

SECURITIES AND EXCHANGE BOARD OF INDIA

BOARD MEMORANDUM

Draft amendments to SEBI (Alternative Investment Funds) Regulations, 2012

1. Objective

1.1. This Board Memorandum proposes amendments to SEBI (Alternative Investment Funds) Regulations, 2012 (“AIF Regulations”) with respect to angel funds, and seeks approval of the Board for the same.

2. Background

2.1. Angel funds encourage entrepreneurship in the country by financing small start-ups at a stage where such start-ups find it difficult to obtain funds from traditional sources of finance such as banks, financial institutions, etc. Further, such funds provide mentoring to the entrepreneurs as well as access to their own business networks.

2.2. In this regard, Hon’ble Finance Minister announced in Budget for FY 2013-14 as under:

“Angel investors bring both experience and capital to new ventures. SEBI will prescribe requirements for angel investor pools by which they can be recognised as Category I AIF venture capital funds.”

2.3. In pursuance with the aforesaid Budget announcement, AIF Regulations were amended w.e.f. 16-09-2013 by inserting a new chapter namely “Chapter III – A” prescribing requirements for angel funds.

2.4. As on February 28, 2018, 398 AIFs are registered with SEBI. Of these, 114 AIFs are registered under Category I including 8 angel funds.

2.5. On November 09, 2017, a meeting was convened wherein SEBI, Department of Industrial Policy and Promotion (“DIPP”) and Angel Investor Groups (“AIGs”) participated in the discussion. The meeting was convened to discuss the issue of

recognizing AIGs by SEBI to enable DIPP to consider providing exemption under section 56(2)(viib) of the Income Tax Act, 1961 to investments in all DIPP recognized startups made by resident investors who are part of such recognized AIGs.

2.6. Based on the discussion, it was decided to form a group which can look into the aspect of simplifying certain provisions of AIF Regulations so that it may provide the ease of doing business for angel funds. Accordingly, SEBI had formed a working group mainly comprising of various angel networks, consultants and startups with respect to “Study of provisions of angel funds under SEBI (Alternative Investment Funds) Regulations, 2012 for understanding the issues and challenges faced by Angel Investor Groups in registering as angel funds”. The said working group had submitted its final recommendations to SEBI in January 2018. The recommendations of the working group were also informed to DIPP vide letter dated January 15, 2018.

3. Proposal to the Board

Taking into consideration the recommendations made by the working group, amendments are proposed in Chapter III – A of AIF Regulations. The proposed amendments along with the rationale are as under:

3.1. Increase in maximum investment amount in venture capital undertakings

3.1.1. Regulation 19F(2) of AIF Regulations states that “Investment by an angel fund in any venture capital undertaking shall not be less than twenty five lakh rupees and shall not exceed five crore rupees.”

3.1.2. It is recommended by the working group that this requirement of maximum investment amount by an angel fund in any venture capital undertaking (“VCU”) may be increased from Rs. five crore to ten crore. It is stated by the group that due to fast changing angel investing ecosystem wherein angels are investing much higher amounts, such increase is needed to provide more opportunities to angel funds. This provision also precludes angel funds from participating in follow on rounds of venture capital undertakings if the limit of Rs. five crore rupees has been exhausted.

3.1.3. Such increase in maximum investment amount in a venture capital undertaking will provide angel funds more flexibility to invest in venture capital undertakings.

3.1.4. Proposal

It is proposed to amend the requirement of maximum investment amount by an angel fund in any venture capital undertaking from five crore rupees to ten crore rupees.

3.2. Minimum corpus of an angel fund

3.2.1. Regulation 19D(2) of AIF Regulations states that “An angel fund shall have a corpus of at least ten crore rupees.”

3.2.2. It is recommended by the working group that considering the fact that angel investments are as low as twenty five lakhs rupees, it is restrictive for angel funds to start with a corpus of ten crores rupees. The requirement of having at least ten crore rupees corpus may be reduced to five crore rupees.

3.2.3. Such reduction in minimum corpus size will enable the angel funds with smaller corpus to register with SEBI. This will help the start-up ecosystem to raise more funds from angel funds set up with such reduced corpus.

3.2.4. Proposal

It is proposed to amend the requirement of having at least ten crore rupees corpus to at least five crore rupees.

3.3. Maximum period to accept funds from angel investors

3.3.1. Regulation 19D(3) of AIF Regulations states that “angel funds shall accept, up to a maximum period of three years, an investment of not less than twenty five lakh rupees from an angel investor.”

3.3.2. It is recommended by the working group that the maximum period for accepting funds from investors should be increased to 5 years as angel funds may not be able to offer sufficient number of investment opportunities in the angel investor’s area of interest and thus angel investors may be mandatorily required to invest in available investment opportunities within three years. During this

mandatory period of three years, there would be scenarios wherein enough opportunities are not available for investment by angel funds due to various reasons such as macro-economic outlook, slow growth economic trends, etc.

3.3.3. Such increase in maximum period to accept funds from investors will provide angel funds more time to identify opportunities and invest in VCUs.

3.3.4. Proposal

It is proposed to amend the requirement of maximum period for accepting funds from an angel investor from three years to five years.

3.4. Filing of scheme memorandum to SEBI by angel funds

3.4.1. Regulation 19E(1) of AIF Regulations states that “The angel fund may launch schemes subject to filing of a scheme memorandum at least ten working days prior to launch of the scheme with the Board.”

3.4.2. It is recommended by the working group that considering the construct of the Angel Fund, where a written approval is sought from each angel investor prior to making an investment and a detailed private placement memorandum is already filed with SEBI at the time of registration, it is onerous to file a scheme memorandum with SEBI at least ten working days prior to launch of the scheme. Accordingly, it is recommended that angel funds may file an intimation with details on the specific investment with SEBI within ten days of launching scheme.

3.4.3. Proposal

It is proposed to replace the requirement of filing of scheme memorandum to SEBI by angel funds with requirement of filing term sheet containing material information, as may be specified by SEBI, regarding the scheme to SEBI within ten days of launching scheme.

3.5. Amendments in Regulations 19D(4) and 19(E)4 of AIF Regulations

3.5.1. Regulation 19D(4) of AIF Regulations states that “Angel fund shall raise funds through private placement by issue of information memorandum or placement

memorandum, by whatever name called.”, whereas Regulation 19E(4) of AIF Regulations states that “No scheme of the angel fund shall have more than two hundred angel investors.”

3.5.2. Further, Section 42 (2)(ii) of the Companies Act, 2013 states that “private placement means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in this section.” It is recommended by the working group that the provisions of Companies Act are applicable only on companies and since the angel funds are generally formed as Trusts, private placement rules, as prescribed in section 42 of the Companies Act, 2013, should not be applicable on them.

3.5.3. The group, in order to get clarification on private placement provisions, has requested amendment in AIF Regulations by inserting a proviso to Regulation 19(D)(4) and 19E(4) of AIF Regulations as under: Provided that the provisions of the Companies Act, 2013 shall apply to the Angel fund, if it is formed as a company.”

3.5.4. In this regard, it is noted that proviso to Regulation 10 (f) of AIF Regulations states that “Provided that the provisions of the Companies Act, 1956 shall apply to the Alternative Investment Fund, if it is formed as a company.”

3.5.5. Proposal

The proviso to Regulation 10 (f) of AIF Regulations is applicable on all AIFs including angel funds. Hence, a separate clarification by way of inserting a new proviso with respect to angel funds is not required and hence, the proposal is not accepted.

3.6. Amendment in Regulation 19G(3) of AIF Regulations

3.6.1. Regulation 19G(3) of AIF Regulations states that “The manager of the angel fund shall 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.”

3.6.2. The working group has stated that this requirement is very onerous and adds to the lead time for deal close. It is also superfluous and unnecessary as, in any case, each investor anyway has to elect to participate in a particular investment in the Angel fund construct. Accordingly, it is recommended that the need to obtain an “undertaking” be done away with and the commitment/consent to invest (given electronically or in hard format) be considered as approval & undertaking. Further, the Manager will give an undertaking to SEBI on a quarterly basis that approvals from all investors were duly obtained.

3.6.3. In this regard, it is observed that, in case of angel funds, the manager of the angel fund obtains an undertaking from every participating angel investor before making investment in VCU. The angel investors can have the discretion of participating in investment opportunities provided by the angel fund and such discretion through undertaking ensures the protection of interest of angel investors. Thus obtaining undertaking from the angel investors by the manager of angel fund ensures the agreed participation in the particular investment by such angel investor.

3.6.4. Proposal

In view of the above, the said proposal may not be accepted.

3.7. Amendments in Regulation 23(2) of AIF Regulations

3.7.1. Regulation 23(2) of AIF Regulations states that “Category I and Category II Alternative Investment Funds shall undertake valuation of their investments, at least once in every six months, by an independent valuer appointed by the Alternative Investment Fund.

Provided that such period may be enhanced to one year on approval of at least seventy-five percent of the investors by value of their investment in the Alternative Investment Fund.”

3.7.2. The working group has stated that given that angel investments are early stage investments, the growth in their valuation is not likely to be dramatic every six months. The requirement of valuing investments once in six months is,

therefore onerous & unnecessarily expensive. Accordingly, it is recommended that the minimum frequency for undertaking valuation of investments should be increased to once a year in relation to angel funds.

3.7.3. In this regard, it is observed that since investment are made by Category I AIFs, including angel funds, in unlisted securities, valuation of such securities less frequently will increase the risk for the investors. Thus, the requirement of valuation at every six months allows angel investors to remain updated about their investment in VCUs. Further, in terms of AIF regulations, AIF has the discretion to increase the period of valuation with the consent of at least seventy-five percent of the investors by value of their investment in the AIF.

3.7.4. Proposal

The proposal to increase the requirement of valuating investments from six months to one year may not be accepted.

4. Proposal

4.1. The Board is requested to consider and approve the proposals at clause 3 above. Further, the Board may authorize the Chairman to make such necessary consequential or incidental amendments to the AIF Regulations for the purpose of implementation of proposals at clauses 3.1, 3.2, 3.3 and 3.4 above and take consequent steps, as may be deemed appropriate, to give effect to the decision.

(The Board Memorandum must be read in conjunction with the minutes of the meeting, the press release issued on March 28, 2018 and the amended regulations, as may be notified.)