SAFE

Simplified Agreement for Future Equity

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Introduction

Types of instruments for raising money

- Equity shares;
- Compulsory convertible preference shares;
- Optionally convertible preference shares;
- Compulsory convertible debentures;
- Optionally convertible debentures;

Demerits of conventional instruments:

- Time consuming;
- Arrive at defined valuation;
- Heavy negotiation;
- Price discovery is difficult;
- Paperwork;
- Discussion on Investor rights;

Introduction to SAFE:

- A simplified agreement for future equity;
- Issued in seed stage of funding;
- Introduced by Y combinator in the US in the year 2013;
- Does not require a price discovery valuation of the company;

Why are SAFEs used for Seed stage of funding?

- Start-up is only an idea which cannot be valued.
- Simple agreement of five pages.
- Founders know their dilution at the time of raising money.
- Lesser post-money valuation cap for taking the early risk.
- Not a debt instrument and has no maturity date.

Sample:

SAFE

(Simple Agreement for Future Equity)

THIS CERTIFIES THAT in exchange for the payment by [Investor Name] (the "**Investor**") of $[_______________] (the "Purchase Amount") on or about **[Date of Safe]**, **[Company Name]**, a [State of Incorporation] corporation (the "**Company**"), issues to the Investor the right to certain shares of the Company's Capital Stock, subject to the terms described below.

This Safe is one of the forms available at http://ycombinator.com/documents and the Company and the Investor agree that neither one has modified the form, except to fill in blanks and bracketed terms.

The "**Post-Money Valuation Cap**" is $[_______________]. See **Section 2** for certain additional defined terms.

Types of SAFE

- Fixed conversion at a future date
- Post-money valuation cap, no discount
- Discount, no valuation cap
- Post-money valuation cap with discount (on pre-money)
- MFN (Most favoured note) only

Note: It is advised to issue post-money valuation SAFEs as it is easier to calculate the dilution percentage.

Merits:

- No interest payment;
- No repayment of investment;
- Expediency in issue;
- Negotiation with valuation cap;
- No valuation;
- Non-drafting of SHA saves:
    - Pre and Post money valuation;
    - Board Seat/Observer;
    - Tag along/Drag along rights;
    - Anti-dilution;
    - Voting rights;
    - Creation of ESOP pool.

Demerits:

- Uncertainty in determining the cap-table

iSAFE

Can SAFE be issued in India?

- No.

Why?

- Section 42 of the Companies act – 60 day condition;
- Section 62 of the Companies act – Valuation Requirement;
- Section 56(2)(viib) of the ITA;
- Section 56(2)(x) of the ITA;

How does iSAFE as an instrument exist?

It is treated as a CCPS/CCD.

Introduction:

- Introduced by venture capitalists 100x.VC in 2019.
- For the purpose of fully diluted cap-table, they are treated as CCPS.
- Non-cumulative dividend of 0.0001%
- Preference over equity in case of liquidation.
- Conversion into equity, in case of:
    - next pricing/valuation round;
    - dissolution, merger or acquisition, etc.;
    - at the end of 3 years from date of it's issue.

Note: Conversion within 3 years is only part of the standard agreement and can be amended. As per Companies Act, 2013 - CCPS have a maturity of 20 years.

What is iSAFE?

- Simplified Agreement for Future Equity;
- Treated as Compulsory Convertible Preference Share;
- Receive money now, issue stock later;
- Minimal negotiations;
- Not debt;

Anatomy of iSAFE?

- Section 1 – events
  - Equity financing
  - Liquidity event
  - Dissolution
  - Liquidation priority
  - Termination
- Section 2 – definitions
- Section 3 – Company representations
- Section 4 – Investor representations
- Section 5 – Additional legal sections

Steps for issue:

1. Increase authorised share capital of the company
   - Pass Board resolution to convene an EGM
   - Pass an ordinary resolution to increase the authorised capital
   - File form SH-7 within 30 days of passing resolution with amended MOA and AOA
2. Execution of the iSAFE agreement with the investors
3. Issue of iSAFE (by way of rights issue to avoid valuation)
   - Pass board resolution for issue of iSAFE
   - Issue of offer letters to existing shareholders
   - Renounce shares in favour of the investors
   - Receipt of investment
   - Board resolution for allotment of shares within 60 days of receipt of money
4. File form PAS-3 as a return of allotment within 30 days of allotment with MCA
5. Issue share certificates within 2 months of allotment
6. Enter the name of the investor in the MGT-1 register

Companies Act compliance

- Agreement to issue CCPS to investor.
- The Start-up to incorporate as a Company.
- Reflected in the financial statement under Shareholders Fund.
- Governed by the following sections of the Companies Act:
  - 42 – Private placement of shares;
  - 55 – Issue and Redemption of preference shares; and
  - 62 – Further issue of Capital.

FEMA compliance:

- Individuals:
  - Invest abroad through liberalised remittance scheme (LRS).
  - Invest up to $2,50,000.
  - Subject to round-tripping provisions.
  - Cannot invest more than 10% of fully diluted cap table.
- Others:
  - Investment through ODI route.
  - Investment up to 400% of net worth.
  - SAFE is treated as debt and debt can be given only by existing equity share holders of the Company.

Note: Non-individuals cannot invest in securities other than equity, CCD, CCPS, ORCPS.

Income Tax compliance:

- At the time of issue:
  - Sec 47(xb) – Not applicable.
  - Sec 56(2)(viib) – Avoided if the start-up is registered.
  - Sec 56(2)(x) – Not applicable if adequate consideration paid.
- At the time of conversion:
  - Sec 47(xb) – Not treated as a transfer.
  - Sec 56(2)(viib) – May not be treated as an issue/avoided if the start-up is registered.
  - Sec 56(2)(x) – May not be treated as an issue/NAV is lower due losses incurred.
- At the time of sale:
  - Selling price – Exercise price = Capital Gain.
  - LTCG if holding >12 months; taxed u/s 112A
  - STCG if <12 months; taxed u/s 111A

Note: Tax exemptions shall be revoked retrospectively in case of violations of any start-up recognition provisions.

How is it Different?

	SAFE	iSAFE
Treatment	Agreement	CCPS/instrument
Process for issue	Simplified issue	Complicated issue
Cap Table	Not visible	Visible as CCPS
Maturity	No maturity	20 Years Maximum
Interest/Dividend	No interest/dividend	Non-cumulative dividend of 0.0001%
Valuation Report	No valuation	Only for private placement

	SAFE	CCPS	CN
Treatment	Agreement for equity	Equity Instrument	Debt Instrument
Documentation	5 page agreement	SHA required	SHA required (if convertible debt)
Conversion terms	Valuation Cap/Discount	Discount	Discount
Valuation	No requirement	Required	Required
Maturity	No maturity	No maturity	10 years
Liquidity preference	At par with CCPS	After Debt	First preference

Conclusion

What did we learn?

- SAFE – How it works.
- SAFE – better option, if negotiated well.
- SAFE – agreement, not instrument.
- SAFE – are not dilutive for other SAFEs.
- SAFE – convert before investment.
- SAFE – post money SAFEs are advisable.
- Investors – dilute founders and SAFE holders.
- Series A round valuation greater than valuation cap is advisable.
- Effect of valuation cap is not large due to negotiations:

Summary on iSAFE:

- No legal recognition by Companies Act, 2013
- Treated like CCPS;
- It makes the issue process easier as SHA/SSA is not required;
- Valuation report required in case of private placement;
- Introduces new negotiation technique of valuation cap.

Thank you

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