Simple Agreements for Future Equity (SAFE)

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Lately, a number startups have been inquiring about Simple Agreements for Future Equity (SAFEs). The SAFE has been around since 2013 and was created by the startup accelerator Y Combinator. The SAFE is similar to other novel forms of convertible securities such as the Keep it Simple Security (KISS) but has gained more prominence and traction in the market. However, the SAFE has yet to be widely adopted in upstate New York to date because of investor reticence to use the SAFE in the place of the more established convertible note.

The SAFE is generally seen as a more company-friendly alternative to the issuance of convertible notes in an early stage debt financing and is intended for use in friends and family and angel rounds. Mechanically, a SAFE is a short, five page investment contract between the company and the investor under which the investor has the right to receive equity in the company on the occurrence of specified events. These events could include a future round of equity financing or an exit event such as a sale of the company. The SAFE is considered company friendly in the sense that it lacks a maturity date that would trigger a renegotiation of terms in the event the company needs an extension of the term. The SAFE also does not accrue interest, but provides upside to the investor in the form of a discount rate and valuation cap.

While the SAFE could be a viable alternative to the convertible note, the extent that they will be adopted widely for use will depend on whether investors can get comfortable with their use and risks. Namely, if the company is unable to raise additional funds, the SAFE will be outstanding indefinitely and the investor will lack the recourse that debt would otherwise provide. In this respect, unless the start-up has the leverage in negotiating the investment or the investors are willing to use the SAFE, the traditional convertible note will likely continue to be the financing instrument of choice between the two options for the foreseeable future.