Market Trends 2021/22: Investment Grade Debt Offerings

A Practical Guidance® Practice Note by
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This practice note explores market trends regarding investment grade debt offerings in 2021 and 2022, including notable transactions, popular deal terms, industry insights, and the market outlook for 2023. Certain market trends and major issuances from the 2021/2022 U.S. investment grade bond market are highlighted below, as well as practical considerations for certain terms of investment grade bond offerings in light of these trends.

In 2021, the U.S. investment grade market remained strong, despite a decrease in issuance volumes compared to the record levels in 2020. Decreases relative to 2020 were driven by record-high cash balances on corporate balance sheets, rising inflation, and economic uncertainty as a result of supply chain disruptions, partially offset by a favorable interest rate environment and large investment grade issuances, in particular by financial institutions, ahead of an anticipated tightening in monetary policies. Issuance volumes in 2022 trended lower, tracking the Federal Reserve's most aggressive set of rate increases since the 1980s in response to persistent inflation. Increasing economic uncertainty, including the impact on global economies of the conflict in Ukraine, was another contributing factor. Looking ahead to 2023, the effects of central bank actions and broader economic trends on the investment grade bond market will need to be watched carefully, with issuers drawing on elevated balance sheets and investors weighing record-high yields in light of a weakening macroeconomic environment.

For additional information on investment grade debt offerings, see Top 10 Practice Tips: Investment Grade Debt Offerings. For general information regarding debt offerings, see Corporate Debt Securities in U.S. Capital Markets.

Overview

The U.S. investment grade bond market remained strong in 2021, despite a decrease in issuance volumes compared to the record levels in 2020, with the number of deals over 18% and total volume over 21% lower when compared to 2020, but still ahead of already strong volumes in previous years. A total of 1,263 U.S. investment grade bond offerings closed during 2021, with a total volume of $1.455 trillion. This compares to 1,547 and 1,073 offerings and a total volume of $1.856 trillion and $1.152 trillion for the years ended December 31, 2020, and 2019, respectively. The U.S. investment grade bond market comprised 8.0% of the global investment grade bond market in 2021 in terms of number of offerings, a decrease from 10.6% in 2020. In terms of proceeds, the U.S. investment grade bond market comprised 31.7% of the global investment grade bond market, a decrease from 38.1% in 2020.

In the first nine months of 2022, there were 682 U.S. investment grade bond offerings that closed with a total volume of $1.015 trillion, which represents a 32.5% decrease in number of deals and a 12.4% decrease in total volume when compared to the same period in 2021. The U.S. investment grade bond market comprised 5.9% of the global investment grade bond market in the first nine months of 2022 in terms of number of offerings, a decrease from 7.9% in the first nine months of 2021, and the total volume of the U.S. market represented 31.2% of the global market, a decrease from 32.3% for the same period in 2021.

Investment grade bonds have a rating of Baa3 or higher from Moody's Investors Service or a rating of BBB- or higher from Standard & Poor's or Fitch Ratings Inc. They are considered attractive investments for risk-averse investors (e.g., institutional investors) who prioritize liquidity. This is due to the greater certainty that the issuer, typically a company with an established operating history and credit, will be able to make timely payments to investors and avoid defaulting on their obligations under the bonds. In exchange for the greater certainty of payment, investment grade bonds typically have lower interest rates and less restrictive covenants than sub-investment grade bonds. For additional information on credit ratings, see Credit Rating Process and Credit Rating Agencies, Credit Ratings Categories for Long-Term Debt Chart, and EU Regulatory Regime for Credit Rating Agencies.

Notable Transactions

In March 2021, Verizon Communications Inc. completed a $24.9 billion notes offering, the largest U.S. investment grade notes offering of 2021 and the seventh largest on record at the time, exceeding AT&T Inc.'s $22 billion offering in 2017, but behind Verizon Communication Inc.'s $49 billion offering in 2013, Anheuser-Busch InBev Finance's $46 billion offering in 2016, CVS Health Corp.'s $40 billion offering in 2018, AbbVie Inc.'s $29.9 billion offering in 2019, Comcast Corp's $27 billion offering in 2018, and Boeing Co.'s $25 billion offering in 2020. The deal helped Verizon raise capital to purchase spectrum licenses.

Other notable U.S. investment grade bond issuances in 2021 included:

- Amazon.com Inc.'s $18.437 billion offering
- Bank of America Corp.'s $15.000 billion offering
- Oracle Corp.'s $14.965 billion offering
- Apple Inc.'s $13.960 billion offering
- JPMorgan Chase & Co.'s $13.000 billion offering

In March 2022, Magallanes Inc. completed a $30 billion notes offering, the largest U.S. investment grade notes offering in the first nine months of 2022 and the fourth largest on record.

Deal Terms

Covenants

Practitioners and issuers should be mindful of the differences in terms as bonds move up and down the investment grade chain, from high-yield to crossover credits to investment grade. A crossover bond sits on the line between investment grade and high-yield (typically BB- through BBB). Depending on whether a credit is moving up or down the credit spectrum, the issuance may have terms that are either better (if the issuer is moving up the credit spectrum) or worse (if the issuer is moving down the credit spectrum) than similarly rated and more stable credits. Bonds with crossover credits, particularly those nearer to high-yield credit status, may have covenant packages more similar to those provided for high-yield bonds than investment grade bonds. This may include highly restrictive negative incurrence covenants, which typically limit the issuer's ability to incur indebtedness, incur liens, make investments, pay dividends to equity holders, service junior debt, transact freely with affiliates, and merge or sell assets. Investment grade bonds typically limit restrictive covenants to limitations on liens, mergers, and sale of all assets. However, certain issuers which have attained credit ratings higher up in the investment grade spectrum are able to reduce the limitations imposed by these covenants even further, and certain investment grade issuers have been able to limit their covenant package to a restriction on their ability to merge or sell substantially all of their assets. Practitioners representing issuers in the crossover space should ensure that the indenture governing the issuer's bonds contains provisions for certain covenants (such as the limitation on investments) to fall away if the bonds achieve higher investment grade status. For a general comparison of high-yield and investment grade covenants, see High Yield vs. Investment Grade Covenants Chart. For more information on high-yield offerings, see Financial Definitions in High-Yield Indentures.

Liens Covenant

Investment grade issuers have historically been able to have the covenant limiting new liens only apply to liens on principal property. The definition of principal property varies from deal to deal and is often highly negotiated. The definition may be limited in such a way to exclude certain of the issuer's material corporate assets, or an issuer may not in fact have any principal property, thus mitigating the impact of the limitation. Furthermore, the limitation applicable to principal property is often worded to permit liens on such property up to an amount not to exceed a certain threshold (typically 15%) of the issuer's consolidated total assets or consolidated net tangible assets, in addition to other carve-outs. For a lien Limitation on Liens Covenant (High-Yield Indenture).

Make-Whole Redemption

Optional redemption features, which had historically been a rarity for investment grade bonds, have matured. The investment grade market generally permits early redemption at a make-whole premium up to a certain point, at which time the bonds become callable at par. Make-whole premiums are calculated from a formula based on the net present value of future interest payment on the bonds (that will not be paid because of the early redemption) combined with the outstanding principal on the bonds. As a result, many issued investment grade bonds are callable at par for a period generally ranging from one month (up to 5-year maturities), three months (5- to 10-year maturities), and six months (more than 10-year maturities) prior to their maturity. Many crossover bonds tend to follow the high-yield early redemption convention, which typically implements a make-whole premium for half the maturity of the bonds, with decreasing premiums to par for a period of time before maturity. For bonds with a par call, the remaining payments are typically being calculated to the par call date, rather than to the maturity date. In November 2021, SIFMA published model make-whole provisions for investment grade bonds, which have increasingly been adopted by the industry for new issuances. Issuers, underwriters, and outside counsel should discuss these new model provisions early in the offering process to allow time to consider and implement any updates. For additional information on make-whole premiums, see Anti-dilution Adjustment Formulas in Convertible Bonds and Debt Securities Restructuring Options.

Equity Clawback

An equity clawback provision allows for the redemption of bonds using the proceeds from an equity offering during certain periods in the life of the bonds. Typically, equity clawback provisions allow for redemption of up to 35% of the bonds for the first three years after issuance at par plus accrued and unpaid interest. Equity clawback provisions have been a mainstay in high-yield indentures and a feature of some crossover bonds, but were not typical in the investment grade space. That has changed over the last few years to some extent in some industries. While still atypical for investment grade bonds, the continuing emergence of the equity clawback in investment grade bonds has provided issuers with greater redemption flexibility.

Change of Control Put

The principal function of the change of control put is to allow bondholders to exit the credit in the event the issuer is acquired or merged by giving the bondholder the option to put the bonds back to the issuer at 101% or 100% of the principal amount. Traditionally, investment grade bonds had a double trigger change of control which triggers the put right upon a change of control and a below investment grade rating event. Typically, the ratings downgrade must occur within a specified period of time following the public announcement of the change of control transaction. High-yield bonds typically only have a single trigger tied to the occurrence of a change of control, which gives prospective bondholders greater flexibility to remove themselves from a credit they might deem to differ materially from their initial investment. The vast majority of investment grade bonds that have a change of control put have a double trigger mechanism. In recent years, the market saw the issuance of a large number of investment grade bonds without a change of control put at all. This has long been the practice for large financial institution issuers and is increasingly common for corporate investment grade issuers. With the market trending in that direction, investment grade issuers and their outside counsel should consider pushing to omit a change of control put entirely from their newly issued bonds. The outcome of these discussions will depend on the issuer's profile, its industry, and market conditions generally. If the bonds provide for a change of control put, "cleanup" calls have become increasingly common, where the issuer has the right to redeem, at its option, any bonds that were not put to the issuer by the holders. For an example of a change of control provision in a Rule 144A debt offering, see Indenture (Rule 144A and/or Regulation S Debt Offering). For an example of a change of control provision in a convertible note, see Convertible Note (Seed-Stage Startup).

Floating Rate Bonds

Until 2017, the London Interbank Offered Rate (LIBOR) fallback provisions in floating rate bonds addressed the possibility of a temporary cessation of LIBOR. Market practice shifted decisively, with documentation expressly contemplating permanent discontinuation, when the UK Financial Conduct Authority (FCA) announced its intention to stop compelling banks to submit rates for the calculation of LIBOR by the end of 2021. At the end of 2021, 24 of the 35 LIBOR tenors were discontinued and the UK FCA confirmed that all tenors of LIBOR would no longer be provided by any administrator after June 30, 2023. During 2021 and 2022, the Secured Overnight Financing Rate (SOFR) has largely replaced LIBOR as the base rate for new floating rate bonds in the U.S. market. SOFR is a broad measure of the cost of borrowing cash overnight collateralized by U.S. treasury securities, and has been published by the Federal Reserve Bank of New York since April 2018. Despite concerns by regulators and market participants that the markets would not be prepared for the cessation of LIBOR, disruptions have been limited thus far as firms have widely adopted SOFR fallback language and transitioned away from LIBOR. For contracts without effective fallback provisions, the Adjustable Interest Rate (LIBOR) Act, which President Biden signed into law in March 2022, implemented mandatory fallbacks for the replacement of LIBOR. The legislation largely tracks the fallback approach recommended by the Alternative Reference Rate Committee (ARRC) of the Federal Reserve Bank of New York. While the legislation covers floating rate bonds, issuers and their outside counsel should be aware that it does not cover the replacement of LIBOR in bonds linked to USD LIBOR ICE Swap Rates (e.g., CMS rates). In June 2022, the ARRC noted that counterparties may need to take proactive steps to address the end of those USD LIBOR ICE Swap Rates. The ARRC developed a set of recommendations including a suggested fallback formula for USD LIBOR ICE Swap Rates fixings. Much less frequently than SOFR, the market has seen other floating rates, such as the Bloomberg short-term bank yield (BSBY), being used by certain financial institution issuers.

Green/Sustainable Bonds

Although sustainable debt has continued to account for a small part of the overall U.S. debt market in 2021, volumes and deal numbers increased, with 96 sustainable bond offerings and a total volume of $64 billion closing during 2021. That trend continued in 2022 as certifications became more standardized and regulators, issuers, and investors continued to emphasize climate solutions. There were 62 sustainable bond offerings that closed in the first nine months of 2022, with a total volume of $46 billion. The key differences between green bonds and traditional bonds are primarily in the areas of use of proceeds, reporting, and independent verification of applicable sustainability criteria.

Industry Insights

Issuers in the financial services industry and the energy and power industry were the most active investment grade issuers in the United States in 2021, consistent with prior years. The real estate sector saw an increase of 18.2% in offerings from 2020 to 2021. The energy and power, industrials, and consumer products and services sectors saw a decrease of 49.6%, 45.9%, and 51.9%, respectively, in offerings from 2020 to 2021. The largest offerings of 2021 came from issuers in the telecommunications industry (e.g., Verizon Communications Inc.), tech industry (e.g., Oracle Corp. and Apple Inc.), and financial services industry (e.g., Bank of America Corp and JPMorgan Chase & Co.).

U.S. Investment Grade Bond Offerings by Industry

Industry	2016	2017	2018	2019	2020	2021
Financial Services	439 (206 banks)	382 (140 banks)	438 (133 banks)	414 (140 banks)	571 (202 banks)	520 (137 banks)
Energy and Power	138 (21 oil and gas)	159 (29 oil and gas)	214 (58 oil and gas)	245 (60 oil and gas)	274 (62 oil and gas)	138 (26 oil and gas)
Real Estate	66 (58 REIT)	90 (78 REIT)	59 (49 REIT)	124 (104 REIT)	99 (90 REIT)	117 (106 REIT)
Industrials	46 (26 transportation and infrastructure)	55 (24 transportation and infrastructure)	69 (32 transportation and infrastructure)	75(38 transportation and infrastructure)	109 (36 transportation and infrastructure)	59 (25 transportation and infrastructure)
Consumer Products and Services	33	57	36	45	79	38

Market Outlook

While 2020's record issuance levels were driven by unprecedented monetary easing policies implemented by central banks around the world, the focus of market participants in 2021 and 2022 shifted to inflation and general economic conditions as the impact of COVID-19 and related governmental actions on issuers and underwriters became less relevant. In 2023, the effects of central bank actions and broader economic trends on the investment grade bond market will need to be watched carefully, with issuers drawing on elevated balance sheets and investors weighing record-high yields in light of a weakening macroeconomic environment.

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Ari is widely regarded for his work on the full scope of financing transactions and related restructurings and has received numerous recognitions for his work. In 2021, Ari was named the "*Top Financing Lawyer in North America*" by MergerLinks. Ari is also highly ranked both Globally and for New York by *Chambers*, which notes Ari is "fantastic", "smart", "engaged" and "commercial". Ari has also received numerous awards for all aspects of finance from virtually every major ranking or guide.

Ari lives on the Upper West Side in New York City with his wife, two daughters and labradoodle.

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