



Oct 21, 2019

Categories:

[Publications](#)

Authors:

[William G. Strench](#)

When SAFEs Fail

Simple Agreements for Future Equity (SAFE) were first introduced by Y Combinator in 2013 as a substitute for convertible notes. They quickly gained popularity and have become the investment vehicle of choice nationally for emerging companies.

SAFES are written contracts in which an investor makes an investment into a company which will convert into equity of the company, or possibly cash, upon the company's next equity financing, sale or dissolution. The SAFE is convertible upon any such event at a discount to the equity valuation in such event. If provided in a SAFE, the valuation at which the SAFE converts will be subject to a capped amount.

As their name suggests, SAFES are simple to prepare. Generally, they require companies to pick one of four SAFE forms which are available on Y Combinator's website and fill in two or three terms. The other provisions are not intended to be modified as one of the SAFE attractions is the creation of a document requiring minimal review and negotiation by investors. Indeed, one of the SAFE provisions is a representation by the issuer that the SAFE form has not been modified except to fill in blanks and bracketed terms.

The SAFE forms have been updated from time to time by Y Combinator to fine tune their terms and the current versions can be found [on the Y Combinator website](#).

While SAFES have many virtues, particularly for early stage companies, they have several features, some obvious, some less so, that investors should be conscious of prior to investing.

SAFES do not bear interest.

Unlike convertible notes, SAFES do not bear interest. Accordingly, SAFES converting five years after issuance convert on the same basis as SAFES converting six months after issuance as there is no adjustment to reflect the time value of money. Furthermore, in the event of a sale of the company at a valuation that is too low to result in conversion treatment, an investor will only receive its

investment back without any return on it.

SAFEs do not have maturity dates.

A convertible note has a maturity date. This allows the holder to force the issuer to repay the investor if a conversion event or liquidity event has not occurred by a specified date. SAFEs lack this feature and therefore SAFEs can remain outstanding for an indefinite period while delivering no return to the investor.

SAFEs are junior to all indebtedness.

Upon a dissolution or sale of an issuer not resulting in a conversion, holders of SAFEs only receive a return after all other debt, including trade payables, has been repaid. Indeed, under such circumstances, SAFEs are not even senior to preferred equity which is entitled to equal treatment with SAFEs. In contrast, convertible notes are senior to all equity and, if secured, can be senior to all other debt.

There is no required minimum size to a financing that can trigger a conversion of a SAFE.

Nearly all convertible notes require a minimum size financing for a conversion of the Notes to occur. This is to ensure that the conversion price is based on market terms that may not be present in a relatively small financing. With a SAFE, so long as the financing is a “bona fide transaction,” conversion of the SAFE will occur regardless of the size of the financing.

SAFEs have no significant investor protection rights.

Investors in SAFEs lack some of the basic rights that routinely are included with other early stage investments such as preemptive rights, right of first refusal on sales of founder shares, tag-along rights, information rights and board seats.

SAFEs issued by limited liability companies have uncertain tax treatment.

LLCs that have not elected to be taxed as C corporations are taxed as partnerships or pass through entities for U.S. federal income tax purposes. Arguably SAFEs should be considered “noncompensatory” options (NCOs) for partnership tax purposes. U.S. Treasury Regulations define noncompensatory options to include “a contractual right to acquire an interest in the issuing partnership other than options issued in connection with the performance of services.” There is, however, no definitive IRS authority on this position. If the IRS were to determine SAFEs are not NCOs, uncertain treatment could result, including the possibility that the IRS could treat the SAFE investor as a member of the LLC dating back to the issuance of the SAFE. This treatment would be supported by Section 5(c) of the SAFE which suggests that the SAFE holder is an owner of equity of the company for tax purposes and is entitled to the same dividends that are payable on the company’s common equity.

For the reasons outlined above, investors should consider whether the simple nature of the SAFE outweighs its limitations. At the very least, they should consider the convertible note alternative or making modifications to the SAFE form to address these concerns.

© 2026 FBT Gibbons LLP. May be considered attorney advertising in some jurisdictions.