Angel Investors under AIF Regulations – A new categorization by SEBI

SEBI (Alternative Investment Funds) Regulations, 2012 (“AIF Regulations”) stands amended by the SEBI (Alternative Investment Funds) (Amendment) Regulations, 2013 (the “Amendment”), with effect from 16 September 2013. While the Amendment provides for certain clarificatory and remedial provisions, its important feature is the introduction of Angel Funds within the purview of “Category I AIF venture capital funds”, as defined in the AIF Regulations. Taking on from the budgetary announcement of 2013-14 granting pass-through status to Angel Funds, SEBI has now prescribed applicable requirements for Angel Funds, as a distinct sub-category under venture capital funds. SEBI’s move to create a distinctive category of AIFs for Angel Investors has twin objectives: (i) a recognition that an Angel Fund has inherent differences in its functioning from other funds; and (ii) the need to ensure the authenticity of such investments and of the ability of such investors to assume the high risks of these investments.

With this Amendment, Angel Funds have been demarcated as a distinct species and those that meet the criteria can assume their distinct identity and operate in their own playing field.

**Who is an Angel Fund?**

The definition of ‘Angel Fund’ is remarkably straightforward – an Angel Fund is one that raises funds from Angel Investors, and invests such funds, as permitted under the AIF Regulations. On the other hand, criteria have been set forth on who can be an Angel Investor. While SEBI recognises individuals as Angel Investors in this category, SEBI states that it is guided by the networth of the investor, indicating sufficiency of capital, as well as the investor’s prior experience, indicative of clear understanding on such angel investments.

In the light of HNIs being largely the investor group in Angel Funds, both the criteria of networth and experience have been made applicable to individuals.

Thus, in its fairly exhaustive definition of an Angel Investor, the Amendment seeks to reduce risks arising from information asymmetry and inexperience by stating that an Angel Investor is any person who proposes to invest in an Angel Fund and satisfies one of the following conditions:

(a) an individual investor who has net tangible assets of at least Rs. 2 crore excluding value of his principal residence, and who:
   (i) has early stage investment experience (i.e. experience in investing in start-ups), or
   (ii) has experience as a serial entrepreneur (i.e. who has promoted or co-promoted more than one start-up venture), or
   (iii) is a senior management professional with at least ten years of experience.
Salient features of AIF Regulations as applicable to Angel Funds

Though Angel Funds have been positioned as a sub-category of a Venture Capital Fund under Category I-Alternative Investment Funds (“Category I- AIF”), their obligations slightly differ from the other Category I- AIFs.

Corpus:

An Angel Fund must:

(a) have a corpus of at least Rs. 10 crore and
(b) accept an investment of not less than Rs. 25 lakh from an Angel Investor.

Both these thresholds are lesser than the respective figures prescribed for other Category – I AIF, and further, an Angel Investor has been provided with a 3-year window within which it can discharge its investment commitment to the fund.

As an exception to the general rule, the units issued by Angel Fund cannot be listed.

Investment in Angel Funds by Angel Investors

Angel Funds can invest such funds only in venture capital undertakings (which are defined in the AIF Regulations to be unlisted companies other than in certain specified businesses). But, going beyond this, SEBI has further narrowed down the investee-entities to ensure that only genuine early-stage investing flows under this route.

It has hence prescribed certain restrictions on investment by Angel Funds.

1. Restrictions pertaining to the investee company:

The investee company must:

(a) have been incorporated during the preceding 3 years from the date of such investment;
(b) have a turnover of less than Rs. 25 crores;
(c) not be promoted or sponsored by or related to an industrial group whose group turnover exceeds Rs. 300 crores; and
(d) not be companies with family connection with any of the Angel Investors who are investing in the company.
II. Restrictions on the investment

(a) The investment must not be less than Rs. 50 lakhs and not exceed Rs. 5 crores.
(b) The investment must be locked-in for a period of three years.
(c) Angel Funds must not invest in its associates.
(d) Angel Funds must not invest more than twenty-five per cent of the total investments under all its schemes in one venture capital undertaking.

Any scheme floated by an Angel Fund can have only up to forty-nine Angel Investors.

Schemes - The Angel Fund may launch schemes upon filing and approval of a scheme memorandum at a shorter time frame of at least 10 working days prior to launch of the scheme with SEBI.

Manager and Sponsor - The continuing interest of the manager or sponsor in an Angel Fund is also lower than in other AIFs, being 2.5% of the corpus or Rs. 50 lakh, whichever is lesser, and such interest should not be through the waiver of management fees.

Taking cognizance of the modus operandi of Angel Funds, where the investors make the decisions relating to the investments, the manager of the Angel Fund is required to obtain an undertaking from every Angel Investor proposing to make investment in a venture capital undertaking, confirming his approval for such an investment, prior to making such an investment.

Summary

The Amendment is stated to address long pending demand to create a separate category for Angel Funds, and in this it succeeds by delineating Angel Funds by its category of investors, by their average corpus/investment size and intended beneficiaries. Angel funds have been given lower thresholds, less procedures in floating a scheme and fee concessions.

However, in a first for an AIF, Angel Funds are required to stay invested for at least 3 years in each of its investee-company under a mandatory lock-in. There are also iron-cast restrictions on investing in associate companies or in companies with a family connection, which even includes companies in which an angel director or his relative has a board seat. These provisions though well-intentioned, may make the Angel Fund weigh in the consequences of investing under this route.

In the light of the glaring gap between the entrepreneurial talent of Indians demonstrated across the world, and lack of adequate early-stage funding channels within India, one is left to conclude that the AIF regulations goes only so far in giving the long overdue recognition to Angel Investors but this could also have been the platform to incentivise and nurture angel investing as a mature investing model for the future.
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For further clarification, you may write to the capital markets team, comprising of Ms. Ryna Karani (Partner) at rkarani@almtlegal.com, Mr. Vaishakh Kapadia (Partner) at vkapadia@almtlegal.com, Ms. Subashini Radhakrishnan (Partner) at sradhakrishnan@almtlegal.com and Ms. Deblina Gooptu (Senior Associate) at dgooptu@almtlegal.com.