

Key Takeaways: SEBI Informal Guidance on Angel Fund¹

- ***An Angel Fund may not purchase shares of its portfolio company pursuant to pre-emptive rights/rights issue/renounced rights issue if, at the time of such proposed purchase, the company has ceased to be a start-up.***

In November 2024, SEBI issued a consultation paper on review of the regulatory framework for angel funds² (“**Consultation Paper**”). The Consultation Paper mentioned that this restriction limits the ability of angel funds to protect and preserve the value of their initial investment. It was then proposed to allow angel funds to make follow-on investment in investee companies which are no longer start-ups subject to certain conditions such as limiting such follow-on investment to investors who participated in the initial investment.

With SEBI taking this position and the proposals still in the works, fund managers should ensure that their investment agreements with start-ups provide protection for their investment in cases where exercise of pre-emptive rights is restricted by this provision, and some may even reconsider investing in start-ups on the verge of maturity as per the DPIIT criteria.

- ***Fees/costs/expenses payable to the Fund by the investors may form part of its committed capital.***

Owing to the unique structure of angel funds, where each investment is a separate scheme, the expenses are incurred at the fund and the scheme level. Some fund managers charge a joining fee or annual fee or both, which is typically not considered a part of the committed capital. Therefore, allowing discretionary powers to fund managers while determining whether fees and expenses form part of the committed capital is key to the structure of an angel fund.

- ***A trust cannot be an angel investor unless it is an AIF or a VCF.***

Whether a trust is a body corporate has been a subject of constant discourse in different contexts. The Ministry of Corporate Affairs (“**MCA**”) visited this matter in 2014 in the context of trusts becoming partners to a limited liability partnerships through their trustees which are bodies corporate (“**MCA Circular**”).³ While the MCA Circular was released in the wake of clarifications sought by SEBI registered trusts such as AIFs, it has been relied upon for non-SEBI registered trusts whose trustees are bodies corporate to become partners in an LLP as well. However, SEBI’s stance seems stricter whereby the nature of the trustee being a body corporate would not entitle the trust to be seen as a body corporate for the purposes of being an angel investor in the angel fund.

- ***Policy concerns become grounds for SEBI to not respond to certain queries.***

SEBI refused to comment on a query relating to the proportion for distribution in case of a partial exit opportunity for an angel fund where investors do not agree to accept their proportionate share of the distribution.

¹ SEBI, vide letter dated 13 March 2025, has responded to an informal guidance request of FirstPost Capital Angel Fund, available at <[SEBI | Informal Guidance request received from FirstPost Capital Angel Fund in relation to provisions for Angel Funds under the Securities and Exchange Board of India \(Alternative Investment Funds\) Regulations, 2012](#)>.

² SEBI Consultation Paper on Review of Regulatory Framework for Angel Funds in AIF Regulations, available at <[³ \[https://www.mca.gov.in/Ministry/pdf/General_Circular_37-2014.pdf\]\(https://www.mca.gov.in/Ministry/pdf/General_Circular_37-2014.pdf\)](https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes'target=' blank' style='color:#007ffc'> Click here to provide your comments >></p></div><div data-bbox=)

The AIF Regulations require⁴ that distributions of a scheme of an AIF be made pro-rata to the capital commitment of the investors. Angel funds have been excluded from the application of this requirement.

The Consultation Paper had attributed this exclusion to the fact that each investor may have varying amount of contribution in each investment of the angel fund. It was accordingly proposed there that investors of an angel fund should have distribution rights pro-rata to their contribution in an investment.

A probable reason for SEBI's refusal to comment on the manner of distribution could be that the proposals from the Consultation Paper are under consideration.

Conclusion

This Informal Guidance comes at a time when a regulatory overhaul of the angel fund framework is in the works. Some of the clarifications given by SEBI under the Informal Guidance may not continue to hold good if the proposals under the Consultation Paper are approved as law. However, until then, fund managers must consider these clarifications as guidance for ensuring compliance with the law.

⁴ Regulation 20(21) of AIF Regulations.