

Angel Funds: SEBI ushers in a new era

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Background

The Securities and Exchange Board of India (SEBI) has overhauled the regulatory framework for Angel Funds through amendments to the SEBI (Alternative Investment Funds) (AIF) Regulations, 2012 (AIF Regulations) and the issuance of SEBI Circular No. SEBI/HO/AFD/AFD-POD-1/P/CIR/2025/128 dated 10 September 2025 (Circular), ushering in a transformative era for early stage investing in India. The revised framework addresses key operational aspects while streamlining compliance requirements for Angel Funds, thereby balancing investor protection with market growth. Collectively, these reforms are expected to strengthen investor confidence, enhance the credibility of Angel Funds, and boost the long-term growth of India's start-up landscape.

Key features of the revised regulatory framework

1. ***Fund raising from Accredited Investors: new requirements and transition period***

Angel Funds registered after the issuance of the Circular	Angel Funds registered on or before the issuance of the Circular
Mandatory to raise funds from Accredited Investors.	<ul style="list-style-type: none"> Mandatory to fully implement the Accredited Investor requirement by 8 September 2026. During the transition period, such Angel Funds will not offer investment opportunities to more than 200 non-Accredited Investors.

The non-Accredited Investors may continue to hold their current investments as per the terms of the private placement memorandum (PPM) of the angel fund.

Comments:

- (i) If participation in an angel fund is made conditional upon investors having 'Accredited Investor' status, it may potentially impact fund-raising by angel funds and, limit the availability of capital for start-ups. While this requirement would allay concerns regarding investors lacking the risk appetite for investing in start-ups through angel funds, it may also reduce access to larger pools of capital.
- (ii) Under the earlier framework, angel funds had the flexibility to issue units to up to 200 investors, however there was no restriction on the number of persons to whom the offer could be made. Under the Circular, fundraising / offering itself is restricted to 200 non-Accredited Investors until 8 September 2026, thereby narrowing the potential investor base. It is important to note that SEBI has not clarified the minimum number of investors that may participate or contribute towards an investment in an investee company by angel funds registered under the AIF Regulations after the issuance of the Circular.

- (iii) SEBI should provide clarity on the investment allocation mechanism between non-Accredited Investors and Accredited Investors in angel funds during the transition period (i.e., up to 8 September 2026) from an operational ease perspective.
- (iv) SEBI's recent reforms demonstrate a strong focus on enhancing the landscape for Accredited Investors with intent to enhance investor protection and align the Indian regime with global practices. However, SEBI may also need to consider the compliance costs associated with obtaining and maintaining accreditation. These costs could be a hurdle for eligible investors and result in constraining capital flow into the start-up ecosystem.

2. **First close requirements**

The AIF Regulations now mandate that angel funds must onboard at least five Accredited Investors before declaring the first close (within 12 months from the date of SEBI's communication of taking the PPM on record). Existing angel funds that have not declared the first close yet, must do so by 8 September 2026. Failure to meet these timelines will require refiling the PPM with SEBI along with the requisite fees.

Comment: The requirement for angel funds to onboard at least five Accredited Investors before declaring their first close was proposed in SEBI's consultation paper titled '*Consultation paper on review of regulatory framework for Angel Funds in AIF Regulations*' dated 13 November 2024. This requirement ensures that angel funds are anchored by investors with adequate risk appetite from the outset, lending credibility and stability to fundraising. However, this may pose a higher entry barrier for new managers, as identifying and securing commitments from five Accredited Investors can be challenging. The current requirement, therefore, while well-intentioned, may slow down fund launches and restrict the early-stage capital flow.

3. **Investment structure and operations**

A fundamental change introduced under the Circular is that angel funds will no longer launch schemes for making investments in investee companies. Instead, investments in investee companies will be made directly by angel funds at the fund level. This eliminates the requirement of filing term sheets with SEBI for launching schemes. However, angel funds must maintain comprehensive records of term sheets for each investment, including details of investor participation and their contribution to the respective investments.

Comment: The Circular eliminates the need to file term sheets with SEBI for every scheme launch, reducing regulatory burden on the manager related to scheme-level filing.

4. **Limits for investments by Angel Funds and follow-on investment provisions**

The AIF Regulations provided that the investment by an Angel Fund in an investee company will not be less than INR 25 lakhs and shall not exceed INR 10 crores. The minimum investment limit has been reduced to INR 10 lakhs, and the maximum investment limit has been increased to INR 25 crores.

Comment: This change is aligned with the growth of the angel ecosystem, evolving market dynamics, and the increasing interest in angel investments as an asset class.

SEBI has now mandated that each investment of an angel fund in an investee company should have contribution from at least two Accredited Investors. Further, the earlier restriction to not invest more than 25% of an angel fund's total invested capital in a single company has been removed.

The Circular introduces specific provisions for follow-on investments in existing investee companies that are no longer classified as startups, subject to the below:

- (i) the post-issue shareholding percentage of the angel fund shall not exceed the pre-issue shareholding percentage, and
- (ii) the total investment in any investee company, including follow-on investments, shall not exceed INR 25 crores.

Additionally, follow-on investment contributions can only be accepted from investors of angel funds who participated in the original / existing investment, on a pro-rata basis, with provisions for reallocation to the remaining investors if certain investors opt out from participating in such follow-on investment round.

5. **Mandatory investment manager / sponsor commitment**

The investment manager or sponsor shall have a continuing interest in each investment of the angel fund of not less than 0.5% of the amount invested or INR 50,000, whichever is higher, and such interest shall not be through the waiver of management fees.

Comment: Previously, the manager or sponsor was required to have a continuing interest in the angel fund of not less than 2.5% of the corpus or INR 50 lakhs, whichever was lower, and such interest could not be through the waiver of management fees. The amendment has enhanced the alignment of interest between the investment manager / sponsor and investors at the level of each investment.

6. **Lock-in period requirements**

Under the AIF Regulations, angel fund investments in underlying investee companies were subject to a one-year lock in period. The Circular now provides flexibility by permitting this period to be reduced to 6 months where the exit from such investee company is through a sale to a third party (excluding buybacks by the investee company or purchases by promoters or their associates). Such sale will remain subject to the terms of the investee company's articles of association.

7. **Prohibition on related party investor contributions**

Under the new framework, angel funds will not accept contribution for investment in an investee company from angel investors who are a related party to such investee company. While the earlier restriction to not invest in 'associates' (as defined under the AIF Regulations) aimed at addressing manager level conflicts, the revised provision aims to mitigate conflicts at the level of investors.

Comment: This restriction will facilitate arm's-length participation from a corporate governance perspective and ensure that participation in an investee company is not influenced by investors who already have a pre-existing relationship with the investee company.

8. **Overseas investment restrictions and calculations**

Angel funds are permitted to invest in securities of companies incorporated outside India, subject to Reserve Bank of India and SEBI guidelines. For overseas investments, the 25% limit¹ will be calculated based on the total investments held by the angel fund at cost as of the application date for overseas investment approval.

9. **Allocation methodology and investor rights**

Under the new framework, the manager is obligated to disclose and offer each investment opportunity to all the angel investors of the angel fund.

The Circular requires the investment managers of angel funds to strictly adhere to the methodology defined in the PPM for allocating investments amongst consenting investors of the angel fund and the manager has no discretion to allocate investments on a case-by-case basis. Existing angel funds must incorporate such methodology into their PPMs. The allocation of any investment made by such angel funds after October 15, 2025, shall be in accordance with the methodology disclosed in the PPM.

Investors shall have rights in an investment in the angel fund and distribution of proceeds, pro-rata to their contribution to such investment, except where returns or profits are shared with the investment manager / sponsor of such angel fund or the employees / directors / partners of the investment manager of the angel fund (in the form of additional return).

Comment: While the Circular clarifies that the investors in angel funds will have rights in investments and distribution of proceeds pro-rata to their contribution (except where returns or profits are shared with the investment manager / sponsor of such angel fund or their employees / directors / partners in

¹ The limit has been prescribed under the AIF Master Circular SEBI/HO/AFD-1/AFD-1-PoD/P/CIR/2024/39 dated May 07, 2024.

the form of additional returns), SEBI may also consider extending this carve-out to cover employee welfare trusts established by the investment manager and other participants in the AIF ecosystem. This would help ensure alignment of interests across the broader manager group and provide flexibility in structuring incentive arrangements.

10. **Compliance and reporting obligations**

The Circular provides that all existing angel funds shall be considered to be registered as Category I AIF – Angel Funds.

Annual audit compliance: The Circular clarifies that annual audit of compliance with terms of the PPM is required only for Angel Funds with total investments exceeding INR 100 crores (at cost).

Performance benchmarking: Angel funds are now required to report necessary information including investment wise valuation and cash flow data to the benchmarking agencies for the purposes of performance benchmarking. Further, wherever the past performance of the angel fund is mentioned (i.e., in PPMs / any marketing or promotional material), the performance versus benchmark report provided by the benchmarking agencies for such angel fund shall also be provided.

The compliance requirements mentioned above shall be applicable from financial year 2025-26 onwards.

Conclusion

The new framework reflects the regulator's intent to promote greater transparency and discipline across the angel fund ecosystem. By strengthening obligations related to fund governance, compliance, and improved transparency and standardisation, SEBI aims to reinforce investor confidence thereby contributing to the long-term, sustainable development of this segment of the AIF industry.

While this is a significant step in the regulation and operation of angel funds, it will be important to ensure that the framework does not become overly prescriptive in a manner that discourages deal-making or deters new entrants. The effectiveness and impact of these reforms will ultimately depend on how well investor interests are safeguarded while sustaining a vibrant investment ecosystem in India.

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