

Corporate Hybrid Debt Market: state of the union one year after Moody's shift

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Detail of a light fixture by designer Philippe Druillet, bank lounges, Paris.

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by **Marc LACRAZ, Vianney HOCQUET, Daniela SAVOIA**

1. An increasingly attractive market for bond investors
2. No end in sight for this trend, which continues to be structurally driven by energy demand and M&A
3. “Moody's structure” is a new feature that is proving popular in the United States and Europe

One Year On: Time for a first assessment



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Last year, we published a white paper based on the Moody's methodology change regarding corporate hybrid debt¹ and its impact on our market. Although seemingly minor, we suspected that this shift would have major implications for this still relatively young asset class in capital market terms. Indeed, the methodology change has made these instruments more attractive to US issuers, paving the way for an increase in issuance volumes. New issuers were also expected to enter the market, thereby improving diversification.

Almost exactly one year from that publication, it is time to take a step back to assess the real impact on the market and consider what 2026 may look like.

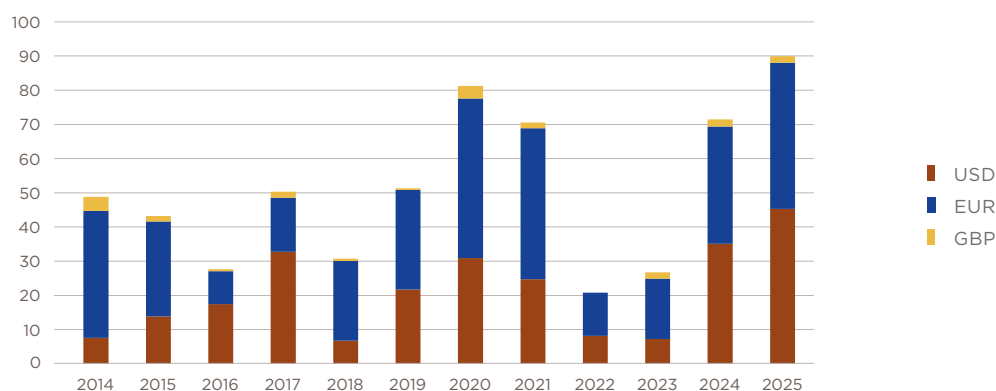
1. Subordinated debt issued by non-financial companies. Corporate hybrid bonds combine the characteristics of a bond, such as coupons, with attributes specific to equity, including long or even perpetual maturities and early redemption options, generally 5 to 10 years after issuance. Treated by rating agencies as 50% equity and 50% debt, they enable companies to raise capital while benefiting from favorable tax treatment, as the coupon paid is tax deductible.



1. An increasingly attractive market for bond investors

In terms of market growth, 2025 fully confirmed our expectations. It was in fact the strongest issuance year for this asset class over the past decade, with nearly \$90 billion in new transactions and, one distinguishing feature: the US dollar component. Issuance in USD was very strong, setting a new annual record and even exceeding the euro-denominated issuance for the second year in a row (see Chart 1), underscoring the internationalization trend of the asset class that we had anticipated.

Chart 1: Annual issuance evolution by currency (in USD)



Source: Edmond de Rothschild AM, Bloomberg.

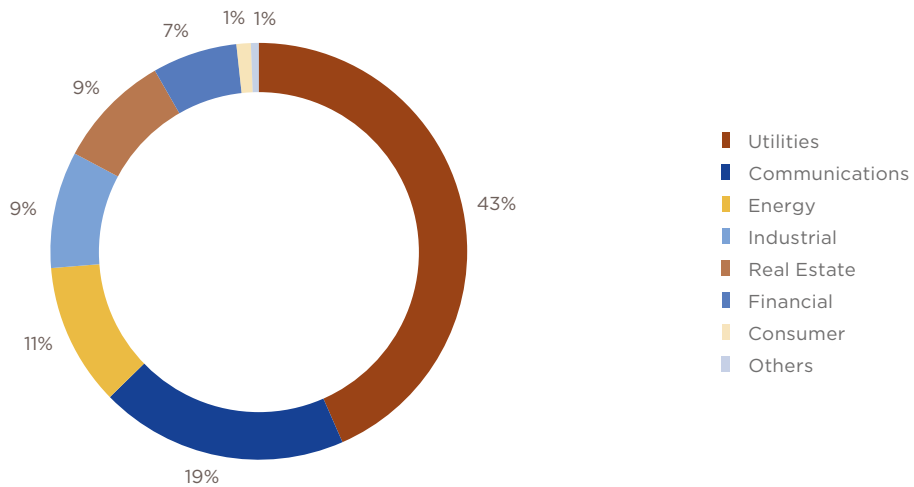
Furthermore, out of the 43 USD issuers we identified, 22 (51%) were first-time hybrid issuers², further diversifying the asset class.

2. Source: Edmond de Rothschild AM, data as of 28/12/2025.

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With that said, we had expected that the investment universe would not change fundamentally from a sector standpoint, which proved to be correct. Traditional sectors such as utilities and telecommunications accounted for a very large share of USD issuance, with roughly 62% of the bonds issued in 2025 (see Chart 2).

Chart 2: Sectoral breakdown of issuance in 2025



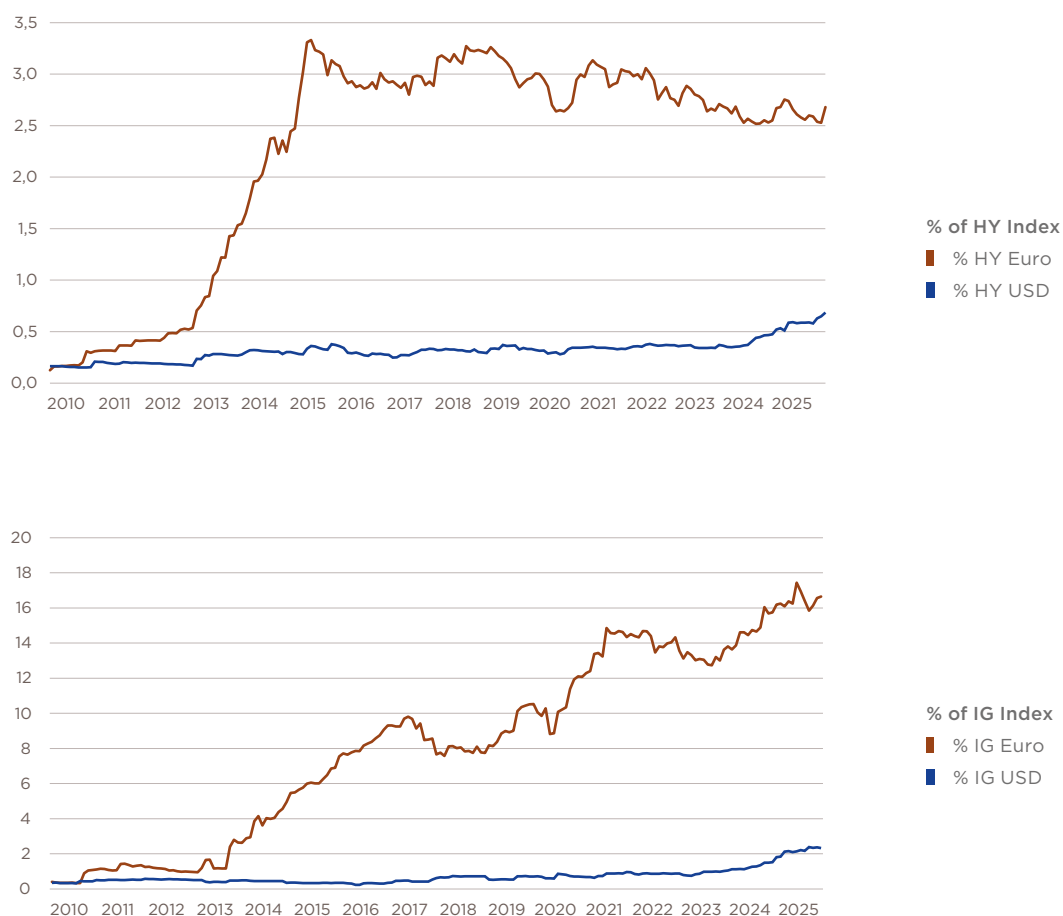
Source: Edmond de Rothschild AM, Bloomberg.

The structural drivers behind this growth should remain in place in 2026. We therefore continue to believe that the total size of the market is set to double over the coming years, with the expectation that US corporate hybrids will ultimately account for the same share of the US corporate index as recorded in Europe.



On this note, Chart 3 highlights the significant growth potential in both the USD Investment Grade (IG)³ and High Yield (HY)⁴ segments to catch up with their euro counterparts in terms of proportion.

Chart 3: Market share of hybrids in IG and HY indices in the United States and Europe



Source: Edmond de Rothschild AM, Bloomberg.

3. Investment grade securities refer to bonds issued by companies whose risk of default ranges from very low (repayment almost certain) to moderate. They correspond to a rating scale ranging from AAA to BBB- (Standard & Poor's rating).

4. High yield securities are corporate bonds that carry a higher risk of default than investment grade bonds and offer a higher coupon in return.

2. No end in sight for this trend, which continues to be structurally driven by energy demand and M&A

A massive investment cycle is beginning in the United States

“The main obstacle we face is not a lack of computing power, but energy,” said Microsoft CEO Satya Nadella in an interview⁵.

After a long period of stagnation, energy demand in the US is growing steadily once again. AI, although accounting for half of this new demand, is not the only factor. Other drivers include the electrification of the vehicle fleet and the reshoring of industrial activities to the US. While it is still difficult to predict the exact amount of additional capacity that will be needed, some studies predict that production will double by 2030⁶.

One thing is certain: utilities will have to invest heavily not only in production sites, but also in strengthening transmission networks.

For example, NextEra Energy⁷, a US power company that issues hybrid bonds, plans to build 15 GWh of capacity by 2035 to meet US data centre demand. CEO John Ketchum refers to this as a “conservative assumption” and indicates that the potential could reach 30 GWh once all new needs are taken into account. By way of comparison, the company’s current generation capacity stands at around 75 GWh⁸.

The current context makes power companies natural candidates for issuing corporate hybrid debt. They need to finance substantial investments, which weigh on their debt levels, while at the same time they must preserve their Investment Grade ratings in order to secure financing at competitive rates.

In fact, in 2025, this sector accounted for 39% of new hybrid issues and 77% of total hybrid volumes. We believe it will remain the dominant sector in the US in 2026.

The long-awaited return of mergers and acquisitions is becoming a reality

In the wake of Donald Trump’s election, markets were quick to price in a strong rebound in merger and acquisition activity, given the highly pro business stance of the new administration. In particular, this was reflected in the appointment of new individuals to key positions at the Department of Justice (DOJ) and the Federal Trade

5. Source: Financial Times.

6. Source: Financial Times, Grid Strategies.

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8. Source: NextEra Energy.

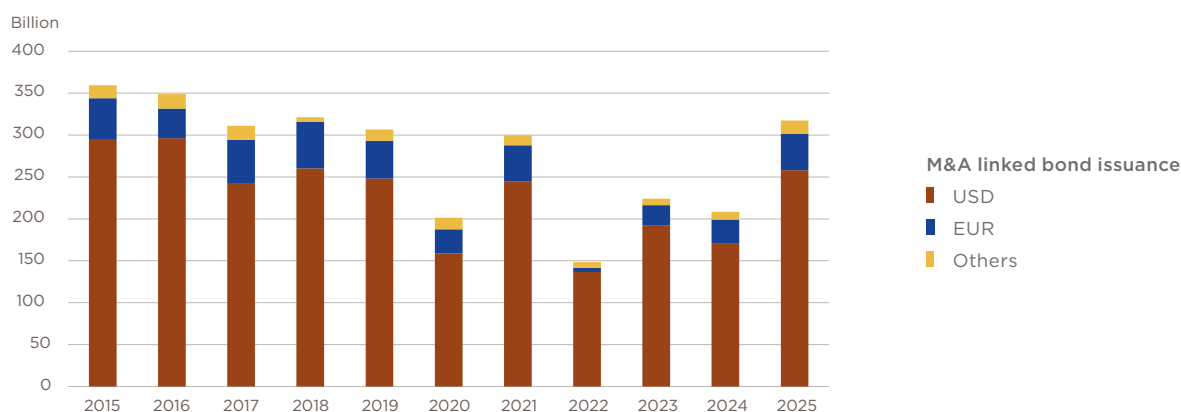


Commission (FTC). However, the first half of 2025 was disappointing, probably due to the uncertainty created by the tariff war. Once markets were reassured by the initial agreements reached, notably with China and Europe, the business climate warmed up. Deal activity then surged, making 2025 the strongest year for M&A since Covid-19 (see Chart 4). The outlook for 2026 appears even more promising, as illustrated by the ongoing battle for control of Warner Bros Discovery.

M&A transactions provide fertile ground for hybrid bond issuance. The acquiring company typically increases its indebtedness in the first instance, often prompting rating agencies to revise their credit ratings downward. Using corporate hybrid debt as part of the financing mix can mitigate the impact on leverage ratios and thus improve agencies' views.

One emblematic example announced in 2025 and expected to close in 2026 is the acquisition of JDE Peet's by Keurig Dr Pepper. According to Fitch, leverage is expected to increase from 3x to 5.5x before falling back to 4x within 24 months, and then to 3x over the medium term. The use of hybrid debt is explicitly mentioned in the agency's report as a factor that will help limit the deterioration in the ratio. Fitch assigns a BBB- rating (Stable Outlook) to the issuer post transaction.

Chart 4: Amount of primary bond issuance related to mergers and acquisitions (in USD)



Source: Edmond de Rothschild AM, Bloomberg.

Replacing preferred shares⁹

Last year, we suggested that corporate hybrids could, at least partially, replace the US preferred share market. In 2025, we have already started to observe this shift. Sempra, an Investment Grade US utility, issued a new USD 800 million corporate hybrid maturing in April 2056, with a five year call option. The proceeds were used to redeem all of Sempra's outstanding Series C perpetual preferred shares, which carried a 4.875% coupon.

This example shows that companies are recognising the advantages of hybrids over preferred shares under Moody's new methodology.

3. "Moody's structure" is a new feature that is proving popular in the United States and Europe

Changes to Moody's methodology have prompted issuers to use a slightly different issuance structure than in the past. As a reminder:

- New issues now typically have a 30 year maturity, with an early call option after 5 or 10 years.
- The 50% equity treatment¹⁰ for the bond is lost after 10 years if the bond is rated by S&P and there is no coupon step up¹¹. As a result, some hybrid bonds with a 5 year call no longer necessarily lose their equity treatment at the first call date, forcing investors to adjust their valuations.
- Depending on the position in an issuer's capital structure and the terms of the issue (subordination rank, maturity, coupon deferral conditions), Moody's may now apply only a one notch rating differential instead of two notches previously, making these bonds more "defensive" instruments.

In practice, this new structure has captured the lion's share of new hybrid issuance in the United States, accounting for 72% of the primary market in 2025.

It is noteworthy that this structure has also started to gain traction in Europe. However, such issuers have included step ups so that the loss of equity credit coincides with the first call date, in line with the prevailing market practice and taking the best of both structures.

In 2025, 33% of euro denominated issues were launched in a 30 year dated format. Among these dated issues in Europe, all included coupon step ups.

9. Preferred shares are a type of stock that gives shareholders partial ownership of a company and priority rights to dividends, but generally no voting rights.

10. 50% equity treatment means that 50% of the bond amount is treated as equity and 50% as debt in the agency's credit analysis.

11. A step-up is a predefined increase in the coupon on a given date (for example, after 5 or 10 years), often linked to a call date or a change in regulatory or accounting status.



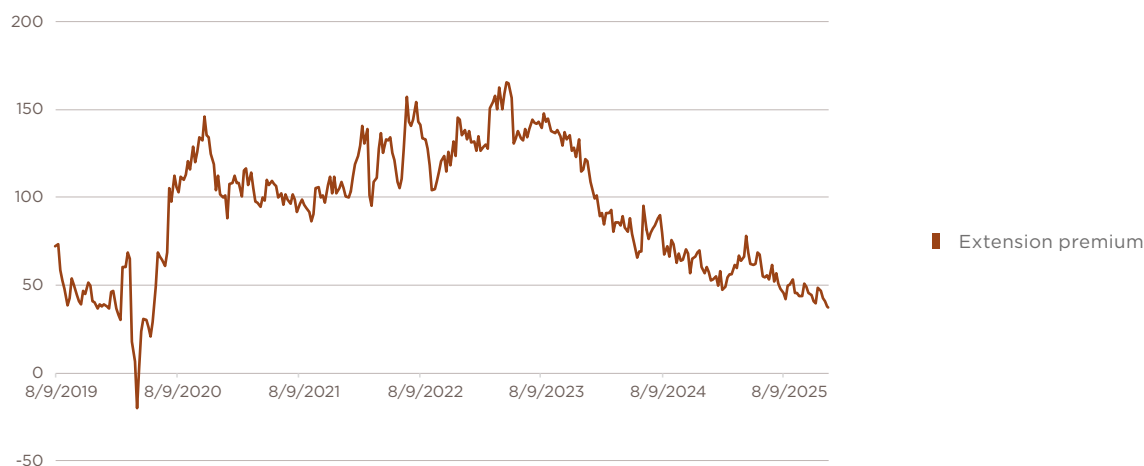
Looking ahead, what to expect in 2026?

Providing an outlook for 2026 is a challenging exercise. Within our team, however, there is a consensus around three key convictions regarding the corporate hybrid debt market.

The first is that **2026 will once again be a year of strong primary issuance**. We estimate that around **USD 60 billion of notional** will come up for refinancing in 2026, making it a very active year¹². At the same time, the US market should remain the most dynamic in terms of net growth, driven primarily by energy producers that must continue to finance massive investment programs and M&A activity. Strong technical dynamics and the inclusion of new investor bases should continue to be supportive, and allow for such growth to be well absorbed by the market.

The second is that **the asset class' performance will largely come from carry**¹³. The **extension premium**, which we calculate simply by subtracting the credit spread from the total spread, has fallen significantly (see Chart 5). We do not anticipate an increase in the near future, and we believe that the potential for further compression is now largely exhausted.

Chart 5: Extension premium at its lowest since 2020



Source: Edmond de Rothschild AM, Bloomberg.

12. Source: Edmond de Rothschild AM & Bloomberg.

13. Carry strategy corresponds to the return an investor receives by holding a bond until a given date (coupon received + any amortization - financing cost). It reflects the “mechanical” performance linked to the passage of time, regardless of changes in spreads or interest rates.

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Finally, we believe that the **risk profile of hybrid corporate debt, which combines high yields with an investment grade default risk**, should remain appealing to investors. Ultimately, it offers the prospect of positive total returns, including carry, across a wide variety of scenarios, even in a potential economic slowdown.

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