

If you want just the formal details of the YC-SAFE, read this instead:

[YC-SAFE is unsafe for founders](#)

The Art of Pre-Seed Fundraising

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Part I - How to Select & Approach Pre-Seed Investors

When contemplating startup funding, the common questions and topics are about which VC firms to approach, how to organize a pitch deck, how to calculate a TAM, what valuation to seek. Such questions generally are far too granular and premature, particularly in the early stages. Far more important questions are “what are my strengths in terms of generating social capital in an ecosystem that is new to me”, “what is my current social capital”, and “how do I synergize the two”?

Part II - Why F&F is the Best Place to Start

Friends & Family is often the best option for pre-seed because it is a more level playing field for you as the founder. Even if you decide not to raise from F&F, the exercise of thinking it through is useful, because you can easily construct an intuition about how this might go, but you have much less intuition about how to deal with VCs. You might even be able to turn active angels and VCs into your F&F, at least for the transaction of your pre-seed. I don't have data to support this, but in my experience startups that start with F&F overwhelmingly have a higher success rate than those that don't. While this is likely both cause and effect (raising from F&F helps a founder & founders who raise from F&F have other positives going for them) you can tap into BOTH advantages by utilizing the following advice.

Part III - MFN is the Ideal Pre-Seed Investment Term for Founders

THE YC-SAFE agreement labelled as MFN-only makes life for the founder much easier for the pre-seed investor. In the example of Google's pre-seed, which we will discuss, the deal was done as a handshake - the investor agrees to accept whatever terms you later set - but such terms can and are written into SAFEs and convertible notes, and indeed YC has an official SAFE with this handshake written in. I am not saying that in all, or even a majority, of cases, founders will be able to achieve MFN terms. But it is worth trying. As i will discuss below, the semantic meaning of the acronym MFN itself is the subject of enormous confusion and ambiguity, and I will do my best to resolve this. I think the likely interpretation means that this version of the YC agreement should be called an MFN-only SAFE, so I will refer to it as such.

Part IV - Valuations in a Nutshell & Using a YC-SAFE Agreement

Before 2013, the instrument used for pre-seed and seed funding was the convertible note, which is essentially a loan that converts to equity upon Series A. A convertible note is orders of magnitude simpler to transact than a Series A preferred equity round, and thus was used to save expense of small financings. In 2013 YC created an even simpler instrument called the Simple Agreement for Future Equity (abbreviated as “safe” but more commonly capitalized as “SAFE”). The SAFE dispenses with the formal construct of the loan as the basis

of the instrument and thus is essentially a convertible note minus the loan, interest, and maturity date.

In terms of valuation, the terms “pre-money” and “post-money” are at their core pretty simple, but the YC-SAFE uses them in convoluted ways.

Related Document: [Tech Startups - The Very Early Corporate Stuff](#)

Part I - How to Select & Approach Pre-Seed Investors

“If you sit in on a poker game and you don’t see a sucker at the table, get up. Because you’re the sucker.” - attributed to many, but originally from John Spooner

“The reality – and it’s a reality that clever players try to obscure from the naive – is that business relationships (including startup ecosystems) are full of both positive and zero-sum games, many of which are unavoidably linked.” - Jose Aker, Silicon Hills Law

Raising the first few \$100K of outside investment can be one of the most intimidating tasks that a founder faces. Some struggle to do it well, and some fail to do it at all, and some (a small minority) handle the task with aplomb. The reason this task can be so challenging for a new founder is that you are trying to learn the rules of a new game while at the same time trying to play it well. It would be like sitting at a chess tournament or a \$100 poker table with the rule book in hand, furiously reading the rules while hoping the strategies and tactics of the game will come intuitively. In almost all cases they will not, and you will lose, because you are the sucker at the table.

As Jose Aker says in the quote above, there is a lot of good will circulating around the startup ecosystem, but it is cleverly embedded within zero-sum games. An accelerator or a seed-stage fund with a reputation as a good actor in the ecosystem is not a bad choice of someone to work with, but they still have a zero-sum game with you with regard to the term sheet they put in front of you. Even after they invest in you, theoretically they are on your side, but they may have hundreds, or thousands, of portfolio companies, so their bandwidth for you is limited— you may cannon fodder for them. An individual angel investor with a smaller portfolio of investments may be a better choice, but that person may have limited experience and know-how. Jose Aker indicates the complexity of the social game in another [post](#).

The best chess or poker teacher is one that will teach you the strategy and tactics, and only show you a harsh lesson in a zero-stakes context, like beating you at a pennies-stake poker game between F&F. The term “Friends & Family” is important because it is also used in the context of investing to connote a similar ecosystem. Of course, if someone you consider F&F is not knowledgeable about whatever tech startup ecosystem you are dealing with, they may be of limited value, but perhaps they have a F&F who is. Alternatively, you can build a relationship with someone who is a player in the ecosystem and perhaps turn them into F&F. This is exactly what Sergey Brin and Larry Page did with two of their professors (not their direct academic advisors) for the pre-seed financing of Google, a story recounted mainly because their checks sat in a drawer uncashed for a while because Google, Inc did not yet exist.

All of this, mind you, is deep work, and I can say that raising pre-seed for your startup, likely anything else important, is best done in a mindful fashion. I hope this document gets you started on the right path.

Part II - Why F&F is the Best Place to Start

While content about start-up funding certainly is not hard to find, I think content on F&F fundraising is relatively unique. For one, it's just not that sexy. Also, Institutional investors have little interest or incentive in writing about pre-seed, particularly when it comes to F&F. As for founders, well-connected and talented founders will find the F&F approach I discuss to be quite intuitive, and when something comes easily to one, one tends not to codify it. This content is aimed at the rest of us normalish folk who may need guidance - guidance I developed after seeing it done many, many times.

The reality is that the success rate is much higher for startups that start with F&F. I don't have data to support this, but in my experience it is overwhelmingly the case. Some of the biggest names we know such as Microsoft, Amazon, and Google, started with F&F, and likely there are many others where we do not hear about the F&F because it is not considered a significant part of the story, e.g., "my parents gave me \$100K to start off". The notion that raising from F&F is much easier if you come from privilege and wealth is of course, but this often acts as an excuse. The emotional path of least resistance is not to consider F&F. Certainly the fear of losing their money is stressful to consider, both in terms of ethics and saving face. The quick answer to this is to only raise as much from anyone as they can comfortably afford to lose.

There are so many advantages to raising from F&F that I think everyone should at least consider it. In addition, raising from F&F can be a sign to yourself and your co-founders that you are "all in". The conventional startup narrative is that a couple of whiz kids come up with something great, get into YC or get some big-name VC money (thus obviating the need for F&F money) and then they are off to the races. This describes companies like AirBnB and DoorDash, so certainly it happens. I think the founders of those companies probably were not necessarily "all in" at the outset in that they seemed OK with the prospect of the project not working out and moving on to something else - an experimental or experiential way of approaching startup life. Aside - I was in the class at Stanford that launched DoorDash, and will share that story in the premium versions of this content.

But reality is that the success rate of founders is much higher when they are "all in". Both Bezos and Gates went to F&F because they had figured out their grand mission in life and effectively were not going to let it fail. I'm not saying that you have to be as much of a visionary as Bezos or Gates, but the closer you can match that sort of mindset, the better, and going through the (perhaps uncomfortable) exercise of thinking through F&F is part of that. The F&F story of Google is particularly instructive, because it involved two middle-class graduate students who relied on a different kind of F&F - professors in their department, not generational wealth.

Let's suppose that after achieving one or two milestones in the next 2-3 years, you think you can raise seed at a healthy valuation, perhaps @\$10-15M. However, life would be a lot easier in the beginning with a little pre-seed. Conventional wisdom is that raising any money at this early stage necessitates a very low valuation. This is reasonable, and largely true, but there

are two ways of thinking about your positioning and value proposition, where you can avoid a zero-sum dynamic - a dynamic in which you lose. I call this zero-sum dynamic “valuation crushing” and describe two counter-strategies of fighting valuation crushing at pre-seed.

- Good-will - asking for a favor - social impact
- Scarcity - doing them a favor - insider deal

As one example, assume you are fortunate enough to know a few VCs who operate funds. To people in certain areas of the world, casually knowing a VC might be unusual, but in NYC or Silicon Valley one is bound to meet a few through the course of ordinary life. If a VC likes your project but it is not right for her fund, she might want to invest her own money. No matter how good a relationship you have with her, if you ask her for \$1M, she is likely to negotiate on terms, because \$1M is serious money, even for her. Then your valuation would get crushed because you are so early-stage. However, if you ask for a relatively small amount, perhaps \$25K, she might not care much about valuation. To say it another way: if you are below a certain threshold, she might be willing to do you a favor, and I’m not saying she would give you the money for free, but she might not care to negotiate terms. She might say “I’m in for \$25K, I don’t really care about the valuation, just give me the same terms as everyone else.” In this scenario you are leveraging counter-strategy #1.

Case Study - Google (1998)

This is essentially what happened with Google in 1998. When Sergey and Larry had dinner with professors Cheriton and Bechtolsheim, the latter each wrote out \$100K checks, famously, before the company was even incorporated, on good-faith, handshake terms. We can accurately describe that \$200K as Google’s pre-seed - although mind you, terms such as pre-seed, seed, and Series A are all terms of art. We can also describe the money that was raised a few weeks or months later as the seed. Anecdotally, David and Andy did not ask for any specific terms in that pre-seed, and thus it was like the example of “I don’t care about valuation” I described above. In other words, they were willing, in good faith, to assume that Sergey and Larry would do a seed round with reasonable and fair terms, and give them the same.

Likely the later seed was done as a convertible note at a 20% discount to the Series A, and David and Andy got the same. While the initial \$200K was initially done with no paperwork, today the same likely would be done with an MFN-only SAFE, which is an instrument that memorializes the “just give me whatever terms you later set” handshake deal.

Thus:

- Pre-Seed: \$200K on MFN-only handshake terms

And a few week or months later:

- Seed: Likely 20% discount to Series A

I have not asked any of the people involved what the exact terms of the seed were, nor do they likely remember. I have spent quite a bit of time with one of the founders, and to be honest it’s not the sort of topic you want to spend cycles on when you get to spend quality time

with such a person. Aside - I can share some amusing (non-tabloidy) stories from that founder in the premium content.

Professors David and Andy could have negotiated over this, i.e., since we are the first investors, give us a better deal. But as a real-life example of counter-strategy #1, they didn't care to. These two angel investors effectively became F&F for Google because they were totally on their side, and didn't act in an adversarial fashion. So too did the VC in my example above.

Perhaps you don't know any fund managers, but you likely know other people who can make such an investment: doctors, real estate magnates, etc. And if such a person is not in your industry domain, you can give her the opportunity to learn about something new by investing in you (a kind of insider deal). This relates to counter-strategy #2, scarcity. If they are people who do work in your industry, perhaps you are giving them the opportunity to invest in something paradigmatically new or disruptive to that industry, e.g., an MD investing in health tech. Aside- the term disruptive is overused in an erroneous fashion, if you want to understand the original meaning of the term, look for the work of Clayton Christenson, who coined the term.

The Social Dynamics of F&F

Pre-seed investment is generally a statement of faith in the founders. There are exceptions where someone might invest at this stage based on belief in the power of the technology, but they are very rare. The major risk in an early-stage company is team risk, because two genius founders with the greatest idea in the world can have a fight two weeks later and the company falls apart, among many, many, reasons why the team can torpedo a promising project.

F&F might come from someone who is successful in and knowledgeable about your industry ("smart money"). It might be someone you have known since college who doesn't have domain expertise ("dumb money") but who has seen you operate, who knows your ability. Even if she can only afford \$10K, multiply \$10K several times and you will start to see real money.

If this approach doesn't sound promising to you because you don't know many such people, then you probably need to rethink your financing roadmap. Building a startup is mostly about building goodwill, particularly early on when you have no resources. If you have been locked in your lab for the past three years doing nothing but engineering or sciencing - a problem articulated in this [article](#) - you are going to have a hard time getting investors, customers, partners, co-founders, employees, because they are not going to care about how great your invention is if they don't care about you. If all you care about is the technology, then perhaps this approach is fine, but if you are building a company, then probably you care about actual people using and buying your product, not just the technology itself.

There are legitimate reasons to not raise from F&F, but "I don't know how I would do it" is not a good excuse to avoid thinking about it entirely. It is much better to plan out how you would do it, then not do it, and use that framework as an initial plan for how to raise from institutional. And this is because raising money from VCs is more similar to asking your buddy from college for \$10K than most people think. Some people think that they can just read formal guidance on how to talk to VCs (pitch deck templates, TAMs, SAMs, etc.) It's kind of like trying to become a good chess player by poring over the rules. Sure you have to know the rules, but actually learning to play chess involves a different sort of learning, and I am suggesting you use the F&F exercise at least as a place to start.

By going F&F, you become a sort of market maker, instead of a market taker, in that you have more power to set the terms and this document is meant to give you more knowledge on how to do that. To circle back to the poker quote, I am saying that if you can get what you need to get done at the \$5 poker table, avoid the \$100 poker table (that is above your head) for as long as you can. Certainly I am not suggesting you take advantage of F&F. This starts with being transparent about the transaction as possible, starting with the risk. Presumably, as a startup, your risk is very high, so have them understand that their investment is effectively already lost, and celebrate if they happen to get a return many years later. Along these lines, while it is possible to raise money from unaccredited investors, this is so problematic and possibly unethical that I would steer away from it.

What is a Lead Investor?

I also want to briefly discuss the concept of “lead investor” in the context of pre-seed. Lead investor is a term of art, but what it means at its core is the investor or investors, who by reputation or the amount of money they are investing, turn the investment from theoretical (a bunch of “soft” commits) into reality. That lead investor usually gets to set the terms of the investment, because as you inch closer and closer to them, realizing that entity or person is the one that will get the switch to flip, you inch towards a handshake agreement that you then instantiate into a formal agreement, which you propagate to everyone else to fill out the round. This is yet another highly social process.

Fundraising Roadmap

One way of grounding your financing milestones (the only way, to be realistic) is to tie them to product milestones. Take the below with a grain of salt, they are all terms of art, but they illustrate a general pattern and point I want to make. What most startups hope for is something like this:

Bootstrap for **Ideation** → **MVP** resulting in Pre-Seed
Use Pre-Seed for **MVP** → **Product** resulting in Series A
Series A - **Product** → **Product-market fit** → Series B
Series B - **Product-market fit** → **Product-market-channel fit** → Series C
Series C - **Product-market-channel fit** → **Growth** → Series D
Series D+ - **Growth to Exit** - IPO or M&A

Some founders cannot raise pre-seed after product or even product-market fit, and such this can be viewed as a critical path, rate-limiting problem. A founder with a lot of social capital can push the initial fundraising roadmap half-a-step or a whole step early, the latter meaning that they can raise pre-seed to do **Ideation** → **MVP**, which makes life a lot easier (one might even be able to take a small salary). Getting into an accelerator sort of counts as that whole step early, although there is often a trade-off re: valuation crushing.

Part III - MFN-only is the Ideal Pre-Seed Investment Term for Founders

An MFN-only SAFE for pre-seed makes life for the founder much easier. In the Google example, the MFN-only was done as a handshake (we will take whatever terms you later set),

but they can be written into SAFEs and convertible notes, and YC has a pre-written MFN version of its SAFE). I am not saying that in all, or even a majority, of cases, founders will be able to achieve MFN-only following my advice. But it is worth trying, at least with F&F. Professional investors are unlikely to even consider MFN-only, unless you hold all the cards, because negotiating over terms is a big part of their game.

The reason that MFN-only is so useful for the founder is not solely due to valuation though that is part of it. An MFN-only agreement is as simple as possible (leave the terms till later), so you don't need to do any heavy mathematical thinking about your cap table. By leaving the terms till later (seed) if someone invests in your pre-seed under MFN-only terms, they effectively are just investing in your seed, just a bit earlier. There is little question that someone investing on MFN-only terms is doing you a favor in terms of valuation (good-will), but sometimes there is a perfectly rational zero-sum reason to do this - they won't be allowed to invest in the seed round. If the seed round is fairly large and led by professional investors, there may be a fairly large minimum check size, and/or it will make sense to only take very smart money then. So for example, a likely scenario is that you would be willing to take a \$25K check at pre-seed but have a minimum of \$100K at seed. So it legitimately could be a "now or never" situation for a potential investor.

Again, MFN-only terms at pre-seed mean that the pre-seed investment becomes part of the seed investment syndicate when that happens. If you can convince people that the chances of you getting to seed are quite high, then there is minimal additional risk. Once the seed round is executed, the pre-seed investors effectively become part of the seed syndicate, as they will be following the lead and the terms set by the seed-stage lead investor.

Unfortunately there is immense confusion about what the acronym MFN stands for and also what MFN amendment (a clause in this YC document) means. I can't totally clarify this because there remains unaddressed ambiguity. My best guess is that there has been a long-standing confusion involving the distinction between MFN and MFN-only, which far from being purely semantic, is actually a meaningful distinction.

The acronym MFN likely stands for "most-favored nation". What does "most-favored nation" refer to in this context? This is my best guess. There is a clause in the YC-document called the "MFN Amendment" which essentially says that the investor has the right to update to a later SAFE agreement with better terms for her. In other words, the investor has the right to update to that "most-favored" set of terms. Thus this agreement is accurately referred to as MFN-only, not MFN, because the agreement contains only this "right to update" clause, and no cap nor discount. For a long time, I thought MFN referred to the startup being "most favored" because it is getting no cap and no discount, but now I realize that MFN likely refers to the investor because the clause is an MFN amendment on her behalf. To be even more precise (and perhaps overly pedantic) the acronym should be interpreted as "more" and not "most" favored nation because it allows for one update, not unlimited updates.

If that last sentence is confusing, just ignore it. The important point is that a coherent interpretation is that the document is an MFN-only SAFE because it contains an MFN Amendment to update on Google-like handshake terms, with the MFN being the latter SAFE investors, not the startup itself. That is why I prefer to refer to this document specifically as the MFN-only SAFE and not the MFN-SAFE, and that rubric is actually logically meaningful. Note that this clause also can be included in non-MFN only SAFEs in order to allow the same type of

update, but it is not in the standard YC documents. Finally, since the meaning of MFN is actually unclear, I would prefer to refer to this clause simply as the “Amendment Clause” but that is ultimately immaterial as long as the clause itself clearly articulates what the update rights are.

To summarize, the amendment clause allows for the original “infinite” valuation of this SAFE to be updated to the later SAFE terms (which we can call the seed). Note that it is possible for the seed SAFE also to be MFN-only, which means that everyone will later convert on Series A terms, but that is very rare.

Part IV - Valuations in a Nutshell & Using a YC-SAFE Agreement

From Convertible Notes to SAFEs

Convertible notes are loans that convert to equity based on a defined financing event. They were a hack from decades ago - take a conventional loan, say \$25,000 for two years at 5% interest, and state that the loan will convert to equity (typically preferred stock) in conjunction with a later, more substantial financing (typically Series A). You can look up what a typical Series A startup investment looks like, but here is a nutshell.

The Series A will give the investors preferred shares at a certain pre or post-money valuation and a share price calculated on this basis. For example, \$10M invested by the investor at a \$40M pre-money valuation (and thus a \$50M post-money valuation) and shares will be issued for this. If in this example the investors gets 1M preferred shares, those shares will be priced at \$10 each, with the remainder of the issued shares being common stock or stock options being held by the founders and employees, 40M shares, which are also sort of worth \$10 each. I say sort of, because \$10 per common shares is the right number to make the overall valuation calculation work, $\$10M + \$40M = \$50M$. But the common shares are not quite worth \$10, as they don't have the same voting rights and liquidation preferences as the preferred shares, so they will typically be worth less, maybe \$2-5. That common share price needs to be determined through a separate process so that the employee stock options can be given at a proper price (the strike price).

For this discussion you don't need to worry about that. Just realize that the overall \$50M post-money valuation number is not quite accurate. It is more accurate to say that the investor portion is worth \$10M and that if the company common shares had the same price, the total would be \$50M. In informal discussions and reporting in the media, the number \$50M (for post-money valuation) or \$40M (for pre-money valuation) is used as a shorthand to get a sense for “how valuable” the company is.

Now back to the main thread. This convertible note hack as an investment instrument is far simpler and cheaper to implement than a Series A - which can be hundreds of pages of documents. And as a hack, the convertible note does present problems in terms of what happens if that priced equity round never happens, whether because the company is not climbing a steep growth trajectory as planned, or more likely, because it is running out of money. Since it is a loan, a convertible note, if not converted to equity, technically must be paid back, although the spirit of the agreement generally is to treat that loan as a fiction. In other words, with trustworthy parties, a good relationship, and transparent intentions, if after good faith effort (rather than malfeasance) a company fails, then the investor just forgets about trying to recoup some or all of the loan. In a more adversarial situation, however, the investor can try to do this,

depending on the precise terms of the note. Eventually, people started to write instruments that carved away the fiction of the loan from the documents, thus creating agreements for “future” equity (most notably Y-Combinator’s SAFE). The original SAFE was “published” in 2013 as a document now referred to as the pre-money SAFE, and revised in 2018 as the document now referred to as the post-money SAFE, the latter of which is the standard SAFE instrument today.

While you can use a convertible note for your pre-seed, I am going to frame my discussion around the YC SAFE v1.2, colloquially referred to as the Post-Money SAFE because the valuation is defined in post-money terms. The concepts I discuss apply in essentially the same way to convertible notes, but you cannot rely on this document to walk you through the entire process, because there are a lot of nuances. You either need a good lawyer, or you need to be very attentive to the technical nuances to understand all of the implications. The good news is that the YC-SAFE is only a few pages long and there is a lot of content on the Internet (not YC itself) for guidance, so theoretically it is possible to “DIY responsibly” and founders often do so. The bad news is that most founders don’t pay enough attention to these details when they do DIY.

In contrast to the standard SAFE, the original 2013 SAFE is referred to as the Pre-Money SAFE. Note that one confusing nuance is that the terms post-money valuation and pre-money valuation have their own meaning, but there are more differences between these two documents than just that one uses a post-money valuation and one uses a pre-money valuation. In terms of valuation, the terms “pre-money” and “post-money” are at their core pretty simple, but YC-SAFE uses the terms in convoluted ways.

Pre-Money vs Post-Money Valuation

The basic concept of pre-money vs post-money is simple. Before the investment money is counted, you negotiate a valuation for the company itself, which is the pre-money valuation, then you add in the money invested, to arrive at the post-money valuation:

$$\begin{aligned} &\textbf{PRE-MONEY + MONEY == POST-MONEY} \\ &\textbf{in other words} \\ &\textbf{COMPANY VALUE + \$ INVESTED == POST-MONEY VALUATION} \end{aligned}$$

The post-money SAFE introduces serious confusion by changing the metes and bounds of the “\$ invested” part of the equation, and this works to the serious detriment of founders. In the main document, I discussed some of the historical reasons why the post-money SAFE has become the standard, and why I don’t think this insidious effect was intentional on the part of the drafters (staff at YC and an external lawyer I am well acquainted with). But the net effect is that the company takes essentially all of the dilution from future SAFEs (and other convertible securities). If you negotiate a higher cap for later SAFEs, it is to the benefit of the first SAFE investor(s), not you. This history is important enough to discuss in some detail.

Before the introduction of the original SAFE in 2013, seed financings were done as discrete, defined rounds. In other words, a company would raise a specific amount of money, say \$500K (no more, no less) and have all the investors involved execute on the same exact date (at the insistence of lawyers). Then the company would not raise money again until another specific point in time. Once YC published the SAFE and more seed financing became DIY,

founders started doing open-ended (“rolling”) rounds. Before this, a company would often find an investor or two to agree to terms, and then construct a round among them and perhaps a few others. After the introduction of the SAFE, what started happening is that instead of closing a discrete round of financing, companies kept raising on the SAFE for months or years. This is a low-friction but less disciplined way of raising money, and it started becoming the norm.

Once a round is closed, the investor owns part of the company, and thus any future financing will dilute investor shares and founder share proportionally. But because the SAFEs were being used in this unintended, open-ended fashion it seems like YC decided that it would be more reasonable for the founders to take all of the dilution from the continued rolling. The consequence is that for the 2018 Post-Money SAFE, the company takes all of the dilution from future SAFEs (and notes), even if that later SAFE has a lower cap or higher discount (cap and discount discussed below).

I think that it would be more reasonable to define a discrete round as the basis of the “\$ invested” part of the equation. In other words, take all of the money invested in a particular week or month and call that the “current round” as a basis to calculate the post-money valuation. I would change the definition of “\$ invested” from “all converting securities” (which includes all future SAFEs, thus diluting primarily the company and not the investors) to specifically enumerate the SAFEs that count as part of the current financing round. It is not easy to do this as a template because the definition of “current round” would vary, and this might not be done correctly DIY. Attorney Aker and Adler have suggested essentially the same change (Box link below). If you want some example cap table examples with the SAFE, see my supplement [SAFE Math and the Adjusted SAFE](#).

YC-SAFE - Cap, Discount, MFN Amendment

When people refer to the terms of a SAFE or convertible note, they will summarize it by “cap and discount”, meaning the valuation cap and the discount percentage. So a SAFE with \$10M cap and 20% discount means that the investors will convert at a valuation of no more than \$10M (however valuation is defined in the SAFE) at Series A or 20% off the Series A price, whichever is better for the investor. Confusingly, in a SAFE, “discount rate” means purchase price, so a 90% discount rate means 10% off.

It is most common for a SAFE to have both of these terms. For the founder, a higher cap and lower discount are better. You can have one without the other, though you can’t say which one is preferable, given you don’t know how the numbers will work out. It is true that the discount is easier to understand, in the sense that 20% discount (80% discount rate) is easy to calculate, whereas valuation is a trickier calculation (see, e.g., our discussion of post-money valuation above).

If you don’t have either a cap or discount then you have an MFN (most-favored nation) SAFE. MFN basically says that you agree to the Series A price, which in numerical terms is a bad deal for the investor, but it also simplifies things. You not only avoid having to negotiate a cap and discount, but it obviates the post-money valuation confusion discussed above because there is no valuation calculation - it is put off to Series A.

In almost all cases, with MFN your investors won’t be getting the Series A price because the MFN SAFE has an amendment provision which states that if a subsequent SAFE has better terms, the investor will convert to that SAFE. This MFN-amendment provision is almost always

incorrectly referred to as MFN. MFN means no cap and no discount. MFN-amendment means the right to update. And the next round (seed) typically will have a cap and/or discount, so using MFN at pre-seed essentially means that your pre-seed investors are willing to accept the later seed terms, as Google's pre-seed investors did.

This brings me to a point on ethics with F&F. Even if the MFN-SAFE had no amendment provision, I think every founder should allow an earlier F&F investor to convert to later terms if they are better. While I think it is OK for a founder to ask F&F to accept MFN, in other words, the same terms as a later investment, I absolutely think that such investors should not be forced to live with worse terms, absent exceptional circumstances. Note that non-MFN SAFEs don't have this amendment provision baked in, so in those cases it certainly is possible for the later seed SAFE to have better terms for the investor than pre-seed, which is yet another reason to try to go with MFN. While experienced investors may balk at the concept of MFN, I stand by my reasoning that it should at least be considered by the founder. I don't necessarily think that most of you will be able to get MFN for pre-seed, but I have given you a lot of reasons to at least consider it as an ideal.

SEC & IRS Compliance

As a fairly accurate simplification, startups need to abide by the same rules as giant hedge funds and companies raising \$500M for a Series A. This can be a serious pain and expense at the early stage, and can cost several or even tens of thousands of dollars. This is in part because each state has different rules, and while they are generally similar, sometimes they are not. Until several years ago - again, before DIY) - lawyers would generally insist that such filings be done in a relatively timely fashion. Most SEC and state rules state that they must be done within 15 days of the first sale. Even before DIY, it was common for these to be done a little late, because it was difficult to round up all the paperwork and because there was little or no consequence of being late. So, if it's OK to be a little late, is it OK to be a lot late (delayed compliance)? It's ultimately for you to decide, although your service professionals will have their own takes.

These are the common early events that require such filing:

1. Founder stock grant
2. Stock option plan
3. Any investment (SAFEs and convertible notes)
4. Any other stock grant that is not part of the stock option plan

As you might imagine, #3 is easier to comply with if there is a discrete financing round on a single day than for a rolling round, where you might technically be required to do dozens of filing for each 15 day window of SAFE issuances. It was and is common to try to wait for more than two of these events to happen so the filings can be done at once, even if they are more than 15 days apart. By this logic, why not wait until many, many, of these things occur and do the filings all at once? With the advent of Clerky and DIY, such delays are happening anyway, sometimes for years since many founders are not even aware of such requirements. So, once they get to Series A, the lawyer identifies the omission and takes care of them. And of course, there is the

logic that if the company fails before Series A, no harm no foul, but that is not quite true, as closing the company technically does not extinguish this obligation.

SAFEs and convertible notes are generally regarded as liabilities for 409a valuation purposes, which means they need not substantially raise your stock option strike price.

Some Resources

[Why Startups shouldn't use YC's Post-Money SAFE](#)

[Trust, "Friendliness," and Zero-Sum Startup Games](#)

[When VCs "Own" Your Startup's Lawyers](#)

[What's the best founder-friendly term sheet?](#)

[YC Safe Financing Documents | Y Combinator](#)

[Post-Money SAFEs Give Investors Extreme Anti-Dilution Protection. Here's How to Remove It](#)

[SAFEs Archives](#)

Ancer and Adler: <https://app.box.com/s/bwm02h8ahtb0wwn6ugbasuwoh9y0thq2>

[SAFEs and Convertible Notes | News | Haynes and Boone](#)

[Model Legal Documents - National Venture Capital Association - NVCA](#)

[SAFE and Convertible Note Calculator](#)

[The Carta SAFE for Seed Rounds - Silicon Hills Lawyer](#)

[What is "Shadow Stock"? - Law for Startups](#)

[The Shadow CEO: Equity Beyond Stock Option](#)

[Carta - Cap Table 101](#)

[SAFE Calculator for the Y-Combinator Post Money SAFE](#)

[Pre-Seed: 5 Practical Things To Do When It's Just You And A Startup Id](#)

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