Angel Funds specified in Regulation 19F(5) of AIF Regulations.
Proposal 10.	Each investment of an Angel Fund shall have contribution from minimum 3 Accredited Investors (other than contribution from manager/sponsor of the Angel Fund towards maintaining continuing interest).
Proposal 11.	In case an Angel Fund is proposing to make investment in a group company/related party of an existing investee company, then the same shall also be disclosed to the investors at the time of obtaining consent from the investors.

19. <u>Investment Avenue for Angel Funds</u>

(a) **Investment in Unlisted Companies**: Angel Funds are mandated to invest only in start-ups as defined by DPIIT, which meet certain specified conditions. The WG proposed allowing Angel Funds to invest up to 25% of their investable funds in other VCUs or unlisted companies, as well as in units of other Angel Funds or Category I AIFs. They also recommended allowing follow-on investments in portfolio companies that are no longer classified as start-ups.

(b) The regulatory intent behind Angel Funds is to channel investments into genuine Indian start-ups. Allowing investments in other unlisted companies (that are not start-ups) could dilute this intent. Therefore, it is proposed that Angel Funds should not be allowed to invest in companies other than start-ups.

(c) Further, Angel Funds are designed for deal-by-deal investments with specific investor approval for each investment, so that the investors evaluate the investment opportunity in an investee company independently. Permitting them to invest in units of other Angel Funds or AIFs would negate this and create a layering effect and potentially obscure transparency.

(d) **Follow-On Investments in Portfolio Companies**: The WG highlighted that the current restriction on investing only in start-ups is a barrier for Angel Funds exercising pre-emptive rights in their portfolio companies once those companies are no longer considered start-ups. The WG recommended allowing Angel Funds to make follow-on investments to protect and preserve the value of their initial investments. While this recommendation is reasonable, it is suggested that follow-on investments should only be allowed for existing investors in the company who had invested when it was still a start-up, to protect their initial stakes.

(e) It is proposed to allow Angel Funds to make follow-on investments in their portfolio companies that are no longer start-ups, but with safeguards in place to ensure this flexibility is not misused. These safeguards would preserve the regulatory intent of Angel Funds while enabling existing investors to protect their investments.

AIPAC noted that the proposal seeks to maintain the integrity of Angel Funds while providing flexibility for follow-on investments, ensuring the funds remain focused on genuine start-ups and safeguarding investor interests. After discussions, AIPAC recommended the same.

Proposals for consideration:	
Proposal 12.	Angel Funds may be allowed to make follow-on investment in its existing portfolio investee company (which is no longer a start-up), subject to the following conditions: - Contribution to be accepted only from the investors who had contributed in the existing investment in the portfolio investee company when it was a start-up, to the extent that the post-issue beneficial interest of the Angel Fund in the investee company does not exceed that prior to the follow-on investment. - Follow-on investment shall not be in breach of the maximum permissible investment limit in an investee company (proposed to be INR 25 crore).

20. <u>Lock in of Investment</u>

(a) **Lock-in period:** The WG has recommended removing the one-year lock-in period for Angel Fund investments in start-ups, provided that any exits from the start-up are not made via sale to the promoters or their affiliates.

(b) Initially, when the Angel Funds framework was introduced, a 3-year lock-in for each investment was required. This was later reduced to 1 year in 2017. While other categories of AIFs do not have such a lock-in requirement, this was introduced for Angel Funds to ensure that start-ups receive long-term capital, which is crucial for their growth. The lock-in period is primarily intended to prevent premature exits that could destabilize the start-up. In the case of a secondary sale (i.e., sale to a third party), capital raised by the start-up remains unaffected. However, completely removing the lock-in could undermine the stability of management of the investee company, which is a key concern.

(c) To balance the need for flexibility with regulatory intent, it is proposed to reduce the lock-in period to 6 months for any Angel Fund which exits by way of sale to a third party (other than the start-up or its promoters/affiliates). This would allow some flexibility for exits while still maintaining the stability of the start-up's capital base.

AIPAC noted that this proposal aims to align the exit flexibility with the need for long-term capital support for start-ups while preventing destabilizing exits to promoters or affiliates. After discussions, AIPAC recommended the same.

Proposals for consideration:	
Proposal 13.	The lock in requirement for investment by Angel Fund in a start-up to be reduced to 6 months in case that Angel Fund sells the investment to a third party.

21. <u>Offering and Allocation of Investments by Angel Funds -</u>

(a) **Challenges in Investment Allocation**: There is lack of clarity in Angel Fund industry regarding how to allocate an identified investment opportunity among investors, as each investor may have different investment commitments, and some may choose not to invest in a particular opportunity. Additionally, if investors are willing to invest different amounts than those initially offered, there is uncertainty around how to allocate the investment across consenting investors.

The WG suggested that investments under each scheme be offered and allocated to investors as specified in the PPM of the Angel Fund. They also recommended allowing Angel Funds to selectively offer investments to a subset of their investors.

(b) Allowing discretion to the fund manager in offering investment opportunities could lead to unequal treatment among investors (non-pari passu rights), which may result in preferential treatment for certain investors. To avoid this, it is proposed that investment opportunities should be offered to all investors of the Angel Fund.

(c) While investment opportunities must be offered to all investors, flexibility in the manner of allocation is necessary, as investors may opt to contribute different amounts.

AIPAC noted that this proposal aims to ensure fairness and transparency in the allocation of investment opportunities while giving Angel Funds some flexibility in managing the varying investment sizes of different investors. AIPAC recommended the proposal but also emphasized that the manager must strictly adhere to the allocation methodology disclosed in the PPM. The manager should not have unilateral discretion in how investments are allocated among investors.

(d) Further, AIFs are required to maintain rights of investors in an investment, including distribution of proceeds, pro-rata to their commitment to the scheme. The said requirement is not applicable to Angel Funds, considering that each investor may have varying amount of contribution in each investment of the Angel Fund. The extant regulatory framework for Angel Funds is silent in this regard. Considering the proposal to remove commitment requirement for Angel Funds, the rights of investors shall be maintained in each investment, pro-rata to their contribution to the said investment.

Proposals for consideration:		
Proposal 14.	-	Each investment opportunity shall be offered to all the investors; and allocation of contribution in an investment among consenting investors shall be in the manner as explicitly disclosed in the PPM.
	-	A clear methodology for allocation of investment among consenting investors shall be disclosed in the PPM. Such methodology shall be objective and not provide the manager a blanket/plain discretion or discretion to decide the allocation on a case to case basis.
Proposal 15.	-	The investors of an Angel Fund shall have rights in an investment and in distribution of proceeds of such investment, pro-rata to their contribution to the said investment.

22. Sponsor/Manager's Continuing Interest

(a) Reg 19(G)(2) of AIF Regulations requires the manager and/or sponsor of an Angel Fund to maintain a continuing interest of at least 2.5% of corpus, or INR 50 lakh, whichever is lesser. However, due to the deal-by-deal structure of Angel Funds, there is a lack of clarity on how this continuing interest should be maintained across individual investments, particularly in ensuring the manager/sponsor's "skin-in-the-game."

(b) The regulatory intent behind the skin-in-the-game requirement is to align the interests of the manager/sponsor with those of the investors. To achieve this more effectively, the proposal suggests that the sponsor/manager should maintain a minimum continuing interest in each investment, rather than at the fund level. This would ensure that the manager/sponsor has an interest in every individual deal.

Some members of the AIPAC acknowledged that this requirement could become burdensome for sponsors/managers as the Angel Funds scale up. AIPAC noted that this proposal aims to strengthen the accountability and alignment of interests between the Angel Fund managers/sponsors and the investors by requiring a continuing interest in each individual investment. After deliberations, the Committee recommended the proposal.

Proposals for consideration:	
Proposal 16.	Sponsor/manager of Angel Fund to maintain minimum continuing interest of 0.5% of the investment amount or INR 1,00,000 whichever is higher, in each investment of Angel Fund.

23. Concept of schemes in Angel Funds

(a) Reg 19(E)(1) of AIF Regulations requires Angel Funds to file a term sheet with SEBI containing material information about the scheme before launching it. The term sheet format, as specified in the SEBI Master Circular of May 07, 2024, requires details about each investee company for which an investment is proposed.

(b) Considering the provisions of Regulation 19(E)(1) stated above and that the term sheet is filed for each investment, it may be interpreted that the scheme launched by Angel Funds indeed refers to an investment made by the Angel Fund. However, the same creates ambiguity in the industry (as in case of other AIFs, where a scheme represents a blind pool of multiple investments).

(c) To address this, the WG recommended that the term sheet should be filed after the definitive agreements are executed with the investee company, but prior to making the investment. Additionally, no annual compliance for updating the term sheet should be required.

(d) Angel Funds currently file the same only for informational purposes (not for seeking approval) and other categories of AIFs do not need to file the same before making investments. Given the same and since necessary information may be captured through periodic reporting to SEBI, it is proposed to remove the requirement of filing a term sheet altogether.

This aims to simplify the regulatory process and reduce redundancy by eliminating the term sheet filing requirement and instead relying on periodic reporting to SEBI. After discussions, AIPAC recommended the proposal.

Proposals for consideration:	
Proposal 17.	Regulation 19(E)(1) for filing term sheet may be deleted from AIF Regulations and consequently, any reference to the word 'scheme' may be either removed or suitably modified to reflect an 'investment', as the case may be.

24. Investor Consent for Investment

(a) As stated above, the key distinct features of an Angel Fund framework is the requirement of undertaking from every angel investor proposing to make investment in a start-up, confirming his approval for such an investment, prior to making such an investment.

(b) The WG recommended dispensing with this requirement for explicit investor approval before each investment. They suggested that an angel investor's initial election to invest in an Angel Fund should be considered as approval for any subsequent investments made by the fund, as requiring further approvals is repetitive and may delay decision-making.

(c) The existing regulatory framework allows angel investors to have discretion in participating in specific investment opportunities. The manager of the Angel Fund obtains an undertaking from each investor to confirm their participation in particular investments, which is meant to protect the investor's interests and ensures the agreed participation in that particular investment.

(d) Despite the WG's recommendation, SEBI is of the view that the requirement for investor consent before each investment is an integral and distinguishing feature of the Angel Fund structure, setting it apart from other categories of AIFs. Investors who do not wish to be involved in individual investment decisions can opt to invest in other AIFs, such as Category I AIF - VCFs. Therefore, the requirement for investor approval remains an essential feature of Angel Funds and needs to be retained.

Proposals for consideration:	
Proposal 18.	Requirement of taking investor consent before making an investment to be retained.

25. <u>Format, Filing and Validity of PPM of Angel Funds</u>

(a) **Template PPM and PPM Audit**: The WG suggested that a template PPM be prescribed for Angel Funds, in the format as suggested by them. This is intended to standardize and enhance transparency in the disclosure process to investors. To streamline approvals and improve transparency**,** SEBI may adopt the existing template PPM for Category I AIFs, modifying it to align with the regulatory framework specific to Angel Funds and the new proposals. Additionally, Angel Funds with total investments over INR 100 crore would be subject to a PPM audit to ensure compliance, while smaller Angel Funds would be exempt from this requirement.

(b) **PPM Filing Process**: Once the above standardisation is achieved by prescribing the template PPM, Angel Funds may also be required to file their PPMs with SEBI through a Merchant Banker, in line with other AIFs.

(c) **First Close Requirement**: A key proposal is to introduce a requirement for Angel Funds to conduct their first close within 12 months of having their PPM filed with SEBI. Currently, Angel Funds are not subject to first-close timeline requirement as applicable to other AIFs, allowing their PPMs to remain valid indefinitely, which may not be in the best interest of investors. It is proposed to streamline this, by requiring Angel Funds to onboard a minimum of 5 Accredited Investors to conduct first close within 12 months, or else they will need to file a new PPM.

The proposed changes aim to improve investor protection, transparency, and the regulatory framework for Angel Funds, ensuring that they align with established practices while addressing the unique nature of Angel Funds. After discussions, AIPAC has recommended these proposals.

Proposals for consideration:	
Proposal 19.	To prescribe template PPM for Angel Funds by suitably modify the existing template PPM for Category I AIFs. To mandate requirement of merchant banker of filing of PPMs of Angel Funds with SEBI.
Proposal 20.	To mandate PPM Audit requirement for Angel Funds having total investments more than INR 100 crore.
Proposal 21.	Angel Funds shall conduct their first close, by on-boarding minimum 5 Accredited investors, within 12 months from the date of SEBI communication for taking their PPM on record.

26. <u>Performance Benchmarking for Angel Funds</u>

(a) The WG has recommended that, since benchmarking seeks to bring transparency to investors, especially the first-timers who want to understand metrics, the same level of transparency can be brought to Angel Funds.

(b) Upon discussion with performance benchmarking agencies, it is understood that performance benchmarking of Angel Fund at fund level can be carried out in the same manner as it is carried out for schemes of other categories of AIFs. Accordingly, Angel Funds may also be brought under the mandate for performance benchmarking, to help investors in assessing the performance of the Angel Fund sub-category. AIPAC also recommended the said proposal.

Proposals for consideration:	
Proposal 22.	- Angel Funds shall report necessary information including investment wise valuation and cash flow data to the benchmarking agencies, in a timely manner, for the purposes of performance benchmarking. - In the PPM, as well as in any marketing or promotional or other material, where past performance of the Angel Fund is mentioned, the performance versus benchmark report provided by the benchmarking agencies for such fund shall also be provided.

27. <u>Listing the Units of Angel Funds</u>

(a) Presently, units of Angel Funds shall not be listed on any recognised stock exchange. The WG recommended that units should be permitted to be listed on stock exchange, subject to a minimum tradable lot of INR 25 lakh and after a minimum lock-in period of 5 years from the date of first closing of the Angel Fund.

(b) A specific prohibition has been made for listing of Angel Funds in extent framework since Angel funds do not have a common portfolio for all investors and each investment may have different set of investors, consequently, there may be concerns regarding fungibility of units issued by the Angel Fund. Hence, it may not be feasible to enable listing of units issued by Angel Funds.

Proposals for consideration:	
Proposal 23.	To retain the prohibition on listing of units of Angel Funds.

28. Applicability of the Proposed Framework

While the proposed changes related to investment conditions may be made applicable with effect from the notification of amendment to AIF Regulations in this regard, a glide path may be provided for existing Angel Funds with respect to fund raising and investor on-boarding process, so as to not affect their ongoing investment activities. AIPAC recommended providing a time-period of 1 year to existing Angel Funds for the transition to Accredited Investor regime.

Proposals for consideration:	
Proposal 24.	For new Angel Funds, all the conditions proposed shall be made applicable from the date of notification of amendment to AIF Regulations in this regard For existing Angel Funds – (a) 1 year time period shall be provided as glide path. Post the 1 year period, Angel Funds to ensure that the investments are made only out of capital contributed by Accredited Investors (those having valid accreditation certificate or those deemed as Accredited Investors). (b) During the aforesaid 1 year period, Angel Funds, having non Accredited Investors, shall ensure that the investment opportunity is not offered to more than 200 investors. (c) All other mandates shall be made applicable from the date of notification of amendment to AIF Regulations in this regard.

Public comments

29. Considering the implications of the aforementioned matter on the market participants, public comments are invited on the Proposals 1 to 24 given above. The comments / suggestions shall be submitted on or before November 28, 2024, via online web-based form through the following link:
https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes

30. In case of any technical issue in submitting your comment through web based public comments form, you may contact afdconsultation@sebi.gov.in with the subject of the email as, *"Consultation Paper on review of regulatory framework for Angel Funds in AIF Regulations".*

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Annexure A

Difference between Angel Funds and a typical AIF of other categories

Particulars	AIFs	Angel Funds
Investors	- No eligibility criteria, other than investors being from country which is (i) FATF compliant and (ii) a signatory to IOSCO MMoU or bilateral MoU with SEBI. - Minimum investment amount of INR 1 Crore	- Specific eligibility criteria in terms of net-worth requirement and experience, to ensure that only investors with sufficient capital and prior experience/ adequate awareness of such investments, invest in such funds. - Minimum investment amount of INR 25 Lakhs
Investment avenue	For all other categories of AIFs, no restriction on investment based on the stage/life cycle of the company. However, Category I AIF – Venture Capital Funds and Category II AIFs are required to invest above a specified threshold in unlisted securities.	To invest only in Start-ups as defined by DPIIT, except start-ups which are: (i) promoted/ sponsored by/ related to an industrial group whose group turnover exceeds INR 300 crore or (ii) companies with family connection with any of the angel investors investing in the company.
Decision making/ Pooling	Investment decisions are taken by manager or investment committee set up by the manager and investments are made out of the pool of funds raised from each investor of the AIF, proportionate to their commitment to invest.	Manager to identify investment opportunity and invest money drawn down only from such investors who give approval for the said investment. Thus, angel investors may or may not participate in a given investment opportunity, as per their discretion.
Structuring of schemes	Each investor has pro-rata rights in each investment of the scheme's portfolio.	Each investment made by an Angel Fund is referred to as a scheme of the Angel Fund. Thus, each scheme/investment of Angel Fund may have a different set of investors.
Maximum no. of investors	A scheme of an AIF cannot have more than 1000 investors. Since investments are made by drawing down contribution from these investors, no separate limit is specified at investment level.	No limit on the number of investors on-boarded to the Angel Fund, however, maximum no. of investors who can invest in a particular investment opportunity is limited to 200 to ensure that investment in an investee company is not akin to a public issue.