U.S. Securities and Exchange Commission
Office of the Advocate for Small Business Capital Formation

What different types of securities are issued to startup investors?

Federal securities laws broadly define the term "security" capturing many different forms of investment interests issued to those who provide funding to startups. Many startups and investors refer simply to "equity" to connote an ownership interest in a company.

Key types of securities

The following are some of the key types of securities issued in startup and early-stage investments:

Stock

A stock represents an ownership interest—or equity—in a corporation. Equity holders of stock are often called "stockholders" or "shareholders." Different classes of stock, such as common stock (more commonly issued to founders) and preferred stock (more commonly issued to outside investors), have different voting and economic rights.

An investor's ownership interest is often reflected as either a percentage of stock or a number of shares or units on the company's capitalization table.

Membership Interest

A membership interest represents an ownership interest in a limited liability company (LLC). Ownership and governance of LLCs typically uses different terminology than corporations, such as members instead of shareholders, operating agreement instead of bylaws, and membership interests or units instead of shares of stock. An LLC may assign different levels of voting and economic rights to members by issuing different classes of membership interests.

Stock Option

A stock option provides the holder with the right—but not the obligation—to "exercise" their option to purchase a certain number of shares of company stock at an agreed-upon price (a strike price) after a vesting period.

Startups and other companies often issue stock options to employees and other workers as a part of their overall compensation package.

Restricted Stock

Restricted stock units (RSUs) and restricted stock awards (RSAs) are issued by a company to its employees as compensation. RSUs and RSAs each have different tax consequences and the following attributes:

- The shares of stock underlying an RSA are owned by the recipient on the date of the grant. The holder can sell or transfer the shares after certain vesting conditions are met.
- An RSU is a right to receive shares of stock once certain vesting conditions are met. The recipient does not own any shares of stock on the date of the grant.
- Vesting conditions may include the achievement of milestones, such as length of employment or performance metrics.

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Convertible Instruments

A convertible note is a loan made by an investor to a company that can be converted into a different security. Convertible notes are often used during seed rounds because of challenges valuing a company early in its life cycle. Typically, the note will automatically convert from debt into preferred stock of the company upon the closing of the next funding round or other agreed upon conditions.

A simple agreement for future equity (SAFE) is an agreement between a company and an investor in which the company promises to give the investor a future ownership interest in the company if certain triggering events occur, such as a future equity financing or an acquisition of the company. The owner of the SAFE does not have an ownership interest in the company unless the triggering event occurs and converts the instrument into equity. Like convertible notes, SAFEs are often used during seed rounds; however, unlike a convertible note, a SAFE generally does not include a valuation of the equity at the time of issuance, deferring that calculation until the triggering event occurs.

Debt

Debt, which includes a loan, is an amount owed to an individual or entity for borrowed money to be repaid on an agreed upon maturity date, typically with interest. Depending on the type of debt, it may be classified as a security. Some debts may be repaid or converted into equity.

Have suggestions on additional educational resources? Email smallbusiness@sec.gov.