

SAFE:

CONCEPT AND KEY CONDITIONS GUIDE

REVERA

REVERA law group

An international full-service legal company for innovative & technological businesses striving to expand their global outreach

80+
qualified lawyers

REVERA is an international group of companies

25+
years on the market

Outstanding experience on the legal market

15
areas of law

REVERA is full-service legal advisor

9
industries

REVERA tailors its legal solutions to industry specifics

5+4
offices

REVERA has offices in Poland, Cyprus, Georgia, Belarus, and Kazakhstan as well as legal panels in Armenia, Uzbekistan, UAE and Curacao

Chambers AND PARTNERS
IFLR1000
The LEGAL 500

Offices of REVERA gained recognition of the international experts

Key Contacts

REVERA



NASTASSIA AKULICH
Senior Associate at REVERA law group
a.akulich@revera.legal



ALEXANDRA KOVALYOVA
Leading Associate at REVERA law group
a.kovalyova@revera.legal



ALIONA PRAKAPENKA
Associate at REVERA law group
a.prakapenka@revera.legal

Contents

SECTION 1 5

SAFE: in simple words about «simple contract» 5

I. SAFE:
Concept and Key Benefits 6

II. SAFE structure 8

III. Pro rata rights of the investor 10

IV. Difference between SAFE and convertible loan 11

SECTION 2 12

The evolution of the SAFE valuation: from pre-money to post-money 12

I. Pre-money valuation SAFE: a look at a startup BEFORE rasing investments using SAFE / other instruments 14

II. Post-money valuation SAFE: a look at a startup AFTER raising investments using SAFE / other instruments 15

SECTION 3 16

SAFE types 16

I. SAFE: valuation cap, no discount 18

II. SAFE: discount, no valuation cap 19

III. SAFE: MFN, no valuation cap, no discount 20

SECTION 4 21

Jurisdictions in which investments can be structured using SAFE 21

Introduction

SAFE is often heard about and actively used. However, the parties structuring a SAFE transaction do not always fully understand what its essence is. At first glance, the document may seem very simple, but this is not entirely true.

In this guide, the REVERA team has taken a closer look at what SAFE is, how it works, and what its main benefits are. We also talked about the different types of this document and their features.

Section 1

SAFE: in simple words about «simple contract»

I. SAFE: Concept and Key Benefits
II. SAFE structure
III. Pro rata rights of the investor
IV. Difference between SAFE and convertible loan

REVERA

I. SAFE: Concept and Key Benefits

A startup needs funds for business and product development from the very beginning of its existence, even at the stage of searching for an MVP. At the early stages of startup development, it is impractical to attract equity investments (long, expensive, and difficult). Previously, investments at such stages were traditionally raised through convertible loans.

In 2013, the American startup accelerator Y Combinator developed another tool, a startup-friendly alternative to a convertible loan – SAFE.

> **SAFE (Simple Agreement For Future Equity) –** is a standardized agreement under which an investor provides funding to a startup **now** in exchange for the right to receive shares **in the company in the future** upon the occurrence of certain events. In the United States, SAFE is a security .

From the very beginning, SAFE has become very popular among investors and startups when structuring venture investments, as it has many advantages:

1. Standardization

SAFE was developed by Y Combinator on the basis of extensive experience in structuring venture investments. Therefore, SAFE is a standardized document that everyone knows and trusts.

The SAFE draft is posted on the official Y Combinator website*: it consists of literally 6-7 pages, its terms are standard and are signed as is (i.e. not adjusted).

However, if such an adjustment occurs, it **is necessary to make a note in the document that it has been revised**. It is important to understand that in this case, the document ceases to be a "classic" SAFE and requires a more in-depth study and negotiation of the terms by the parties. Because it is clear to everyone and will definitely work in practice as it should.

2. Ease of conclusion

When concluding a SAFE, the parties only agree and fill in the following information:

- details of the parties, applicable law and date of conclusion of SAFE
- Amount of investment provided
- the maximum valuation of the startup at which investments are provided or the size of the discount on shares in the next equity round (when the startup will sell shares to a new investor).

* https://www.ycombinator.com/documents

3. Speed

Since SAFE is a standardized document, investments are provided quickly as soon as the parties are ready to sign SAFE.

4. Savings

To conclude SAFE, the startup and the investor agree only on the amount of investment and the valuation cap/discount.

The parties do not need to spend resources, including the involvement of expensive lawyers, **on negotiating the approval of complex legal instruments that are in the equity round**: the procedure for decision-making in the startup, the preemptive rights of the parties, the protection of the investor's share from dilution, etc.

II. SAFE structure

SAFE consists of 4 sections:

1. **Events:** possible scenarios for SAFE
2. **Definitions:** Terms used in the text
3. **Representations:** confirmation by the parties of certain facts relating to them/transaction
4. **Miscellaneous:** Amendment/Termination of SAFE Terms, Notices, Applicable Law, and Other

The key section of SAFE is "Events". It provides 3 scenarios for the development of the relationship between a SAFE investor and a startup. Since the maturity date of SAFE is not determined by a specific date, it is important to understand that the relationship between a SAFE investor and a startup may not transform for a long time.*

1. Equity Financing: Raising a Private Equity Round by a startup

Rising direct investment means the sale of startup shares to an equity investor (i.e. an investor who immediately receives a share and certain rights in the startup).

The equity round is the only event trigger for converting investments/SAFE amounts into startup shares. The conversion occurs automatically, regardless of the evaluation of such a round. SAFE is converted into preferred stock, they have special rights and privileges in comparison with the common stock of the founders.

2. Liquidity Event: Change of Control or Initial Public Offering of startup shares

A change of control is the sale of more than 50% of voting shares by a startup, the alienation of all or almost all of the startup's assets, and the merger/acquisition of a startup by another business.

Initial Public Offering is a startup's IPO, listing of shares, that is, offering startup shares to a wide range of people on the stock exchange.

In the event of a liquidity event, the SAFE investor, depending on which is more profitable:

- receives back the investments made under SAFE or
- participates in the distribution of the startup's profits (receives the amount received from the conversion of SAFE into the common stock of the startup and their subsequent sale as part of the Liquidity Event).

Refunds are made in accordance with the order of priority:

Return of investments under SAFE

- The SAFE investor receives his money **after** the startup repays all debts (including convertible loans that have not been converted into startup shares).

* **Important:** the described "scenarios" are based on how SAFE works in the United States. Changes are possible depending on the jurisdiction of structuring the transaction.

- Payments are made **on a par** with payments to other SAFE investors and preferred stock holders of the startup.
- A SAFE investor receives payouts **before** the money goes to common stock holders.

Participation in the distribution of profits

- A SAFE investor receives money only **after** the startup repays all debts (including convertible loans that have not been converted into startup shares) and returns the investment.
- Profit distribution occurs **on a par** with common stock holders (including those who previously had preferred stock, but converted to common).

3. Dissolution Event: Termination of Activities or Bankruptcy

It can also happen that the startup business does not take off. If a startup ceases its activities (is liquidated) or goes bankrupt, the SAFE investor must receive a return on the investments made under SAFE. The same order is applied as in the case of a return on investment in a liquidity event.

However, it is important to understand that in such a situation, a SAFE investor should hardly count on a real return on investment, since when the startup ceases operations, as a rule, there is simply no money left.

III. Pro rata rights of the investor

Pro rata rights are the rights of a SAFE-investor to participate in an equity round. They allow a SAFE investor to retain their stake in a startup as much as possible by purchasing additional shares on a pro rata basis.

When developing the first version of pre-money SAFE, Y Combinator included pro rata rights in SAFE as a basic condition. Over time, Y Combinator came to the conclusion that it was very difficult to standardize pro rata rights for each deal. The tool does not always work as the parties need.

In addition, pro rata rights in the SAFE pre-money valuation were triggered not at the next equity round, when SAFE was converted into a stake (e.g. Series A round), but at the next equity round (Series B). This approach often caused confusion among the parties to the transaction.

Therefore, when developing the post-money valuation **of SAFE, Y Combinator, firstly, moved pro rata rights beyond the basic conditions of SAFE.** Now, in order for a SAFE investor to have such rights, Y Combinator offers the parties to conclude a separate additional agreement – Pro Rata Side Letter, its draft can be found on the accelerator's website.

And **secondly, Y Combinator has changed its approach to the moment of exercising pro rata rights**: now they are applied by the SAFE investor at the next equity round, when SAFE is converted into a share.

Pro rata rights are automatically terminated in case of:

1. **Equity Financing:** at the time the round is closed (i.e. the deal is completed)
2. **Liquidity Event:** Immediately before the change of control or IPO/listing
3. **Dissolution Event:** just before the startup goes out of business,

i.e. together with the termination of SAFE itself.

IV. Difference between SAFE and convertible loan

Early investments in startups are traditionally formalized by two documents, let's consider their key differences:

No.	Comparison Criteria	SAFE	Convertible loan
1.	Automatic conversion into startup shares at the next equity round	✓ Yes	✓ Yes, if the parties have not agreed on other conditions
2.	Possibility of return on investment instead of converting into shares	✗ No, a return on investment is possible only upon the occurrence of a Liquidity Event, Dissolution Event	✓ Yes, if the parties have not agreed on other conditions
3.	% of the investment amount upon return	✗ No	✓ Yes, if the parties have not agreed on other conditions
4.	Maturity date	✗ No	✓ Yes, if the parties have not agreed on other conditions
5.	Legal complexity	✗ Standardized, almost non-negotiable document	✓ A more complex legal document that requires the negotiation of a number of conditions

SAFE is a simpler and more startup-friendly tool compared to a traditional convertible loan, as it reduces the amount of pressure on the startup: having received investment, the startup focuses on business development and does not think about the potential need to repay the loan and pay interest.

SECTION 2

The evolution of the SAFE valuation: from pre-money to post-money

I. Pre-money valuation SAFE: a look at a startup BEFORE rasing investments using SAFE / other instruments

II. Post-money valuation SAFE: a look at a startup AFTER raising investments using SAFE / other instruments

Pre-money and **post-money** are two ways to look at the valuation of a startup. The key difference is the accuracy of determining the dilution of SAFE investors' shares in a startup.

> **Share dilution** is a percentage decrease in the SAFE investor's stake in a startup after the company raises an equity round and issues additional shares to the equity investor.

The dilution of the SAFE investor's stake occurs because in the equity round the SAFE investor is first converted into a startup share, and only then the equity investor becomes part of the startup and dilutes the shares of all current shareholders (that is, our converted SAFE investor, founders and employees with options reserved before the equity round).

I. Pre-money valuation SAFE: a look at a startup BEFORE rasing investments using SAFE / other instruments

When SAFE first appeared, startups were more likely to attract small amounts of investment before a large equity round. The key idea of SAFE was that its holders were, in fact, early investors before a future huge round of private equity.

The first version of SAFE, introduced by Y Combinator in 2013, was based on pre-money valuation. This is the company's valuation before attracting investments for all SAFE, loans and other instruments. Example:

- Pre-money valuation of the startup – $4 million.
- SAFE-investor invests $200 thousand.
- the estimated stake of the SAFE investor before the equity round will be calculated based on the pre-money valuation of the startup – $4 million (i.e. excluding investments in all other SAFE/convertible loans/other instruments).

What happens next? When converting pre-money SAFE into startup shares during the equity round, our SAFE investor's stake will be diluted by both the equity investor and all other SAFE/convertible loan investors whose investment amounts we do not know.

Accordingly, pre-money SAFE creates a lot of uncertainty for a SAFE investor regarding the future stake in the startup.

II. Post-money valuation SAFE: a look at a startup AFTER raising investments using SAFE / other instruments

Over time, the situation changed. Startups began to raise larger sums through SAFE, and SAFE began to be perceived as independent stages of funding. It has become much more important for a SAFE investor who provides a large amount of money to understand what stake in a startup he can expect after the conversion. Pre-money valuation did not meet such needs.

Thus, Y Combinator introduced a new version of SAFE – post-money in 2018. This is the valuation (value) of the company after raising investments for all SAFEs, loans and other instruments (but before the round of direct investments). For example:

- Pre-money valuation of the startup – $8 million.
- SAFE-investor invests $1 million
- the estimated share of the SAFE investor before the equity round will be calculated based on the post-money valuation of the startup – $9 million ($8 million + $1 million)

The post-money valuation of a startup helps the parties to more accurately predict what final stake each participant will receive: in this case, only the equity investor will dilute the share of the SAFE investor. Other SAFE investors (both those who came before our SAFE investor and those who came after) do not dilute each other in terms of post-money valuation. It is also important to note that the size of our SAFE investor's stake is not affected by the valuations of other SAFE investors.

Moreover, **if a startup has a plan to raise certain amounts of investment, a SAFE investor can determine his future stake in the company with sufficient accuracy.**

Section 3
SAFE types

I. SAFE: valuation cap, no discount
II. SAFE: discount, no valuation cap
III. SAFE: MFN, no valuation cap, no discount

Y Combinator has developed three kinds of SAFE:

1. valuation cap, no discount
2. discount, no valuation cap
3. MFN, no valuation cap, no discount

They differ in their approach to determining the valuation of a startup and, accordingly, the stake of the SAFE investor when converting into startup shares during the equity round. The choice of the SAFE type depends on the negotiations between the SAFE investor and the startup.

Before we move on to each of the types of SAFE, let's understand the definitions that we will need to do this:

Valuation cap is the maximum valuation of a startup at which a SAFE investor will be converted into a share of the startup. The valuation cap protects the investor from too high a valuation of the next round and excessive dilution of his share.

Discount is a discount on the share price in the equity round, which is provided to a SAFE investor. The amount of such a discount depends on the stage of development of the startup at the time of conclusion of the SAFE and can vary from 10 to 30%.

MFN stands for Most Favored Nation.

I. SAFE: valuation cap, no discount

SAFE valuation cap, no discount is one of the most popular investment vehicle options for financing early-stage startups. A SAFE investor has every reason to believe that by the equity round, the company's valuation may increase significantly. Therefore, he chooses this type of SAFE, which fixes the maximum valuation cap of the startup, at which the SAFE investor will be converted into a share.

What happens during the equity round and the conversion of the SAFE valuation cap into startup shares?

Let's assume that a SAFE investor has provided a startup with $100 thousand through SAFE with a valuation cap of $5 million.

At the same time, SAFE is automatically converted into startup shares immediately before the equity investor is issued to the equity investor, depending on the equity round valuation and what is more profitable for the SAFE investor:

Round valuation above valuation cap	Round valuation below valuation cap
For example, the equity valuation of the round is $10 million, the conversion takes place at the valuation cap, because in this case the SAFE-investor receives more shares. The SAFE investor's stake in the conversion will be calculated using the formula **I/C**, where I = SAFE investment amount ($100 thousand) C = Valuation Cap ($5 million) **That is, our SAFE investor will receive a 2% stake in the startup ($100 thousand / $5 million) before issuing shares to the equity investor (he will dilute the SAFE investor)**	For example, the estimated equity of the round is $4 million. The conversion takes place based on the valuation of the new round, because in this case the SAFE-investor receives more shares. The SAFE-investor's share in the conversion will be calculated using the formula I/V, where I = SAFE investment amount ($100 thousand) V = startup valuation in a new round ($4 million) **That is, our SAFE investor will receive 2.5% stake in the startup ($100 thousand / $4 million) before issuing shares to the equity investor (he will dilute the SAFE investor)**

II. SAFE: discount, no valuation cap

Under SAFE discount, no valuation cap, the investor is given a discount on the price of the startup's shares upon conversion, but the maximum valuation of the startup is not set. Only the valuation of the nearest equity of the round will be taken into account.

So SAFE with a discount allows a SAFE investor to get a discount on shares in any case when converting compared to an investor in the equity round.

What happens during the equity round and the conversion of the SAFE discount into startup shares?

For example, a SAFE investor invests $100 thousand through a SAFE c discount of 20%. The startup's valuation in the next equity round is $5 million.

When a trigger event occurs, i.e. the equity of the round, SAFE is converted into startup shares according to the formula **I / (C * (1 – D)**,

where

- I = SAFE investment amount
- C = valuation of the company in a new round
- D = decimal discount percentage (20% = 0.2)

So, in this example, our SAFE investor will receive 2.5% in the startup ($100 thousand / ($5 million * (1 - 0.2) before issuing shares to the equity investor (he will dilute the SAFE investor).

III. SAFE: MFN, no valuation cap, no discount

This is a special type of SAFE, which does not have pre-defined clear conversion conditions, such as valuation cap or discount, but has a unique feature – the ability to “upgrade”.

> **MFN** is a provision that provides a SAFE investor with the opportunity to apply the best terms that the company can offer on subsequent SAFE/convertible loans and other similar instruments prior to the equity round of financing .

This type of SAFE is most often chosen at the earliest stages of the development of a startup’s product, which does not allow you to unambiguously determine the value of the company, and it is also obvious to the parties that before the equity round, investments will still be attracted using SAFE and/or other instruments.

For example, if a startup issues new SAFE with more favorable terms (valuation cap or discount), the SAFE MFN holder can update their contract to receive these improved terms.

An investor with MNF SAFE can exercise this right once.

What happens during the equity round and the conversion of SAFE MFN into startup shares?

A SAFE investor invests $100 thousand through SAFE MFN. The startup is rising direct investment at a valuation of $6 million.

If a SAFE investor has applied MNF, then his SAFE MNF is replaced by another type of SAFE (valuation cap, discount), convertible loan or other instrument with more favorable terms. Conversion into startup shares will take place under the terms of the updated document.

But if the SAFE investor has not applied the MFN condition, then the SAFE MFN will be automatically converted into startup shares on the same terms as the equity investor enters. That is, according to the same formula as in the SAFE Valuation Cap – **I / V**,

where

- I = SAFE MFN investment amount ($100K)
- V = Startup valuation in a new round ($6 million)

Also, do not forget that the equity investor dilutes the SAFE investor.

Section 4

Jurisdictions in which investments can be structured using SAFE

REVERA

SAFE was created by Y Combinator for the investment deals in the United States, where the venture capital industry is growing the fastest. Subsequently, the accelerator developed SAFE templates that can be used in structuring investments in Canada, the Cayman Islands and Singapore. Thus, these four jurisdictions (including the United States) are the regions where SAFE can be freely concluded today.

For all of them, the Y Combinator website has the corresponding standardized SAFE drafts. In terms of content, drafts do not differ from each other.

* * *

If a startup is located in a jurisdiction where SAFE is not implemented in the legislation, you need to look for the most similar tool to SAFE in the legislation of such jurisdiction and try to adapt it as much as possible to the conditions of classic SAFE.

Usually, such instruments are a convertible loan/conventional loan. When agreeing on the terms of SAFE analogues, the parties must take into account the requirements of local legislation. We recommend consulting with local lawyers, tax experts and accountants to minimize risks and adapt the chosen tool to the requirements of your jurisdiction.

The search and agreement on the terms of similar instruments will naturally lead to a greater waste of resources of the parties. However, it will allow you to structure your relationship according to a model similar to SAFE.