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TOP 10 PRACTICE TIPS BY EXPERTS: INVESTMENT GRADE DEBT OFFERINGS

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This practice note outlines 10 practice points for internal and external counsel to consider when working on investment grade debt offerings. Because investment grade offerings are most often registered with the Securities and Exchange Commission (SEC), the practice note assumes that the offering is registered (e.g., it refers to prospectuses and underwriters, rather than offering memoranda and initial purchasers), but, except where the context indicates otherwise, the practice points generally apply to unregistered (i.e., Rule 144A (17 C.F.R. § 230.144a)) offerings as well.

1. FAMILIARIZE YOURSELF WITH RECENT MARKET PRACTICE

Investment grade notes (particularly issuances in the same industry and/or with the same ratings) typically share certain common features, such as limited covenants and standard redemption structures. These market features evolve, though, and new terms or features can be introduced from time to time. For example, prior to 2010, it was unheard of for an investment grade bond to include a par call option, allowing the issuer to redeem the bonds at their face value for a period (typically the final one to six months) before the maturity date. Today, par call options are common in investment grade offerings. In addition, the terms of restrictive covenants are often evaluated by reference to other issuers in the industry with a comparable credit profile, particularly for a new investment grade issuer.

You should review the Description of Notes section of prospectuses for recent investment grade issuances in the issuer's industry. You should also focus on issuers with similar credit ratings — investors view BBB issuers and A issuers differently, and the terms of the notes may reflect that.

2. BE AWARE OF THE ISSUER'S EARNINGS AND REPORTING CYCLE

It is important to consider the issuer's earnings and reporting cycle from the outset of the offering process. All other factors being equal, the best time to launch an offering is immediately after the issuer has filed an annual or quarterly report. This timing mitigates the risk that there is a material undisclosed development concerning the issuer.

Launching at other times in the earnings and reporting cycle is common, but you should consider the implications of the proposed timing. For example, if a period-end has passed but the issuer has not yet reported earnings for the period, you may need to include flash numbers in the prospectus (i.e., preliminary abbreviated financial results). At a minimum, you will need to conduct diligence with respect to the period's results to make sure that there are no trends that need to be disclosed. Similarly, launching after an earnings release but before the report on Form 10-Q or 10-K has been filed will require diligence to ensure that the periodic filing will not contain material new disclosure that should have been included in the prospectus. In conducting such diligence, in addition to reviewing the earnings release, you should listen to the issuer's earnings call or management webcast, which often provides a good summary of material company developments and investor concerns

3. UNDERSTAND (AND DISCLOSE) THE RESTRICTIVE TERMS

Compared to high yield bonds, investment grade bonds typically contain very few restrictive covenants. For non-financial issuers, negative covenants are often limited to a lien covenant and a (related) sale-leaseback covenant. The indenture may also include an obligation to offer to repurchase the notes upon a change of control.

Despite the short list of restrictions, it is important to understand their subtleties in order to ensure that they are appropriate for the issuer and that the prospectus disclosure adequately and accurately describes the implications and risks presented by the terms. The lien covenant, for example, may be limited to liens on certain defined principal properties. The change of control repurchase offer may require a double trigger — both a change of control and a subsequent downgrade in the notes' rating.

Structural implications may also be important. For example, investment grade debt is often not supported by subsidiary guarantees. In that case, the notes will be structurally subordinated to the liabilities of the issuer's subsidiaries. You should disclose this fact in the risk factors and, if appropriate, disclose the amount of liabilities of the issuer's subsidiaries. It is not uncommon to include related disclosure on the cover of the prospectus supplement and in the prospectus summary.

4. INVOLVE THE AUDITORS EARLY IN THE OFFERING PROCESS

Auditors' internal processes for drafting and delivering comfort letters can take considerable time. You should ensure that the proper members of the working group begin discussions with the auditors concerning the comfort letter early in the process, especially given that investment grade offerings often have compressed timelines. You should focus on issues raised by the timing of the offering in the issuer's earnings and reporting cycle (as discussed above), as well as any recent business acquisitions, as these may impact the content and timeline of the comfort letter.

5. UNDERSTAND WHAT FINANCIAL INFORMATION IS REQUIRED

At the outset of the offering process, you should consider whether any material transactions have occurred or are probable that require pro forma financial information or other financial statements to be included in the prospectus. Rule 3-05 (17 C.F.R. § 210.3-05) of Regulation S-X requires that the prospectus include separate audited financial statements of certain acquired businesses, and Article 11 (17 C.F.R. §§ 210.11-01 – 11.03) of Regulation S-X requires pro forma financial information in certain circumstances. Similar rules apply to guarantors (Regulation S-X Rule 3-10 (17 C.F.R. § 210.3-10)) and certain subsidiaries (Regulation S-X Rule 3-09 (17 C.F.R. § 210.3-09)). In conducting this analysis, you should consider the materiality of each transaction (see the significant subsidiary tests in Rule 1-02(w) (17 C.F.R. § 210.1-02) of Regulation S-X), as well as the type of offering that you are conducting (e.g., registered, 144A, or shelf takedown).

6. RAISE DILIGENCE ISSUES EARLY

Investment grade offerings move quickly, and diligence issues can take time to work through. Therefore, if you are aware of a development that will require attention (and may require disclosure), you should not wait until the all-hands diligence call, which often takes place shortly before the launch date, to raise it.

This is especially the case for any developments relating to the Foreign Corrupt Practices Act of 1977, Office of Foreign Asset Control sanctions, money laundering statutes, or other regulatory matters. Underwriters focus intensely on these concerns and will conduct internal reviews of even minor compliance issues. You should raise any developments on these matters as soon as you become aware of them and may need attorneys with specialist expertise in these areas to become involved.

7. CONSIDER SELECTIVE DISCLOSURE ISSUES

Although Regulation FD (17 C.F.R. §§ 243.100 – 103) does not apply to most primary registered debt offerings, many issuers seek to avoid selective disclosure even when Regulation FD does not apply. In addition, Regulation FD will apply in Rule 144A offerings. You should consider whether any material disclosure in the prospectus supplement has not otherwise been made available to the public, such as through a press release or report on Form 8-K. This is particularly important when you intend to launch the offering later in the issuer's earnings and reporting cycle.

8. UNDERSTAND THE ROLES OF THE VARIOUS UNDERWRITING BANKS

Unlike in high yield offerings where the role of lead left underwriter (i.e., the underwriter with the lead role in managing and marketing the offering) is usually clearly identified, it is not uncommon in investment grade offerings (particularly by blue chip, regular issuers) for the lead banks to each have an equal role. In these situations, there will be no lead left bank. The issuer will designate separate banks to run the marketing effort, documentation and diligence, and billing and delivery, and will typically communicate the allocation of responsibility to all parties on or before the initial organization call. It is important to understand that the lead banks have equal responsibility and should be treated that way. Also, it is not uncommon for co-managers to join the bank syndicate during the offering process. This may happen late in the process (sometimes as late as the pricing day), in which case you should be prepared to quickly update the documentation to reflect the new banks and coordinate with the new parties as necessary.

9. BE PREPARED TO LAUNCH QUICKLY

Investment grade offerings are market sensitive. Fundamental characteristics of the offering, such as the number of tranches, may remain unsettled on the launch date as the issuer and the underwriters evaluate the market and investor feedback.

When the issuer and the underwriters decide to proceed, you must be prepared to act quickly. You should have the prospectus supplement, press release, and report on Form 8-K, if necessary, finalized in advance, and SEC filings should be prepared. You should have all necessary signatures and release authorizations for the underwriting agreement. To the extent that significant aspects of the offering are still uncertain on the launch date, you may need to prepare multiple versions of each document in order to reflect each possible launch strategy.

10. STAY INFORMED OF FINANCIAL AND ECONOMIC DEVELOPMENTS

Execution of investment grade offerings is particularly sensitive to financial and economic developments, including changes in U.S. treasury rates and credit spreads. Economic and geopolitical events often influence trends in, and the direction of, interest rates and investors' appetite for risk. It is helpful when preparing for an investment grade offering to understand the current economic and geopolitical climates, including any key announcements that are on the calendar. These factors can affect the timing, dynamics, and overall viability of your deal.

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