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DCM Perspectives with Fitch Ratings

Corporate Hybrids

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Jakub Zasada, Director, EMEA Natural Resources, Analytical - Fitch

Matt Palmer, EMEA Head of IG Corp Coverage, BRM - Fitch

Peter Pears, Partner, London – Mayer Brown

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Corporate Hybrids – An Overview

Corporate hybrid bonds occupy a unique position between debt and equity, offering distinct advantages to both issuers and investors

- **For Issuers –** Depending on structure, “Hybrids” can be accounted as debt or equity in IFRS financial statements and as equity by rating agencies (typically up to 50%), allowing issuers to strengthen their financial structure without capital calls. Corporate hybrids thus enable firms to raise capital with a lesser impact on leverage, protecting their credit rating
- **For Investors -** Hybrids offer a higher yield than traditional senior bonds from the same issuer – typically, robust IG companies.

Key Structural Features	
Subordination	Long dated or perpetual maturity
Optional/deferrable coupon payments	Issuer call options
Step-up coupons	Replacement language
Structured for equity credit	Tax-deductible interest
No voting rights	Limitations on EoDs

Corporate Hybrids – An Overview

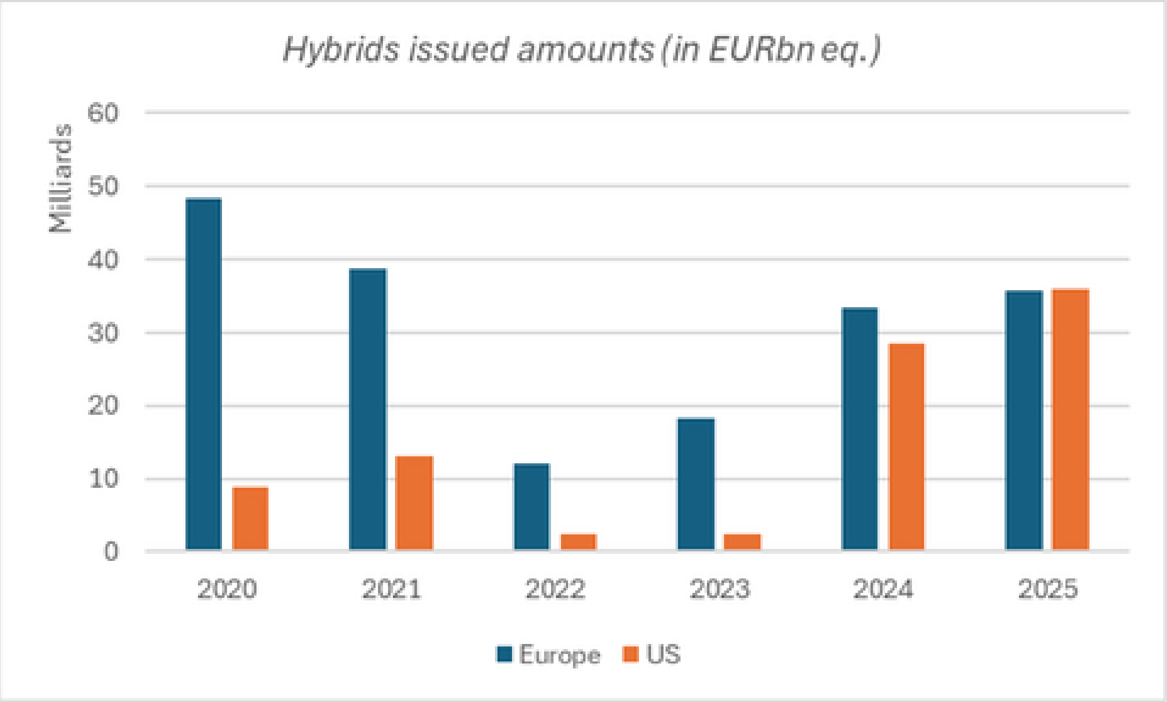
In practice, the most active issuers of corporate hybrids tend to be large, investment-grade corporations in the utilities, telecommunications, energy, and industrials sectors, where the combination of capital intensity and credit rating sensitivity makes the hybrid structure particularly beneficial

- **Investment-grade companies near rating thresholds** – Issuers at risk of a credit downgrade can use hybrids to strengthen credit metrics through partial equity treatment without diluting existing shareholders
- **Capital-intensive industries** – Utilities, energy companies, and telecommunications firms with large infrastructure financing needs frequently issue hybrids to fund projects while preserving balance sheet flexibility
- **Companies pursuing M&A** – Acquirers can finance transactions with hybrids to avoid shareholder dilution while mitigating the impact on leverage ratios
- **Companies with cyclical or volatile cash flows** – The coupon deferral feature provides a cushion during downturns, making hybrids attractive for issuers in sectors exposed to economic cycles
- **Companies with limited access to equity markets** – Issuers facing depressed share prices or unfavourable equity market conditions can use hybrids as a quasi-equity alternative

Market Overview

- **Europe** - Long the mainstay of the market, issuance as high as EUR30-50bn in recent years
- **US** - Continued growth driven by utilities' investment needs and methodological adjustments. Reverse Yankees popular (e.g. Verizon, Next Era Energy)
- **Asia** - Emerging as a growing market (e.g. MTR Corp, Japan Tobacco)
- **Non-IG Issuers** - Methodological adjustments benefit speculative-grade issuers (e.g., CPI Property Group refinanced hybrids with 100% Moody's equity credit)
- **Green Hybrids** – "….one in every six corporate hybrids is now in green or sustainable format…." (Natwest, 2023)

The US is an increasingly important market

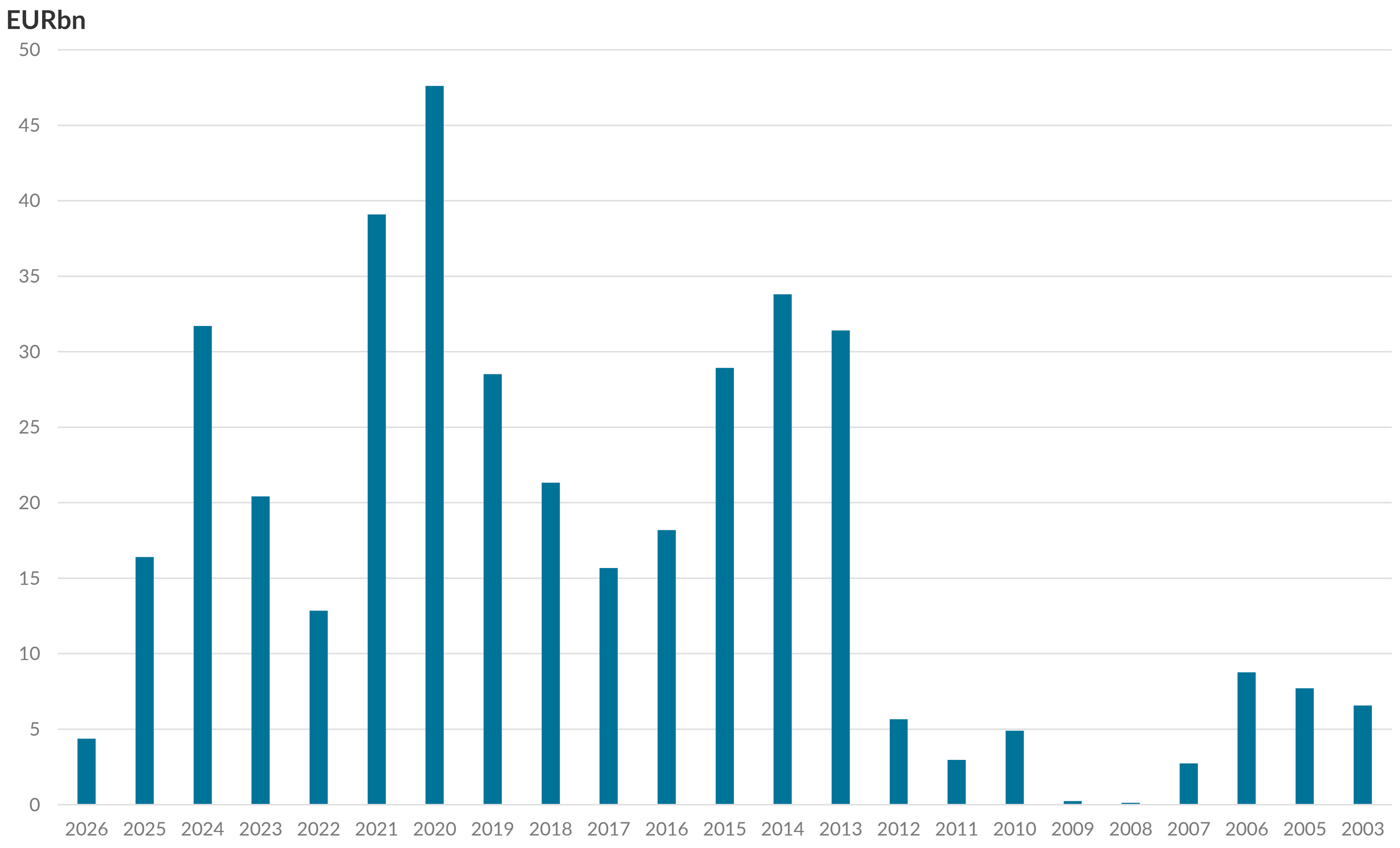


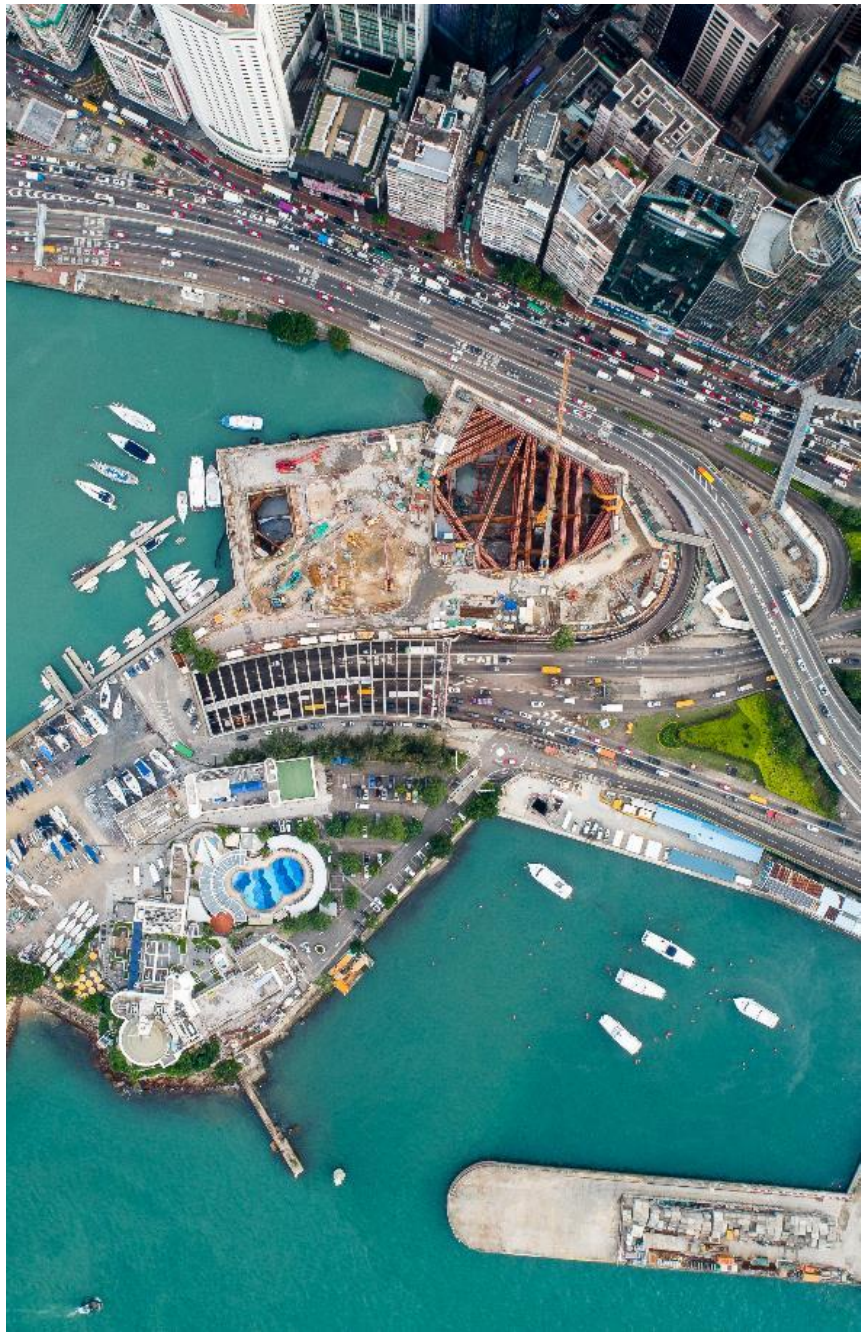
Source: Société Générale, December 2025

Reverse Yankees fuel Europe's corporate hybrids with lure of extra premium

GlobalCapital

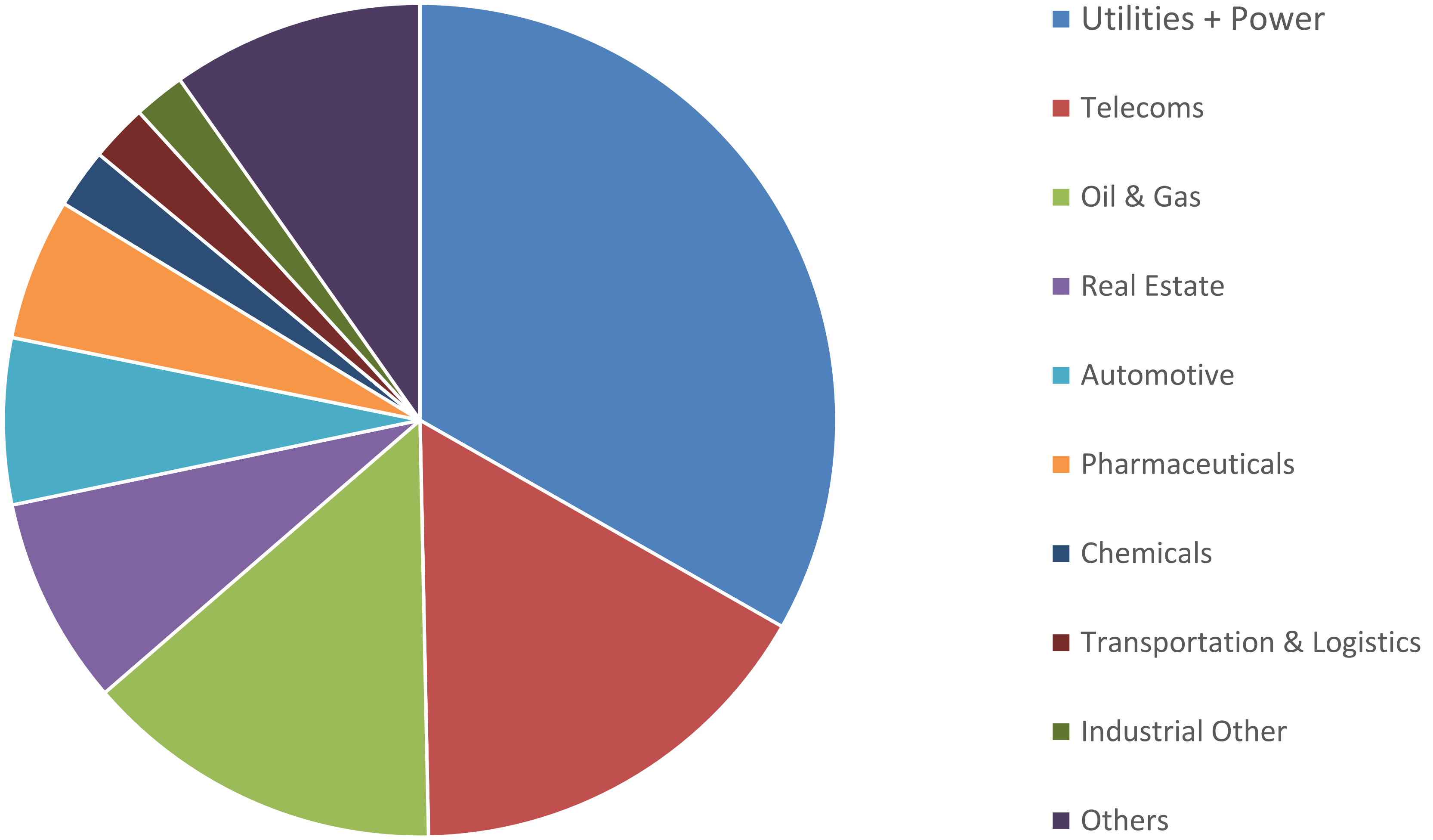
EMEA Corporate Hybrid Issuance Volumes

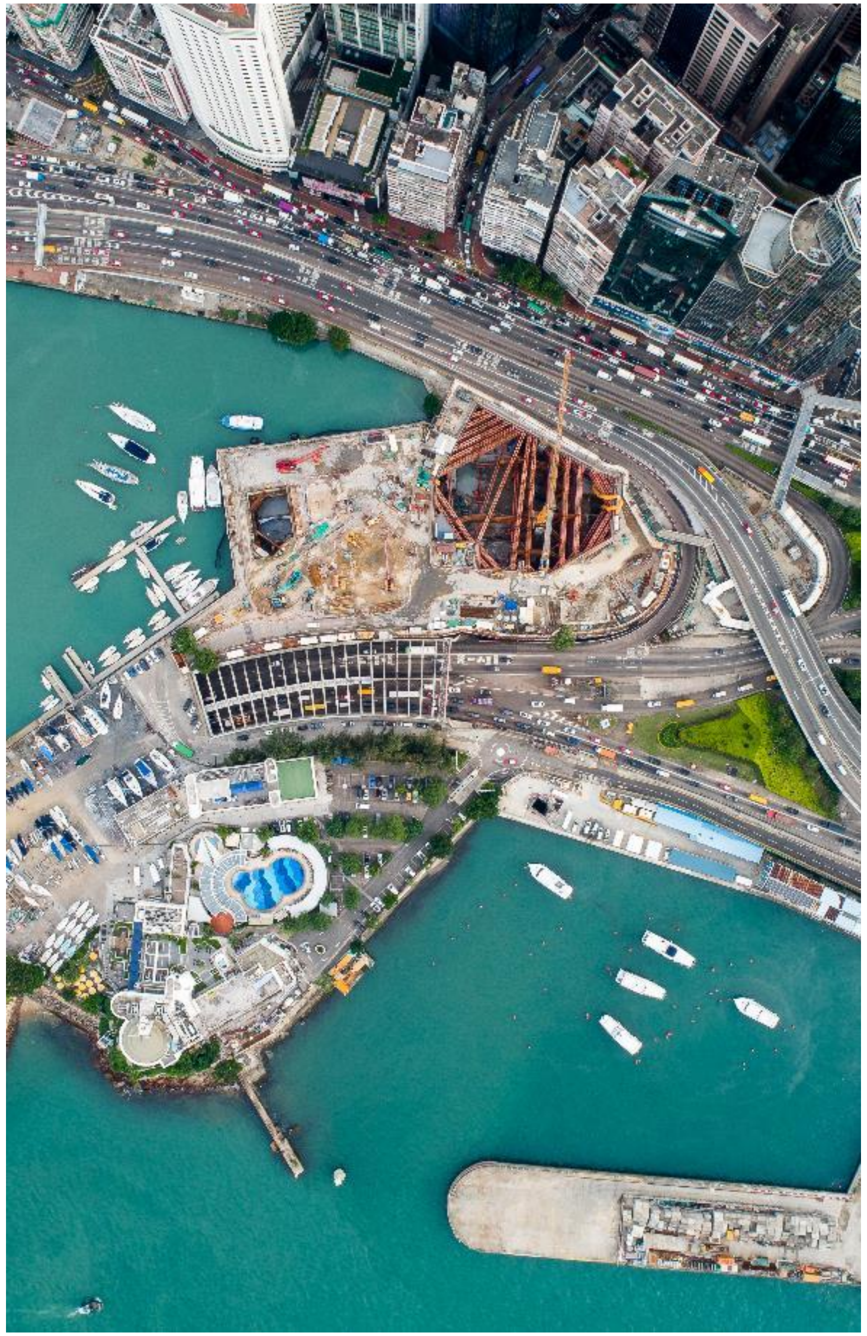




Source: Bloomberg

EMEA Corporate Hybrid Issuance by Sector



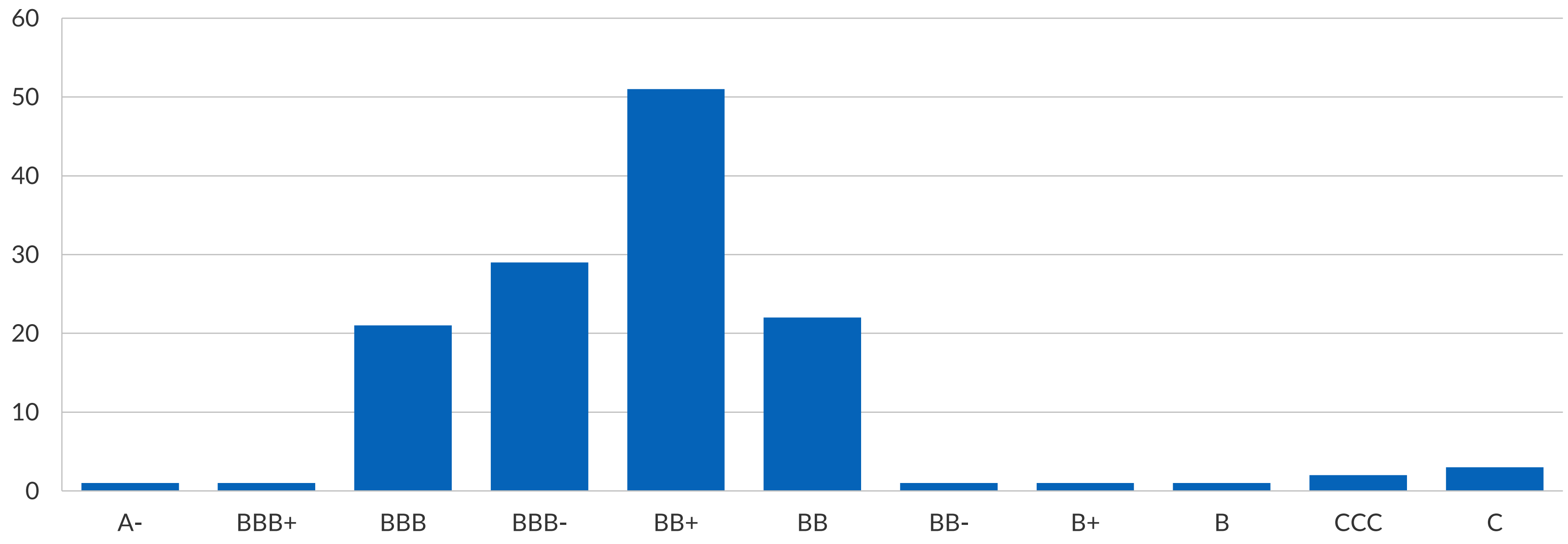


Source: Bloomberg

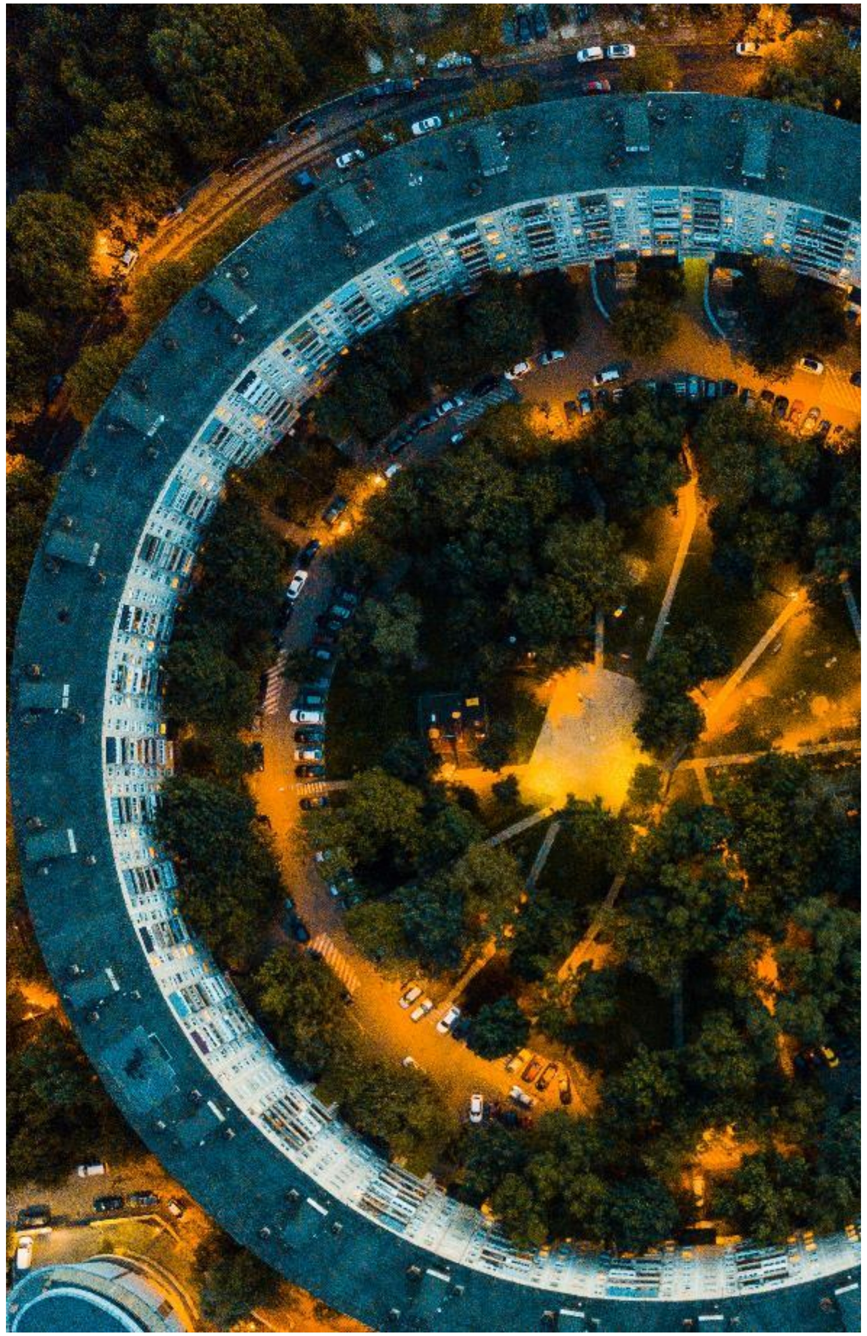
Fitch's Hybrid Coverage – Ratings Distribution

Rating Distribution
Global Corporates

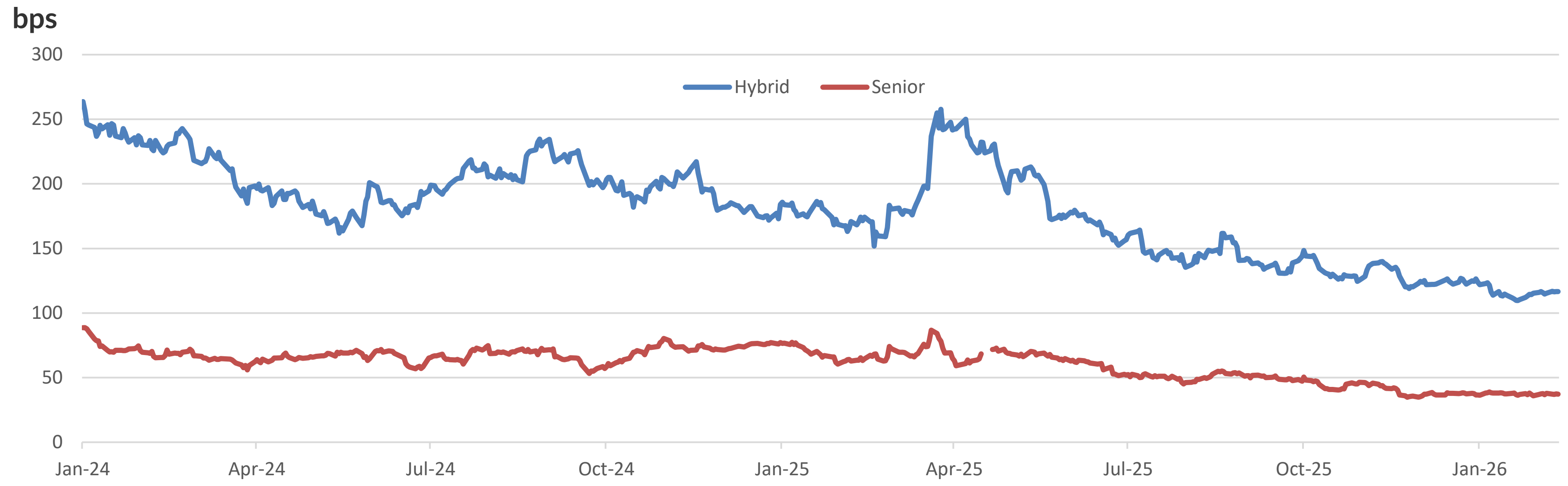
(No.)

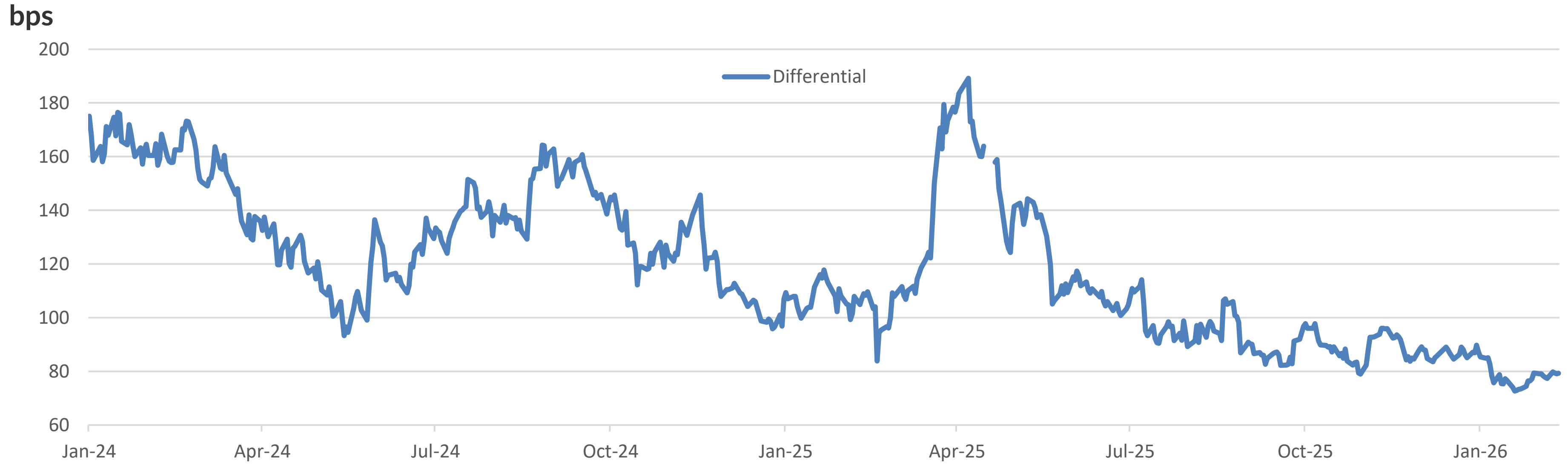


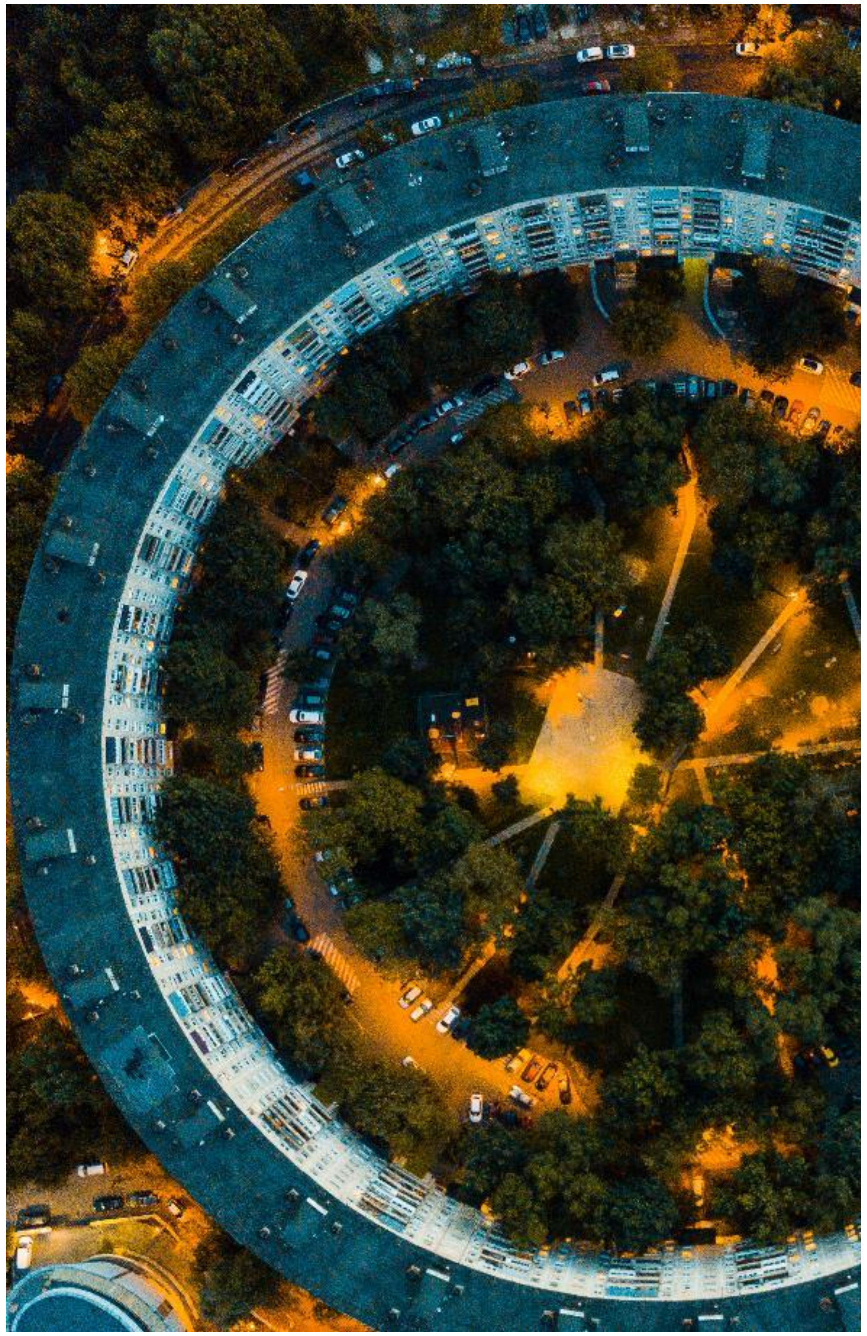
Source: Fitch Ratings, data as of Sept 2025



Narrowing Subordinated Premium







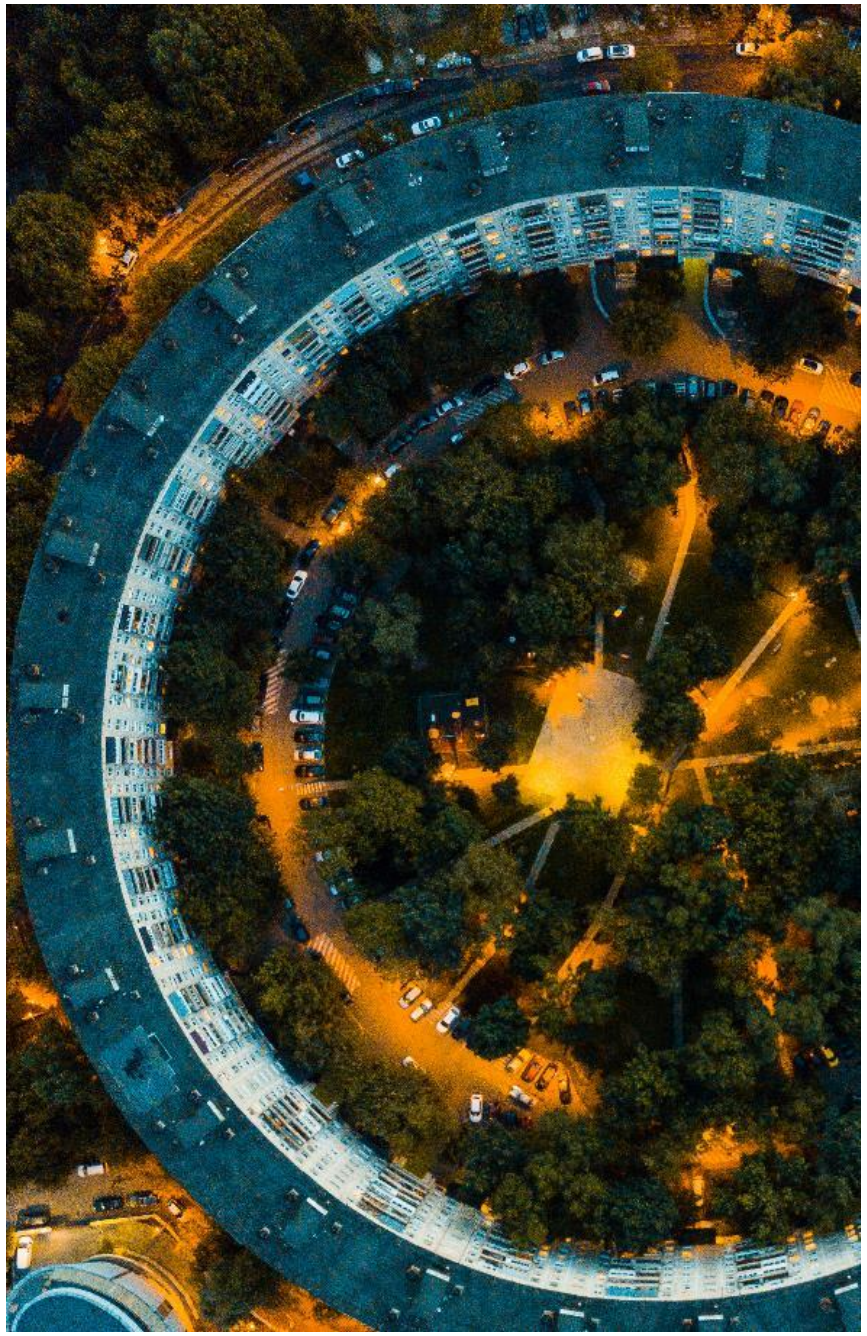
Applying Fitch's Hybrid Criteria

Determination of equity credit requires understanding of the instrument's structural features and the company's financial policy

Evaluation of EC focuses on features that enhance equity-like character:

1. Liquidity preservation through unconstrained coupon deferral of at least five years
2. No near-term principal repayment through effective maturity of at least five years or conversion, no mandatory prepayments from change of control provisions
3. No ability to trigger default, i.e. no cross-acceleration or events of no material covenants
4. Loss absorption by means of subordination
5. Ability to take advantage of the equity-like structural features, e.g. absence of punitive consequences on deferral, call or conversion and permanence
6. Coupon step-up equal of less than 100bps, leaving aside market rates

Market standard 50% equity credit and
two notch debt rating differential to senior debt



Emphasis on Permanence

Replacement language is not mandatory according to Fitch's criteria, discussion with management is sufficient

Examples of questions to management:

- What circumstances could lead to management changing its views on maintaining hybrids as part of the capital structure?
- What is the main purpose of the hybrid? (e.g. managing financial profile, sizeable capex, acquisitions, pensions, to support re-structuring plan)
- How does hybrid issuance fit into the wider context of financial policies?
- How does management expect to adapt the capital structure over time? Does it plan to issue more hybrids?

Replacement issue treatment

- Equity credit of the instrument to be refinanced reduced to zero and the new instrument gets equity credit according to methodology

Shareholder Loan or Hybrid?

Is the instrument held by a shareholder or affiliated investor whom strategic and economic interests are (and likely to remain) aligned with those of common equity(a)?

Y → Holdco PIK & shareholder loans guidance as per *Corporate Rating Criteria*

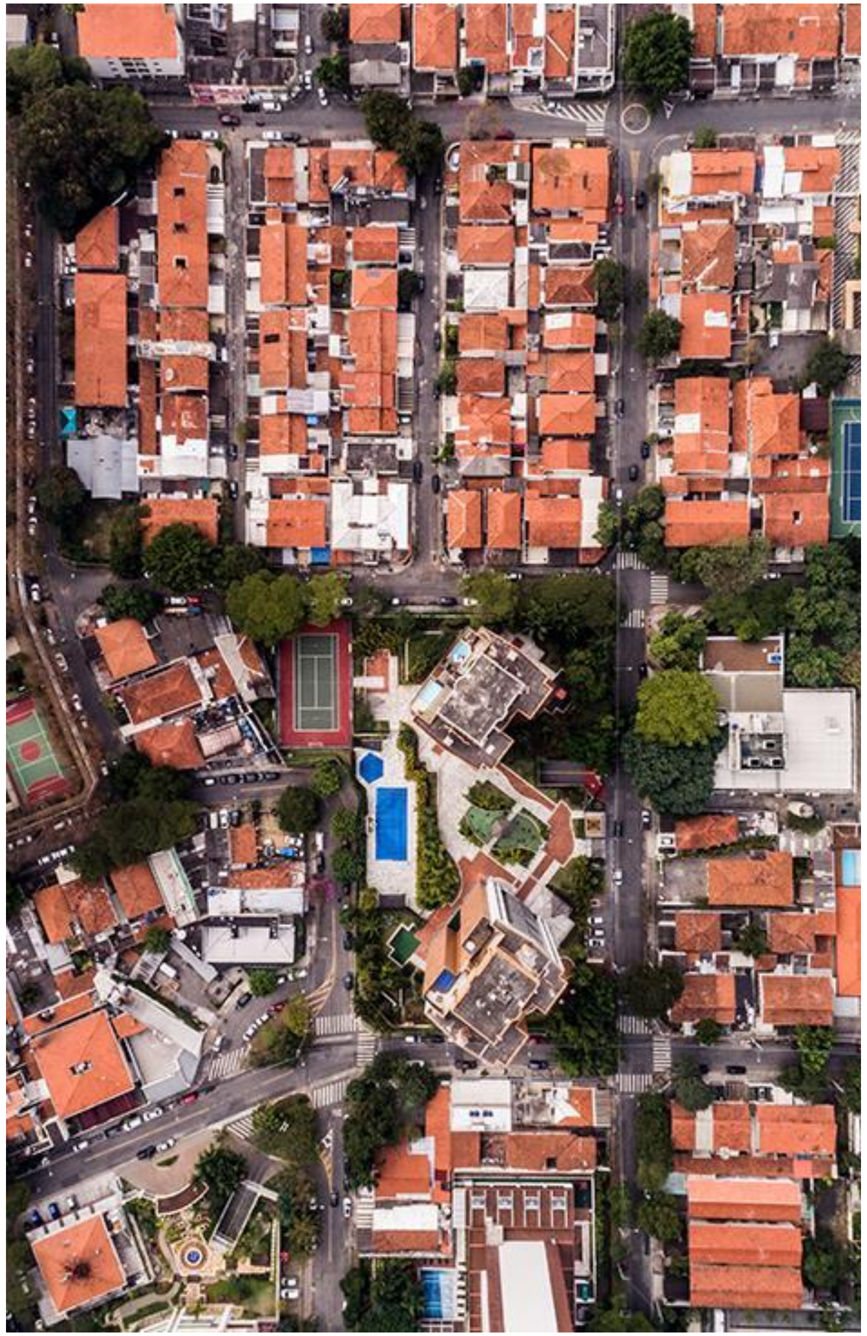
N ↓

Is PIK/SHL issued outside the rated entity (RE) perimeter (or restricted group)?

Y → Holdco PIK & shareholder loans guidance as per *Corporate Rating Criteria*

N ↓

Corporate Hybrids Treatment & Notching Criteria

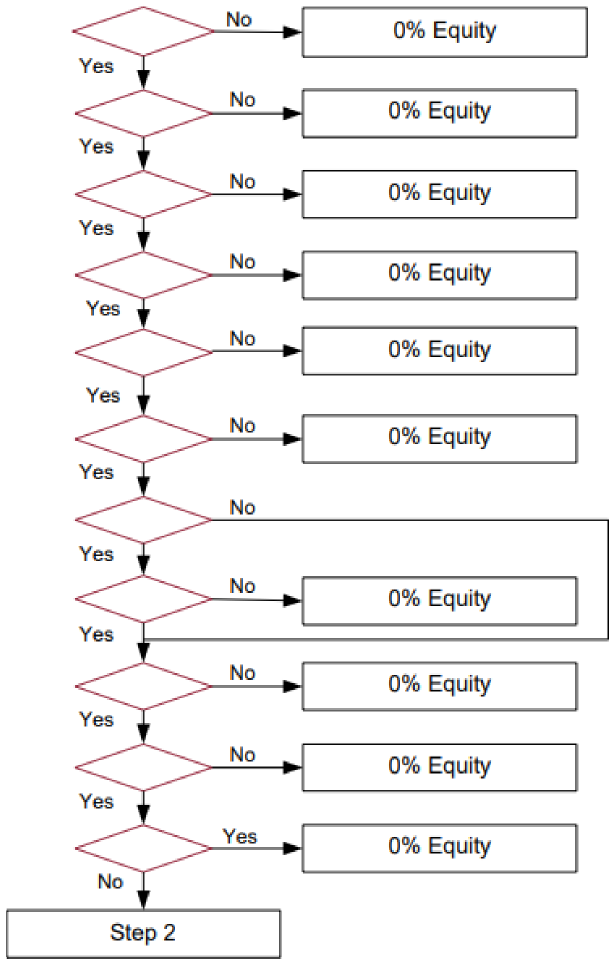


[a] Fitch considers interests are aligned if it believes that the holders of SHL/ PIK instrument are unlikely to exercise all available remedies in case of default (i.e. a shareholder loan action to force an insolvency would be an unlikely scenario

Criteria for Equity Credit Recognition (Step 1)

Step 1: Criteria for Equity Recognition

Subordination?	Subordinated to all senior debt or mandatory convertible?	
Covenants or EODs?	No cross-acceleration, cross-defaults or EODs, other than a) bankruptcy and liquidation, b) failure to redeem after invalidation c) failure to pay coupon after all permitted deferrals?	
	No material covenants?	
	No COC clause? If existent, can it be remedied through mandatory conversion to equity or a coupon step up <=500bps?	
Permanence?	Can permanence be established through a) discussion with management b) replacement language or covenant or c) economic incentives or conversion to equity?	
Effective maturity >=5y?	Maturity of >=5y or conversion?	
	Call dates within next 5y?	
	Aggregate step-ups =< 100bps within 5y?	
Unconstrained ability to defer/omit coupon for >=5y?	Ability to defer or omit for >=5y or until conversion of hybrid?	
	No look-back provision?	
	Does interest deferral or non-payment of principal trigger events that are incentives to redeem?	

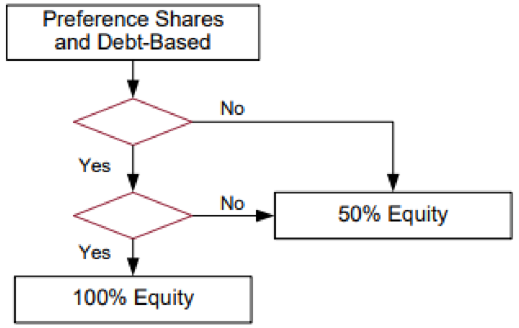


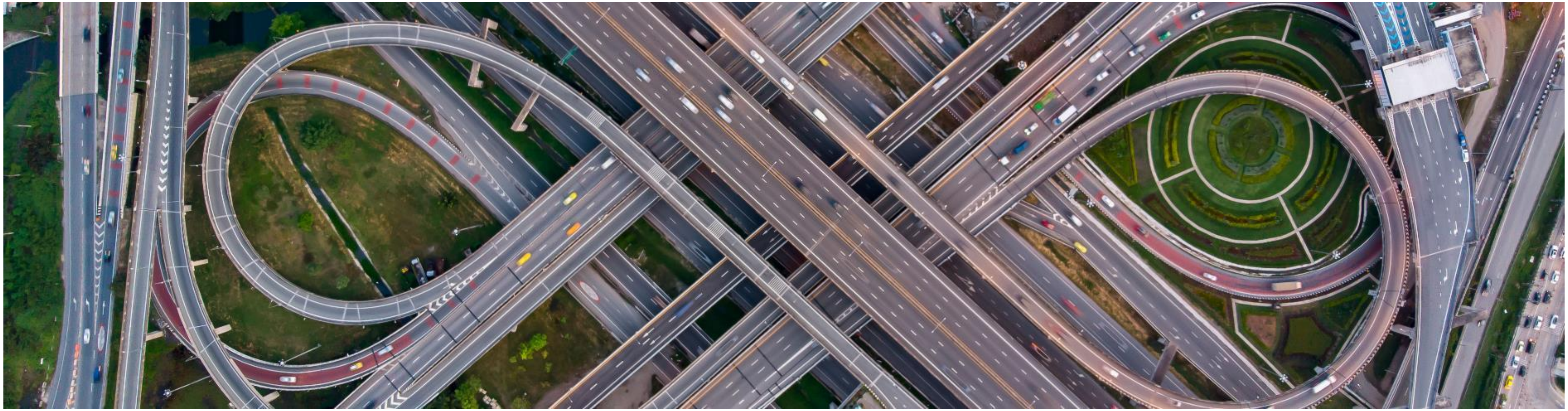
Decision points
EOD – Event of default
COC – Change of control

Criteria for Equity Credit Recognition (Step 2)

Step 2: Determine Equity Credit

Deferral non-cumulative?	Coupon deferral non-cum or if cum can only be settled through equity?
Seniority?	Senior only to equity?



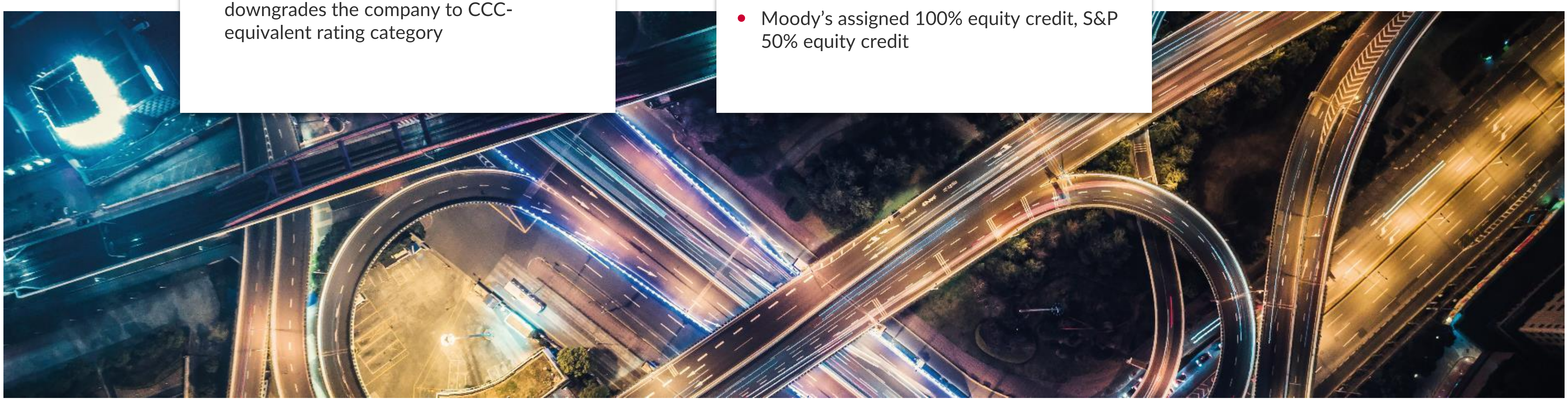


Current Themes: Conversion to CBU (1/2)

CPI Property

- CPI was downgraded to sub-investment grade by Moody’s and lost equity credit for its hybrids
- New hybrid converting to Conversion Beneficiary Units (CBUs) once Moody’s downgrades the company to CCC-equivalent rating category

- CBUs retain key parameters of hybrids, except:
  - Ranking is below other hybrids
  - Creditors’ rights are removed
- CBUs similar to preferred shares
- Moody’s assigned 100% equity credit, S&P 50% equity credit



Current Themes: Notching for Subordination and Mandatory Interest Settlement (2/2)

Simple vs Deep Subordination

- Minus two notches for both types if coupled with cumulative coupon deferral

> "Hybrids that are either subordinated or have deferrable coupons are rated at least one notch below the issuer's IDR, although they are denied equity credit if they do not combine both features."
>
> Corporate Hybrids Treatment and Notching Criteria

Mandatory Deferred Interest Payment

- Deferred interest needs to be paid five years from the first deferred interest payment date
- Provision in line with Fitch's criteria requiring interest deferral for at least 5 years

Hybrid Liability Management

Issuer Options for hybrid liability management:

Call and refinance with hybrid debt

Call and replace with other instruments/cash

Not call

In case of partial redemption, focus on permanence and implications on capital/ debt structure key for our equity credit considerations

- No prescriptive share for hybrids in the capital structure
- But share of hybrids should be relatively stable
- Issuer’s financial profile strengthens, or a restructuring occurs

Case Study 1: Fitch Maintained Equty Credit – OMV AG

- Company **redeemed** EUR750 million hybrid in 2021
- EUR2.5 billion remaining hybrids **on the balance sheet**
- Management confirmed they view hybrids as a permanent feature of the capital structure
- Financial situation of the company at the time of **redemption remains very strong,** leverage lower than at the time the hybrids were issued
- Repayment from **cash on hand**

Fitch Ratings-Warsaw/London-15 October 2021: The planned redemption of EUR750 million hybrid bond issued in 2015 will have no impact on the equity credit for OMV AG's (A-/Negative) remaining EUR2.5 billion outstanding hybrid bonds, Fitch Ratings says.

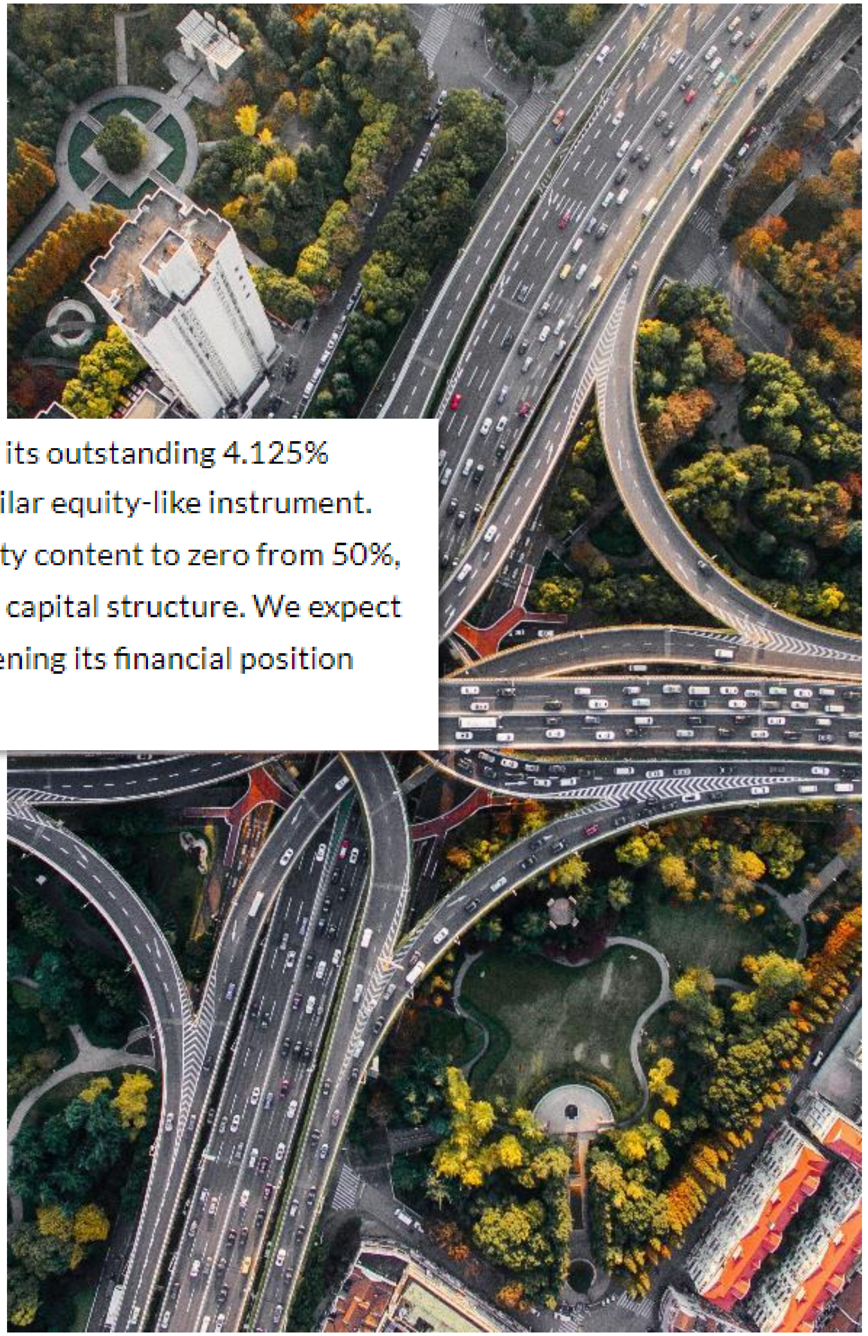
Fitch understands that hybrid capital is a permanent feature of OMV's capital structure. The planned redemption comes at a time of improved hydrocarbon prices, which will have a positive effect on OMV's cash flows. We forecast OMV will maintain funds from operations (FFO) net leverage comfortably below 2.0x, the negative rating threshold, over 2021-2024. Fitch believes a company may decide to reduce the hybrids in its capital structure via buyout offers if its financial position is sustainable, and the redemption will not put pressure on leverage metrics.

Case Study 2: Fitch Withdrew Equity Credit – Naturgy

- **Company recorded very strong financial results** and given the high interest rate environment, the Issuer announced plans to **redeem** EUR500 million hybrid from cash on hand

- Management informed Fitch they **do not plan to refinance** other hybrids in the future (EUR1 billion outstanding)

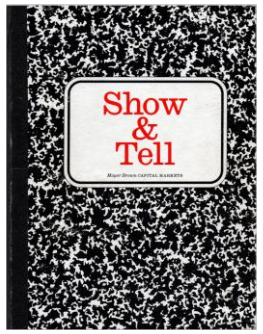
Hybrids Lose Equity Credit: Naturgy has announced its intention to redeem its outstanding 4.125% EUR500 million hybrid debt this November without refinancing it with a similar equity-like instrument. Regarding the remaining EUR1.0 billion hybrid debt, Fitch is revising its equity content to zero from 50%, as we do not have sufficient assurance that the instrument will remain in the capital structure. We expect Naturgy to absorb the EUR750million of additional net debt without threatening its financial position given the strong expected operating performance.



Resources

Read: **26 Trends Affecting Capital Markets in 2026**

Read our wrap up Summing up 2025 and more.



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