COUNTRY COMPARATIVE GUIDES 2022

# The Legal 500 Country Comparative Guides

# Sweden

# PRIVATE EQUITY


## Contributing firm

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This country-specific Q&A provides an overview of private equity laws and regulations applicable in Sweden.

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# SWEDEN
# PRIVATE EQUITY

## 1. What proportion of transactions have involved a financial sponsor as a buyer or seller in the jurisdiction over the last 24 months?

Financial sponsors are very active in Sweden which has been the case for many years. Our statistics show that the involvement of financial sponsors has been steady for the past two years and they were involved in 35% to 45% of all transactions. Although the number of PE buy-outs fell significantly in 2019 and during the first half of 2020, financial sponsors have been very active again since Q3 2020 and have continued to drive M&A activity in the Nordics. In 2020, secondaries and exits remained at the level of previous years. As we have seen a surge in PE activity in Sweden during 2021, we expect the proportion of PE transactions in 2021 to be even higher than in the preceding years.

## 2. What are the main differences in M&A transaction terms between acquiring a business from a trade seller and financial sponsor backed company in your jurisdiction?

A financial sponsor more often uses a controlled auction and has a more strict view on terms such as that: (i) the buyer must assume the merger clearance risk; (ii) there will be no conditions precedent to completion (except for mandatory merger control clearance) ; (iii) the sponsor backed company will not offer any representations and warranties unless the buyer takes out a warranties and indemnities insurance policy ("W&I insurance"). Almost all PE backed exits will require the buyer to take out W&I insurance.

## 3. On an acquisition of shares, what is the process for effecting the transfer of the shares and are transfer taxes payable?

The transfer is effective (i.e. the buyer obtains the right in rem in relation to the shares and is able to exercise all rights pertaining to the shares) when the buyer is entered in the target company's share register as owner of the shares. In those cases where share certificates representing the shares have been issued, the transfer is fully effected when the certificates have been endorsed and transferred to the buyer. There are no Swedish transfer taxes applicable to a transfer of shares.

## 4. How do financial sponsors provide comfort to sellers where the purchasing entity is a special purpose vehicle?

With an equity commitment letter from the fund.

## 5. How prevalent is the use of locked box pricing mechanisms in your jurisdiction and in what circumstances are these ordinarily seen?

Locked box pricing mechanisms are commonly used in Sweden. In our experience, during the last few years, locked box mechanisms were chosen in approximately 60% of all the transactions (65% in 2020). Locked box mechanisms are generally more predominant but other purchase price adjustment mechanisms (i.e. closing balance sheet mechanisms and other forms of true-ups) are still an important tool for more complex transactions, particularly spin-offs and carve-outs of which we have seen a larger number on the Swedish market over the last few years. Locked box pricing mechanisms are still particularly favoured by financial sponsors. In transactions where there is a financial sponsor on the sell-side, locked box pricing mechanism are chosen in more than 80% of the transactions (92% in 2020).

## 6. What are the typical methods and constructs of how risk is allocated between a buyer and seller?

It varies, but it is more common that warranties are

 

given both at signing and completion so that the risk actually remains with the seller until completion. Swedish law and market practice puts a lot of responsibility on the buyer to perform proper due diligence and everything that is fairly disclosed in the data room will be considered disclosed against all warranties (normally) and any specific diligence findings will need to be negotiated as specific indemnities.

## 7. How prevalent is the use of W&I insurance in your transactions?

The activity level has been steady over the last few years and in particular in large cap transactions where the deal value exceeds SEK 500 million, and in transactions where the seller is a financial sponsor, W&I insurance is very frequently used (around 50%). As brokers and underwriters active on the Swedish market have recruited M&A specialists and developed the product and the underwriting process, W&I insurance has become a more flexible and thus viable part of transactions.

## 8. How active have financial sponsors been in acquiring publicly listed companies and/or buying infrastructure assets?

Recently, public to private deals by financial sponsors have been rather uncommon, with only one or two transactions per year. However, in 2021 and 2020 we have seen an increased number of public tender offers by financial sponsors. There have also been several deals which have involved financial sponsors buying infrastructure assets.

## 9. Outside of anti-trust and heavily regulated sectors, are there any foreign investment controls or other governmental consents which are typically required to be made by financial sponsors?

Amendments to the Protective Security Act (Sw. *Säkerhetsskyddslagen*) were introduced in January 2021 with the aim to establish a control system over the sale of certain security-sensitive activities. An extensive duty to determine if an acquisition involves a transfer of a security-sensitive activity is put on the operator of the business – i.e., the seller. The starting point for the assessment of if an activity is security-sensitive is if it affects Swedish external or internal security interests. This may include a wide range of activities, including in sectors such as energy supply, electronic communications and financial services. There are no thresholds or other qualifying conditions that clarify when the proposed requirements become applicable. Consequently, the business operator's security analysis must be performed prior to every transfer that may include a security-sensitive activity.

A transfer that is considered inappropriate by the operator of the business (the seller) in a security protective perspective must not be carried out. If the operator concludes that the transfer is not unsuitable in a security protection perspective, the operator has an obligation to consult with a government authority regarding the transfer. This authority may decide that the transfer could only be carried out under certain conditions or, ultimately, that it may not be carried out at all. Moreover, the consultation procedure is not time-limited. The lack of specific time limits can have a significant impact on time-critical transactions.

Swedish investment funds, or their managers (as applicable), may also be subject to the Alternative Investment Fund Managers Directive and therefore required to register with, or seek a permit from, the Swedish Financial Supervisory Authority. The same applies to foreign investment funds, or their managers (as applicable), that intend to market their funds in Sweden.

Finally, it should be noted that a proposal for a new Swedish FDI-regime was put forward on 1 November 2021. The proposed legislation is meant to introduce extensive requirements concerning the screening of investments/transactions and are expected to have a significant impact on the Swedish transaction market. It is suggested that the new act should enter into force on 1 January 2023.

## 10. How is the risk of merger clearance normally dealt with where a financial sponsor is the acquirer?

It is fairly common, regardless of the parties involved, that it is the buyer who will be required to assume the merger clearance risk. It is often less difficult for a financial sponsor to agree to this (if the fund does not already own competing businesses). However, often an industrial buyer acquires a competitor to create synergies in one aspect or another and the issue of who should bear the merger clearance risk then often becomes more complicated.

## 11. Have you seen an increase in the number of minority investments

 

### undertaken by financial sponsors and are they typically structured as equity investments with certain minority protections or as debt-like investments with rights to participate in the equity upside?

We have definitely seen an increase in the number of minority investments made by financial sponsors, although the most conclusive trend is that the size of the financing rounds / investments is growing. The recent uptick in both number and size of investments may, at least partly, stem from the fact that the number of financial sponsors focusing on venture capital has increased in Sweden over the last few years, as has the size of the funds. Established venture capital firms continue to actively invest in Sweden, there are several new players on the market, and traditional buy-out funds have also started to dedicate resources and raise capital specifically for minority investments. Although debt-like investments occur, the vast majority of deals are structured as equity investments.

### 12. How are management incentive schemes typically structured?

Typically, management will invest into a “TopCo” (as individuals or via a wholly owned company or via a jointly owned ManCo with the rest of management) in which the lead investor also invests. The TopCo usually owns a MidCo and the MidCo owns a BidCo. It is the BidCo which takes up the external financing so most sponsors want the management incentive scheme to be in a company outside the banking group. Most commonly, management invest via a mix between preference shares and ordinary shares with a mix which is substantially heavier on the ordinary shares compared to the mix of the lead investor.

### 13. Are there any specific tax rules which commonly feature in the structuring of management's incentive schemes?

There are no specific tax rules other than the tax rules for capital gains. Management incentive schemes based on shares or options set up for Swedish resident managers by Swedish companies generally allow for capital gains taxation at a tax rate of 30%. Management incentive schemes taxed at the progressive tax rates for employment income, e.g. traditional employee share option schemes, are unusual due to high marginal tax rates (up to ~53%) and the cost of employer social security charges (the general uncapped rate is 31.42%).

The terms and conditions governing the management incentive scheme have to be structured in such way that the instruments are deemed to be actual securities. Farreaching transfer restrictions and lockups or terms such as that the managers are not allowed to vote for their shares or they are not allowed to be registered as owners in the share register, may determine at which rate any gain is taxed.

### 14. Are senior managers subject to non-competes and if so what is the general duration?

Yes, most commonly during their holding of shares and for twenty-four months thereafter.

### 15. How does a financial sponsor typically ensure it has control over material business decisions made by the portfolio company and what are the typical documents used to regulate the governance of the portfolio company?

The financial sponsor regularly holds the majority of the shares and voting power in the portfolio company (often the lead investor ‘s shares carry 10 votes and management’s shares carry 1 vote) and as a result thereof controls the appointment of board members and CEO in the portfolio company. In addition thereto, in case there are other shareholders, the ownership of the portfolio company is normally regulated by a shareholders agreement according to which the financial sponsor and/or its representatives on the board may have veto rights in relation to certain material business decisions. Further, the board in a Swedish company regularly adopts governance documents to establish structures for the decision making process in the company. Common documents include rules of procedures for the board, instructions to the CEO and instructions for financial reporting. Since the financial sponsor normally has the power to appoint the board (or a majority thereof), it may indirectly dictate the content of such governance documents and thereby ensure control.

### 16. Is it common to use management pooling vehicles where there are a large number of employee shareholders?

It is not uncommon but it is still more common that managers own individually. The latter is less complex when there are leaver and joiner situations and some

 

management teams prefer the sense of having a transparent and clear investment. However, some sponsors feel that they have better control of one party (a management pooling vehicle) and thus require that.

## 17. What are the most commonly used debt finance capital structures across small, medium and large financings?

Typically, private equity transactions are financed by a combination of debt and equity. The portions of debt and equity vary depending on various factors such as relevant sector, geography, size of the deal, market conditions and availability of debt and thus it will differ from case to case. The type of debt varies but bank loans remain the most common form of financing although there has been increasing competition between traditional bank lenders and non-bank, or alternative, lenders and funds which has resulted in a wider array of debt products being offered on the Swedish market. The form of bank debt is generally a combination of: (i) term debt used to finance the acquisition and refinance the target companies' existing indebtedness; and (ii) working capital (typically structured as a revolving facility) to fund the working capital requirements of the target companies. Traditionally, "Swedish" (initially founded by Swedish individuals and with a strong foothold on the Swedish market) private equity funds have enjoyed a strong banking relationship with designated Nordic "house banks" supplying funding to them on attractive terms.

Small and mid-cap transactions: The Swedish finance market is highly relationship-driven and the large Nordic commercial banks have been, and indeed still are, the biggest lenders for small and midcap transactions. However, within certain sectors and for certain borrowers there has been a funding gap, partially caused by appetite for increased leverage, and as a result thereof, the Swedish market has experienced a growing direct lending market where debt funds and other alternative debt providers are increasingly active. Mezzanine debt and other types of junior financing are relatively unusual in the small and mid-cap space.

Large-cap transactions: During the past decade, the Swedish market has seen an increase in corporate bonds (high yield and investment grade and both within the domestic and international bond markets), as well as other alternatives to bank financing such as alternative debt providers and financing through preference shares. However, bond debt is not yet customary in private equity transactions in Sweden and bank loans thus remain the main source of financing also for large-cap transactions. For the largest transactions where the Swedish market is unlikely to meet the full demand for debt financing, bond issuances governed by English or New York law are more common and the same is true for mezzanine debt and other types of junior financing.

## 18. Is financial assistance legislation applicable to debt financing arrangements? If so, how is that normally dealt with?

Swedish law contains rules regarding financial assistance that prohibit the granting of loans, security and guarantees for the purpose of financing the acquisition of shares in such lender (or its parent/sister company). These rules apply to both private and public companies. As most private equity transactions are financed by bank loans, the lending banks will usually require that the target company and its subsidiaries (as applicable) accede to the loan agreement as guarantors and also provide security over certain assets. The issue of financial assistance is usually mitigated by the target (and its subsidiaries) providing security and guarantees after a time period of approximately 90 days having passed since closing of the relevant acquisition. To our knowledge, the time period has never been adjudicated by a Swedish court but to apply a period of time is standard in the Swedish market and something that both lenders and borrowers/guarantors are comfortable with and expect to see in the loan documentation. In addition to the above, the granting of security and guarantees by Swedish companies is subject to certain company law restrictions on distributions, prohibited loans and the object(s) of the target's business. These issues, as well as the restriction on financial assistance, are usually dealt with by including a Swedish law limitation language provision in the relevant accession, security and guarantee documents.

## 19. For a typical financing, is there a standard form of credit agreement used which is then negotiated and typically how material is the level of negotiation?

The loan documentation with regard to large-cap transactions is typically drafted in English and based on the Loan Market Association's ("LMA") template. Inhouse precedents from both law firms and banks are often based on the LMA template as well with only certain transaction-specific items being subject to negotiations between the parties. With regard to small and mid-cap transactions, the loan documents, which are typically on a bilateral basis, are often individually tailored to the practices on the Swedish market and based on precedent documentation previously entered into between the relevant bank and private equity fund (if

 

such precedent exists). These loan documents are often similar to the documents used for large-cap transactions and can be seen as a shorter and less detailed version of the LMA template (commonly referred to as “Nordic Light LMA”).

### 20. What have been the key areas of negotiation between borrowers and lenders in the last two years?

As a result of a continued use (and arguably an increase during the Covid-19 pandemic) of more diversified purchase price mechanics (including earn-outs, deferred purchase prise payments and reinvestment programs), there has been an increase in negotiations between lenders and borrowers around how such competing stakeholders should be treated in financial covenants and undertakings (to what extent their potential claims should be viewed as debt) and in terms of subordination (whether the borrower should be allowed to pay them without injection of additional equity). Further, there has been a renewed increased focus on sanctions provisions and unsurprisingly, pricing, security package and general tightness of representations and warranties, covenants and undertakings continue to attract a lot of attention. During 2021, negotiations and discussions around IBOR discontinuation and a transition to risk free rates for certain currencies (predominantly GBP and USD) have also had a significant impact on documentation in the Swedish market.

### 21. Have you seen an increase or use of private equity credit funds as sources of debt capital?

Yes, an increased level of competition between traditional lenders and alternative debt providers has given rise to a range of new products on the market and we have seen an increased presence of private equity credit funds and debt funds which have not previously been present on the Swedish market. However, they are yet to have a significant impact in terms of debt volumes for private equity financing, which remain concentrated around the banks and in particular the Nordic banks.

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