Convertible Right (SAFE) Instrument

Policy Statement
Small Business Venture Capital Act (SBVCA)
s. 1(1), 12, 28.3(1), 28.93 of the Act;
s. 3.2 of the Regulation

Introduction

As part of Budget 2019, "convertible right" (i.e., Simple Agreement for Future Equity, or "SAFE") was added to the definition of "equity share" under the Small Business Venture Capital Act (the "Act").

For convenience, this policy statement will use the term "SAFE" to mean a convertible right.

The purpose behind adding SAFE to the definition of "equity share" is to give eligible business corporations ("EBCs") and eligible small businesses ("ESBs") another option to raise venture investment for which the EBC investor can claim a tax credit, or in the case of a venture capital corporation ("VCC"), a SAFE investment is an "eligible investment" that counts towards the VCC's pacing requirements.

Despite the intent to make SAFEs tax credit eligible, or an eligible investment for a VCC, not all SAFE instruments are the same: some contain provisions that are contrary to the Act. This policy statement explains the features of a SAFE instrument that make them compatible with the Act, and those features that make SAFE instruments ineligible for tax credits or ineligible for VCC investment.

EBCs/VCCs must ensure their proposed SAFE instrument meets the eligibility requirements of an "equity share" under the Act.

SAFE Investment Requirements for Tax Credit Eligibility/Business Investment Eligibility

Since a SAFE falls under the definition of "equity share" under the Act, the requirements of the Act apply equally to an investment in shares or an investment in a SAFE, or the converted shares of a SAFE. Consequently, the requirements for a SAFE to be tax credit eligible or an eligible investment for a VCC include:

- The SAFE must be an "at risk investment", which is an equity investment under the Act that is at risk both as to return of capital and return on capital. Equity is a residual claim on assets and earnings after all of the EBC's/ESB's obligations have been met (see: Equity Shares Policy Statement).
- An EBC eligible investor must hold their shares or SAFE (or the shares thereof) for 5 years from the date of investment (the "5-year hold period").
- An EBC must not allow "equity shares", for which tax credits have been issued, to be redeemed, acquired, or cancelled unless the investor has held the shares or SAFE (or shares thereof) for 5 years, or the investor has repaid the tax credit to the province.
- The SAFE instrument must not include any interest feature (paid or accrued).
- The SAFE instrument must not include any security assignment feature.

- The EBC must not claim tax credits on behalf of the investor if at any time during the 2 years immediately preceding the date of investment in the SAFE, the investor has disposed of a share of any class of shares or disposed of a SAFE (or the shares thereof) issued by the EBC.

- The EBC must ensure that funds raised by a SAFE instrument must not be used for prohibited purposes as outlined in section 28.93 of the Act and;

- The VCC must ensure that funds raised by a SAFE instrument must not be used for prohibited purposes as outlined in section 12 of the Act.

SAFE Features Contrary to the Small Business Venture Capital Act

The following table outlines some common SAFE features and how they are treated by the Small Business Venture Capital Tax Credit Program.

Eligible Business Corporations		
SAFE Provision	**Legislative Requirement**	**Treatment**
Liquidity Event – A liquidity event or any other event where the SAFE investor has the option to receive immediately prior to or concurrent with the liquidity or other event, a cash payment equal to the original purchase amount.	Act – section 28.3 (1)(b)(i) - equity capital will consist of equity shares that do not carry rights and restrictions attached to the shares or convertible rights that create a debt between the holder or beneficial owner of the shares or convertible rights and any other person.	A liquidity or other provision in the SAFE instrument, where the investor has the option to receive a cash payment prior to (but not immediately prior to or concurrent with) the liquidity or other event, and the EBC has an obligation to provide a cash payment to the SAFE investor, creates a debt between the EBC and the investor at the time the request for payment is triggered. This is contrary to section 28.3 (1)(b)(i) of the Act.
	Act – section 28.3 (1)(b)(ii) - equity capital will consist of equity shares that entitle the holder or beneficial owner of the shares or convertible rights to reduce the impact of any loss the holder or beneficial owner sustains in holding or disposing of the share or convertible right.	A liquidity or other provision in the SAFE instrument, where the investor has the option to receive a cash payment prior to (but not immediately prior to or concurrent with) the liquidity or other event, and/or where the payment amount to the SAFE investor is more than the original purchase amount, reduces the impact of any loss the SAFE investor sustains in holding or disposing of the SAFE. This is contrary to section 28.3 (1)(b)(ii) of the Act.

	Act – section 28.3 (1)(b)(iii) - equity capital will consist of equity shares that provide the holder or beneficial owner of the share or convertible right with the right to require the EBC to repurchase the shares or convertible rights before the expiry of 5 years after the date of issue.	A liquidity or other provision in the SAFE instrument, where the investor has the option to require the EBC to repurchase the SAFE before the expiry of the 5-year hold period is contrary to section 28.3 (1)(b)(iii) of the Act.
Dissolution Event - A dissolution or other event before the SAFE expires or terminates, where the company is required to pay the SAFE investor an amount equal to the original purchase amount, immediately prior to or concurrent with the consummation of the dissolution or other event.	Act – section 28.3 (1)(b)(i) - equity capital will consist of equity shares that do not carry rights and restrictions attached to the shares or convertible rights that create a debt between the holder or beneficial owner of the shares or convertible rights and any other person.	A dissolution or other provision in the SAFE instrument, where the EBC is required to pay the SAFE investor an amount prior to (but not immediately prior to or concurrent with) the dissolution or other event, creates a debt between the EBC and the investor at the time the request for payment is triggered, and is contrary to section 28.3 (1)(b)(i) of the Act.
	Act – section 28.3 (1)(b)(ii) - equity capital will consist of equity shares that entitle the holder or beneficial owner of the shares or convertible rights to reduce the impact of any loss the holder or beneficial owner sustains in holding or disposing of the share or convertible right.	A dissolution or other provision in the SAFE instrument, where the EBC has a requirement to provide a cash payment to the SAFE investor prior to (but not immediately prior to or concurrent with) the dissolution or other event, reduces the impact of any loss the investor sustains in holding or disposing of the SAFE, and is contrary to section 28.3 (1)(b)(ii) of the Act.
	Act – section 28.3 (1)(b)(iii) - equity capital will consist of equity shares that provide the holder or beneficial owner of the share or convertible right with the right to require the EBC to repurchase the shares or convertible rights before the expiry of 5 years after the date of issue.	A dissolution or other provision in the SAFE instrument, where the EBC has a requirement to repurchase the SAFE before the expiry of 5 years after the date of issue is contrary to section 28.3 (1)(b)(iii) of the Act.

For clarification, a SAFE instrument that specifies that an investor can receive proceeds immediately prior to, or concurrent with a liquidity event, and the proceeds will be less than or equal to (but not greater than) the original purchase price of the SAFE instrument, then the SAFE instrument is acceptable and an Eligible Investment under the SBVCA.

SAFE instruments that grant investors rights to proceeds prior to liquidity events, and amounts greater than the original purchase price (i.e., 1.5 times the original purchase price), are contrary to the SBVCA, and are NOT Eligible Investments under the SBVCA.

A SAFE instrument that contains liquidity, dissolution or other provisions that are contrary to section 28.3(1) of the Act are not eligible for tax credits. The EBC must ensure the SAFE instrument does not contain these provisions if an investor plans to claim a tax credit for the investment, or the investor has waived the right to invoke liquidity, dissolution, and other provisions contrary to the Act.

The issuance of tax credits for an investment in a SAFE will be granted on the understanding that the EBC has complied with, and will continue to comply with, the Act and Regulation. The Province of British Columbia makes no representations or warranties regarding the merits of a SAFE instrument and does not in any way express an opinion as to the value of any SAFEs or shares issued by the EBC, the financial condition of the EBC, or the merits of any investment or business proposal.

Venture Capital Corporations		
SAFE Provision	**Legislative Requirement**	**Treatment**
Liquidity Event – A liquidity event or any other event where the SAFE investor has the option to receive immediately prior to or concurrent with the liquidity or other event, a cash payment equal to the original purchase amount.	Regulation – section 3 (1)(a) - Subject to the Act, prescribed rights and restrictions, for the purposes of the definition of "equity share" in the Act, are rights and restrictions attached to the share or rights and restrictions contained in or forming part of an agreement, commitment or understanding in respect of the share that create a debt between the holder or beneficial owner of the share and any other person.	A liquidity or other provision in the SAFE instrument, where the investor (the VCC) has the option to receive a cash payment prior to (but not immediately prior to or concurrent with) the liquidity or other event, and the ESB has a obligation to provide a cash payment to the SAFE investor (the VCC), creates a debt between the ESB and the SAFE investor (VCC) at the time the request for payment is triggered. This is contrary to section 3 (1)(a) of the Regulation.
	Regulation – section 3 (1)(d) - Subject to the Act, prescribed rights and restrictions, for the purposes of the definition of "equity share" in the Act, are rights and restrictions attached to the share or rights and restrictions contained in or forming part of an agreement, commitment or understanding in respect of the share that will entitle the holder or beneficial owner of the share to reduce the impact of any loss the holder or	A liquidity or other provision in the SAFE instrument, where the investor (the VCC) has the option to receive a cash payment prior to (but not immediately prior to or concurrent with) the liquidity or other event, and/or where the payment amount to the SAFE investor (the VCC) is more than the original purchase amount, reduces the impact of any loss the SAFE investor sustains in holding or

	beneficial owner will sustain in holding or disposing of the share.	disposing of the SAFE. This is contrary to section 3 (1)(d) of the Regulation.
Dissolution Event - A dissolution or other event before the SAFE expires or terminates, where the company is required to pay the SAFE investor an amount equal to the purchase amount, immediately prior to or concurrent with the consummation of the dissolution or other event.	Regulation – section 3 (1)(a) - Subject to the Act, prescribed rights and restrictions, for the purposes of the definition of "equity share" in the Act, are rights and restrictions attached to the share or rights and restrictions contained in or forming part of an agreement, commitment or understanding in respect of the share that create a debt between the holder or beneficial owner of the share and any other person.	A dissolution or other provision in the SAFE instrument, where the investor (the VCC) has the option to receive a cash payment prior to (but not immediately prior to or concurrent with) the dissolution or other event, and the ESB has a requirement to provide a cash payment to the SAFE investor (the VCC), creates a debt between the ESB and the SAFE investor (VCC) a the time the request for payment is triggered, and is contrary to section 3 (1)(a) of the Regulation.
	Regulation – section 3 (1) (d) - Subject to the Act, prescribed rights and restrictions, for the purposes of the definition of "equity share" in the Act, are rights and restrictions attached to the share or rights and restrictions contained in or forming part of an agreement, commitment or understanding in respect of the share that will entitle the holder or beneficial owner of the share to reduce the impact of any loss the holder or beneficial owner will sustain in holding or disposing of the share.	A dissolution or other provision in the SAFE instrument, where the investor (the VCC) has the option to receive a cash payment prior to (but not immediately prior to or concurrent with) the dissolution or other event, and/or where the payment amount to the SAFE investor (the VCC) is more than the original purchase amount, reduces the impact of any loss the SAFE investor sustains in holding or disposing of the SAFE, and is contrary to section 3 (1)(d) of the Regulation.

For clarification, a SAFE instrument that specifies that an investor can receive proceeds immediately prior to, or concurrent with a liquidity event, and the proceeds will be less than or equal to (but not greater than) the original purchase price of the SAFE instrument, then the SAFE instrument is acceptable and an Eligible Investment under the SBVCA.

SAFE instruments that grant investors rights to proceeds prior to liquidity events, and amounts greater than the original purchase price (i.e., 1.5 times the original purchase price), are contrary to the SBVCA, and are NOT Eligible Investments under the SBVCA.

A SAFE instrument that contains liquidity, dissolution or other provisions that are contrary to section 3(1) of the regulation is an ineligible investment. The VCC must ensure the SAFE instrument does not contain these provisions for the SAFE investment to count towards a VCC's investment pacing requirements, or the VCC has waived the right to invoke the liquidity, dissolution, and other provisions contrary to the Act.

The Province of British Columbia makes no representations or warranties regarding the merits of a SAFE instrument and does not in any way express an opinion as to the value of any SAFEs or shares issued by the ESB, the financial condition of the ESB, or the merits of any investment or business proposal.

EBC - SAFEs

- As of March 2, 2019, a SAFE investment in an EBC is eligible for a tax credit, subject to the SAFE complying with the Act as outlined above. A SAFE is a right that will convert to an equity share at a later date – generally at the next round of financing.
- For an EBC, tax credits are only issued on a SAFE investment at the time the SAFE is issued and the EBC receives the investment proceeds. Tax credits are not issued when a SAFE converts to equity shares.
- The 5-year hold period begins at the time of investment in the SAFE of the EBC.
- An EBC must be registered in the program for their SAFEs to be eligible for a tax credit. SAFEs issued prior to registration in the province's tax credit program are not tax-credit eligible.
- A SAFE is not included in the $25,000 equity capital requirement for EBC registration.

VCC - SAFEs

- A VCC cannot issue a SAFE.
- As of March 2, 2019, a VCC investing in a SAFE of an ESB will we be an "eligible investment" at the time of investment and will count towards the VCC's investment pacing requirements.
- A VCC that invested in an ESB's SAFE prior to March 2, 2019, will have its investment become an "eligible investment" as at March 2, 2019, and count towards the VCC's investment pacing requirements from that date.

For further information or clarification on the changes, please contact the Investment Capital Branch at 1 800-665-6597 or via email at InvestmentCapital@gov.bc.ca.