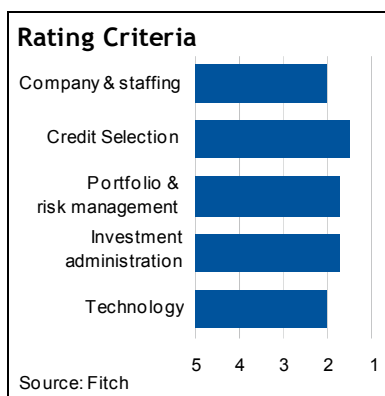


Credit Asset Manager
UK
Rating Report

Alcentra Ltd

Asset Manager Rating



'M1' Description

Very Strong: Asset manager operations demonstrating lowest vulnerability to operational and investment management failure.

Analysts

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Related Research

Applicable Criteria:

- [Reviewing and Rating Credit Asset Managers \(July 2009\)](#)
- [Reviewing and Rating Asset Managers \(June 2009\)](#)

Other research:

- [Credit Asset Management Quarterly - Q210 \(June 2010\)](#)
- [European CLO Asset Management Industry Update \(June 2010\)](#)

Summary

Fitch Ratings affirmed the Asset Manager Rating assigned to Alcentra Limited (Alcentra) at 'M1' for its European credit management activities on 1 July 2010.

The affirmation of the 'M1' rating reflects the stability of Alcentra's established and robust European sub-investment grade management platform over the last year, despite challenging market conditions. The affirmation also considers the continued progress Alcentra has made in transitioning its business to a more diversified credit product offering, including distressed debt and structured credit funds. These additional business areas are seen as a natural extension of Alcentra's historic, core collateralised loan obligation (CLO) business. It has also been an active consolidator of the CLO management industry, acquiring CLOs from other managers both in the US and in Europe to date.

Alcentra's key strengths include its position as one of the largest and longest established European credit asset managers, its tenured and professional staff and its strict credit discipline. Key challenges include the raising of additional assets from institutional investors, such as pension funds, for its new credit funds, where a priority for its enlarged marketing team will be overseeing and coordinating the Alcentra-related activities of the parent's 50-strong fund management sales force. In addition, Fitch perceives the potential for Alcentra to strengthen risk management in its special situations fund, which relies on a select few individuals.

Key drivers supporting the overall rating are the support Alcentra receives from its parent, The Bank of New York Mellon Corporation (rated 'AA-' / Stable / 'F1+'), while operating as an independent subsidiary. Alcentra's financial condition remains strong, in spite of the challenging market conditions experienced in 2009. It remained resiliently profitable in 2009 without needing to downsize its operations, despite some subordinated CLO management fees being temporarily shut-off. As of July 2010, Alcentra was receiving subordinated fees again in the majority of cases, which Fitch expects to make a positive contribution to profitability in 2010. Alcentra's staff has remained largely stable over time, with a good breadth and depth of experience and benefitting from a strong leadership team.

The rating is also driven by Alcentra's robust credit selection process, which has remained stable over time. Fitch notes in particular Alcentra's good access to issuers and the market. Its approach to portfolio management is stable and conservative within a buy and hold framework for the CLOs, although it is more opportunistic in the funds, in-line with the investment objectives of those funds.

Lastly, the rating is driven by Alcentra's administrative capabilities which Fitch considers best-in-class in Europe, based on its strong team, appropriate systems and effective processes. Its investor communication has always been strong, augmented in 2010 through the refinement of its marketing materials. Alcentra's technology is based on 'Wall Street Office' for loan administration and other tools, such as 'Intex', for its structured credit fund and a recently added trading and portfolio analysis system, Everest.

Manager Profile

Alcentra Ltd

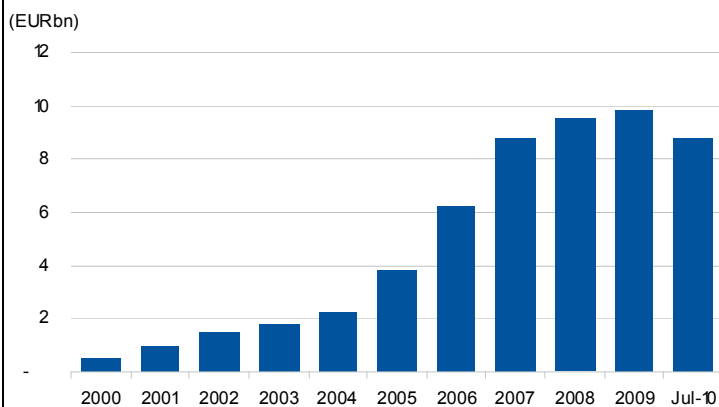
Alcentra is a global asset management firm focused on sub-investment-grade debt fund management. It was formed through the acquisition of Barclays Capital Asset Management Limited from Barclays Bank Plc in Europe in March 2003, and the acquisition of Imperial Credit Asset Management from Imperial Credit Industries, Inc. in the US in March 2002. In January 2006, a majority stake in Alcentra was acquired by The Bank of New York Mellon Corporation. The senior management team and employees currently own 5% of the company.

Alcentra manages European sub-investment-grade debt through CLOs, mezzanine funds and total return funds for a total of EUR8.8bn. The firm has been an active consolidator of the global CLO management industry, acquiring nine funds in the US and one CLO in Europe to date. It has also developed its non-CLO, fund management business through the addition of loan and structured credit funds and the development of a managed account business.

Address	Alcentra Europe 10 Gresham Street London EC2V 7JD	Ownership	Bank of New York Mellon (95%) and executives and employees (5%)
Web site	www.alcentra.com	Parent/affiliates	Alcentra Management (Ireland) Ltd, Alcentra NY LLC, Alcentra Investments Limited (Bermuda)
Type of organisation	Asset Manager	Chairman and CEO	David Forbes-Nixon
Year founded	2002	CIO	Paul Hatfield
Domicile, place of incorporation	UK	CFO and COO	Robert Bennett
Registration(s)/jurisdiction(s)	FSA, SEC, Irish Financial Regulator	Key portfolio managers	Graham Rainbow (CLO), Damien Miller (Special Situations), Graeme Delaney-Smith (Mezzanine), Hiram Hamilton (Structured Credit)
No. of employees	38 in Europe (57 globally)	No. of investment professionals	16 (Europe), 15 (US)

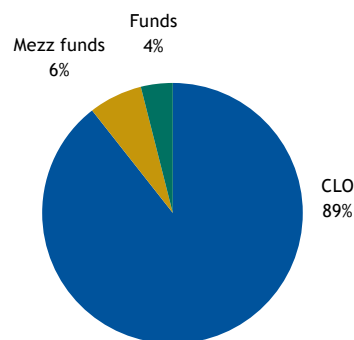
Assets Under Management

European AuM Development



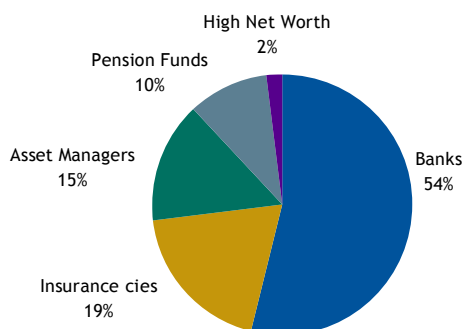
European AuM Breakdown by Product Type

(July 2010 in nominal)



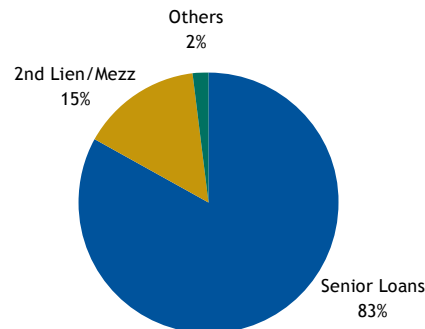
AuM Breakdown by Investor Type

(July 2010)



AuM Breakdown by Asset Class

(July 2010)



Alcentra Ltd

Rating
M1

Key Rating Drivers

Strengths

- One of the three largest and longest established European CLO managers.
- Tenured and experienced professional team at all levels, demonstrating stability over a considerable period of time.
- Strict and stable investment and credit discipline.
- Increasingly diversified product offering within the sub-investment grade debt space.

Challenges

- To continue the development of the non-CLO fund management business through an expansion of its fund and managed account businesses.
- To strengthen existing and develop new relationships with key institutional clients, in particular pension funds and intermediaries.

Score
2.00

Company & Staffing

Alcentra is a well-rounded and mature investment manager, benefitting from strong leadership and very high quality of staff. It has made substantial and sustained progress in transitioning its business from a CLO to a broader sub-investment grade debt focus.

- 95% owned by the parent, Bank of New York Mellon Corporation and 5% by executives and employees.
- Well capitalised and highly profitable in spite of reduced subordinated fee income in 2009.
- One of the longest established CLO managers in Europe, having launched its first CDO in 2000 and first CLO in 2001.
- Active consolidator of the CLO management industry having acquired one CLO in Europe and nine in the US to date.
- Control structure focusing on first level (ie controls by operational staff) supported by technology and reporting capabilities; presence of a dedicated operational risk officer at the parent since 2010.
- Clear separation of responsibility between front- and middle- /back-office functions; average investment staff experience of approximately 11 years.

Credit Selection

1.50

Rigorous credit selection process based on robust fundamental credit analysis and unparalleled access to management.

- Access to market facilitated by size, track record and established relationships with key market participants.
- Two-step analysis process, including a pre-screening phase and a full due diligence phase.
- Top-down and bottom-up analysis includes industry review, financial modelling, scenario analysis and formal internal ratings.
- Committee-based preliminary and final credit approval; portfolio managers take investment decisions.
- Relative value assessed through price feeds and portfolio manager judgments, formalised at the investment committee.

Portfolio & Risk Management

1.75

Disciplined asset-level risk monitoring driving a stable and conservative yet flexible portfolio management process.

- Largely a buy-and-hold approach except the funds, which are more trading/relative-value oriented.
- Portfolios are not overly diversified in general, with sizable top positions in line with strong opinions of credit research.
- Presence of dedicated work-out specialist to support credit analysts; complemented by knowledge and experience of seniors.
- Risk management embedded in the selection and monitoring processes, relying on technology and firm-wide reporting.
- Asset-level credit risk monitoring based on monthly financial monitoring of individual issuers, maintenance of a watchlist and semi-annual full portfolio reviews.
- Investment, fund allocation and sell decisions are the responsibility of the portfolio managers.

Investment Administration

1.75

Best-in-class administrative capabilities reflecting a highly appropriate combination of staff, systems and processes.

- Concise and relevant supplemental reporting produced to complement trustee reports, accessed via dedicated investor web site.
- Marketing materials refined and consolidated in 2010; targeted investor education reports added.
- Administrative capability based on Wall Street Office (WSO), and documented procedures that are well adhered to.
- Scalability of processes demonstrated through integration of acquired CLOs to Alcentra's platform.
- Close relationship with same trustee for all of Alcentra's CLOs facilitates information flows.

Technology

2.00

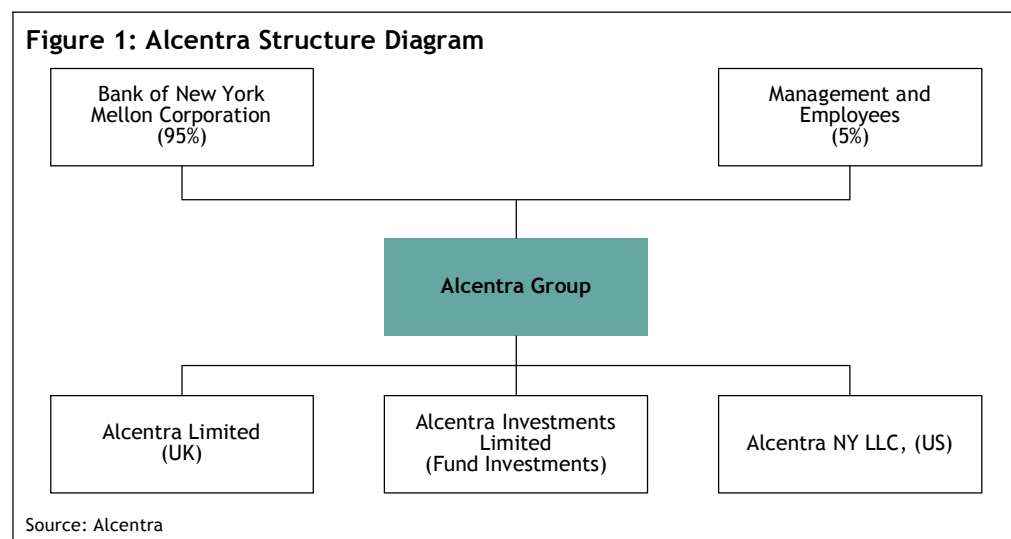
Appropriate technology supporting administration and portfolio management; however, credit research remains spreadsheet-based.

- Front-office credit research tools largely spreadsheet-based, complemented by Intex for the structured credit fund.
- All CLOs and funds are set up and monitored via WSO, which has been implemented since 2001.
- Fund administration largely automated through systems and data feeds acquired.
- Data architecture based on WSO which drives administrative processes and provides data to front-office analysis tools.
- Front to back office trading and portfolio management system, Everest, implemented and being rolled out in 2010.

Company & Staffing

Shareholding & Financial Standing

The Alcentra Group was established in 2001 through the acquisition – by the Alchemy Group, a private equity group, and the founding partners – of Imperial Credit Asset Management from Imperial Credit Industries Inc in March 2002, and of Barclays Capital Asset Management (BCAM) from Barclays Bank Plc in March 2003. In 2005, the Alchemy Group, Alcentra Group management and employees, sold a combined 80% holding in the Alcentra Group to the Bank of New York Mellon Corporation (BNY Mellon, rated ‘AA-’/Stable/F1+’) with Alcentra Group senior staff retaining the remaining 20% stake in the company. Since then, BNY Mellon has increased its stake with senior management and employees now retaining only a minority stake in the business. BNY Mellon owns directly or indirectly a total of 18 investment managers, including Alcentra. The Alcentra Group is incorporated in the US and directly or indirectly owns the entities as depicted in *Figure 1* below:



Fitch’s ‘M1’ asset manager rating is assigned to Alcentra Limited (Alcentra), the UK operating subsidiary of the Alcentra Group, and covers all of Alcentra’s European credit management activities. Alcentra NY LLC – the US subsidiary (see *Table 1*) – currently falls outside the scope of the rating.

• Well capitalised and highly profitable in spite of reduced subordinated fee income in 2009.

Alcentra’s revenues are primarily driven by management fees¹ from the CLOs under management, which form the bulk of its asset base. Due to market conditions, a number of Alcentra’s CLOs cut-off subordinated fee payments in 2009; however, in the first half of 2010, all save two of Alcentra’s CLOs made subordinated fee payments.

Alcentra has been highly and resiliently profitable since inception, although in 2009 profits were reduced from 2008 levels due to a reduction in subordinated fee income. Nonetheless the

Table 1: Alcentra NY LLC

Headcount	Number
Portfolio Managers	3
Analysts	11
Other	5
Total	19
AUM	Data
Cash CLOs	13 (USD4.5bn)
Synthetic CLOs	1 (USD101m)
Mezzanine Funds	2 (USD350m)
Total Return Funds	1 (USD51m)
Total (USDbn)	5

Source: Alcentra

¹ CLO fees consist of a senior (typically smaller) and a subordinated (typically larger) component, with subordinated fees temporarily cut-off if certain conditions arise, notably relating to the presence of larger proportions of low rated (ie ‘CCC’ or below) assets in the portfolio and/or lower asset valuations.

company did not need to reduce its cost base in 2009, which is largely staff-based; however, it did recalibrate its bonus pool towards stock and away from cash. In 2010, Fitch expects the resumption of subordinated fee payments (including missed subordinated fee payments due from 2009) to have a positive impact on Alcentra's profitability.

Operating cash flows are generally reinvested in the form of seed capital in the funds and holdings of equity tranches of CLOs. These investments are lodged in a sister company, Alcentra Investments Limited. A one-off impairment charge was taken on the investments in this company in 2009, reflecting the impact of market conditions on investments held.

As an FSA-regulated entity, Alcentra Ltd is required to hold appropriate levels of regulatory capital. In practice, it has cash balances and liquidity facilities that equates to several years of expenses. The Alcentra Group has some debt with its parent, BNY Mellon, in the form of a term loan and a revolving credit facility.

Experience and Asset Structure

Alcentra is one of the largest and longest established European CLO managers. According to data compiled by Fitch, Alcentra was the second largest CLO manager in Europe as of June 2010 (see the special report "[European CLO Asset Managers: Industry Update](#)", dated 10 June 2010 and available at www.fitchratings.com). Alcentra launched its first collateralised debt obligation (Blue Eagle) in Europe in 2000, followed by its first European CLO, Jubilee I, in 2001; thus, it has one of the longest organisational CLO management track records among its peers in Europe. The experience of the core team from BCAM goes back even further to 1998. Alcentra's CLO experience also includes a strong realised CLO performance: Jubilee I was called in December 2006 at a 12.1% equity internal rate of return.

As of July 2010, Alcentra managed a total of 18 CLOs in Europe, all but one of which was originated by Alcentra (see *Appendix 1* for list of all the CLOs and funds managed by Alcentra). Globally, Alcentra has been an active consolidator of the CLO management industry; in the US it acquired three funds from BNY Mellon and six from Rabobank, while in Europe it has acquired one CLO to date (Silver Birch CLO I B.V. EUR270m), from West LB in June 2010. In Fitch's opinion, Alcentra is well positioned to selectively acquire additional CLOs from other smaller managers; indeed, the agency predicts that there will be further consolidation opportunities in the short to medium term.

Alcentra's asset performance has been consistently strong over the years; its (self-calculated) default rate has been lower than the aggregate S&P European Leveraged Loan Index default rate every year since inception.

Alcentra's strategic priority involves developing a diversified sub-investment grade asset management platform. Currently, its main activity remains leveraged loan management, through its CLOs under management. However, it has been steadily building its fund business since 2004, initially with a credit hedge fund (where the one outstanding share class is in the process of being liquidated). Since then it has launched a series of other funds and products, including a loan fund, a distressed fund, mezzanine funds and managed accounts. In 2009 it launched a structured credit fund. In Fitch's opinion, Alcentra's activity in launching new funds and products, and the assets it has raised in these funds over the years, provide a good indication of its commitment to its stated strategic objective of developing a diversified sub-investment grade management platform. A key challenge for Alcentra will be maintaining the momentum in fund launches and the raising of new money in existing funds and products, along with the development of new initiatives such as high yield bond funds.

Alcentra's investor base is well diversified, largely reflecting the mixture of investors in its CLOs under management. In developing its fund management

- One of the longest established CLO managers in Europe, having launched its first CDO in 2000 and first CLO in 2001.

- Active consolidator of the CLO management industry, having acquired one CLO in Europe and nine in the US to date.

business (as opposed to its core, historic CLO management business) Alcentra has actively stepped up its marketing activities to key institutional investors, such as pension funds. This activity has included the strengthening of the marketing team (see *Staffing* below) and further development of its marketing materials. More fundamentally, Alcentra places a greater focus on its brand and the role this takes in attracting and maintaining relationships with key investors. In Fitch's opinion, the increased focus on marketing activities is supportive of both the development of the Alcentra brand and its relationships with key institutional investors. In its marketing activities, it further benefits from its access to the BNY Mellon sales force (see *Staffing* below). One member of the sales force is dedicated purely to relationships with investment consultants, a key gatekeeper for pension fund investment, particularly in the UK. Fitch believes that a key challenge for Alcentra will be leveraging and overseeing the activities of this sales force; should it be successful, its access to this sales force – and through it, key institutional investors – could become a significant competitive advantage to Alcentra.

Corporate Independence & Governance

Alcentra benefits from a robust control environment with well-documented procedures. Controls are largely effected by operational staff through the company's administrative systems (see *Investment Administration* below); these provide management with comprehensive reporting, allowing it to provide effective oversight to the business. Additionally, the company was initially structured in preparation for launch as a publically listed and traded company². As a result, its compliance and control environment has always been strong. Since its purchase by BNY Mellon, Alcentra has continued to develop its control environment through the use of consultants and the recruitment of additional compliance staff.

While benefiting from the support of its parent, Alcentra operates as an independent subsidiary in terms of operations, controls and investments. The board of the holding company consists of nine directors, all from Alcentra or BNY Mellon, without external independent members. Alcentra Ltd is FSA regulated and other affiliates are regulated by the SEC or the Irish Financial Regulator.

All the funds and CLOs use well respected service providers, including BNY Mellon as CLO trustee and hedge fund custodian, Goldman Sachs as prime broker and KPMG as fund auditors.

Alcentra is audited by BNY Mellon's internal audit function. A key improvement in 2010 was the addition of a dedicated (operational) risk officer at the BNY Mellon level to oversee Alcentra. Fitch takes comfort from the additional layer of oversight and the control this provides to an already well-controlled business.

Staffing

At the most senior level, the operational responsibilities are split between the chairman and CEO, David Forbes-Nixon, the CIO, Paul Hatfield, and the CFO/COO, Robert Bennett. The management team is highly experienced and long tenured, with an average of over 20 years' experience and over nine years' company tenure (see *Appendix 2* for biographies of key staff). The global senior management team is based in London, complemented by the co-heads of the US team (Julian Coville, and Ron Grobeck). In Fitch's opinion, the senior management team brings consistent and stable leadership to the business.

Alcentra benefits from good breadth and depth of staff across the organisation. Roles and responsibilities between and within teams are clearly defined and Fitch can identify a clear segregation between investment and operations. Alcentra

- Control structure focusing on first level (ie controls by operational staff) supported by technology and reporting capabilities.
- Presence of a dedicated operational risk officer at the parent since 2010.

- Clear separation of responsibility between front- and middle-/back-office functions.
- Average investment staff experience of approximately 11 years.

² The Alchemy Group had initially planned an IPO for Alcentra as its exit strategy; however, its holding was instead bought out by BNY Mellon, nonetheless leaving Alcentra with a compliance and control environment built to the standards of a publically-listed company.

employs a total of 38 people in Europe (see *Table 2* below), along with 19 in the US, for a total global headcount of 57 (as of July 2010).

Table 2. European Headcount

Function	Number of Staff
Senior Management	3
European Portfolio Management/Credit	13
Structured Credit	2
Fund Administration	10
Financial Administration	2
Business Development	4
Compliance & Other	4
Total	38

Source: Alcentra

Alcentra has experienced a low staff turnover since inception. There have been few departures from the team, which has in fact grown with the addition of staff from acquired CLOs and additional compliance and business development/marketing personnel in 2010. The staff retention strategy incorporates a market rate salary and bonus and an equity distribution scheme. In Fitch's opinion the equity distribution scheme provides a strong incentive (given Alcentra's profitability) for staff to remain long term. Additionally, the founding partners have signed three- and five-year non-compete contracts and lock-in contracts that prevent them from extracting their personal investment from the firm for a predefined period.

Portfolio Managers

The portfolio managers are highly experienced and long tenured. CLO portfolio management is the responsibility of Graham Rainbow as the main CLO portfolio manager, supported by the CEO and CIO. The mezzanine funds are managed by Graeme Delaney-Smith and the special situation fund by Damien Miller. The recently launched structured credit fund is managed by Hiram Hamilton. Fitch perceives some key person dependency on the portfolio managers, particularly in the distressed fund, which relies on a few individuals. Nonetheless, they are well supported by the senior credit analysts and the current number of distinct portfolios and trading volumes do not create excessive risk.

Research Team

The research team consists of a pool of 10 credit research staff. Members of the portfolio management/credit team have an average 11 years' leveraged finance experience. Alcentra operates a matrix approach to research, with analysts specialised by industry sector where appropriate. Each analyst covers two sectors and analysts are responsible both for analysing new issues and monitoring loans under management. Some analysts also have specific jurisdictional coverage. On average, each analyst has a relatively low workload of around 17 loans, while Alcentra considers 25 loans per analyst to be an absolute maximum.

In addition to the seven analysts who are specialised by industry sector or country Alcentra also employs one work-out specialist and one analyst dedicated to distressed assets.

Administration Team

Alcentra's European administration team is well staffed by nine experienced professionals. It is led jointly by James Algar and Stuart Medlen. In Fitch's opinion they provide effective leadership to the team.

Analysts in the team are divided appropriately between the following functions:

- CLO administration (three staff);
- loan settlements and support (three staff); and

- total return fund administration (three staff).

All members of staff in the administration team have experience of operating Wall Street Office (WSO), resulting in a good overlap of staff. Historically, Alcentra has mainly recruited administrative personnel who already have WSO experience.

The business development team consists of four staff, headed by Simon Perry, previously head of the European CLO business at UBS. The strengthening of this team is of strategic importance to Alcentra as it continues to move away from the bank-led marketing that was central to the marketing of CLOs towards manager-originated and marketed fund products. This team focuses on the development of Alcentra's marketing materials and leads its sales efforts. As part of the sales force, it has a key role interacting with the BNY Mellon sales force of 50 staff. The BNY Mellon sales force is shared across the 18 different investment managers in the group, including Alcentra. Success in leveraging the BNY Mellon sales force, and in overseeing and directing these efforts, will be an important factor for this team and, indeed, the company as a whole.

Alcentra's compliance effort is headed by James Algar as Chief Compliance Officer. The compliance function is further supported by reporting lines into the parent and by a recently added dedicated compliance assistant. Alcentra also retains the services of a specialist compliance consultancy.

Non-core activities, such as IT are outsourced to properly selected service providers.

- Access to market facilitated by size, track record and established relationships with key market participants.

Credit Selection

Alcentra's credit investment and portfolio management processes are both thorough, and executed with the highest standards of care. The investment style is conservative, credit focused, and buy-and-hold, demonstrated through Alcentra's consistent credit strategy. The special situations fund, with EUR105m under management as of July 2010, is a total return fund, and is thus more opportunistic and trading oriented.

Sourcing

Historically, Alcentra has sourced the majority of its assets from the primary market and has one of the best sourcing capabilities in that market in Europe. Until the primary market slowed down in summer 2007, Alcentra benefited from excellent sourcing capabilities, driven by a number of interrelated factors, including its significant market share (estimated by Alcentra at 6.4% of the total European leveraged loan market as of July 2010), long track-record, and established relationships with private equity sponsors.

Credit Research

The investment process involves two steps; an initial pre-screening stage focuses the comprehensive research on a limited number of credits while the full due diligence phase applies a robust bottom-up and top-down analysis framework.

The pre-screening criteria cover aspects such as the size of the company – Alcentra prefers to target larger companies with an enterprise value of greater than EUR200m – the capital intensity of the business, and the amount of cash the business can generate, among other factors. The mezzanine fund however focuses on middle market transactions (EUR20m to EUR40m positions). At the pre-screening stage, particular attention is focused on more volatile industries and businesses with significant differences from their peers. In these cases, investments are made on a case-by-case basis. The result of the pre-screening is presented to the investment committee for preliminary approval.

The full due diligence is detailed and of good quality. It follows a standardised methodology, beginning with a top-down analysis of the industry (and of the company within the industry), including the market positioning of the company and operational aspects of the company. Macroeconomic views are factored into the

- Two-step analysis process including a pre-screening phase and a full due diligence phase.

- Top-down and bottom-up analysis includes industry review, financial modelling, scenario analysis and formal internal ratings.

process by analysts and at the level of the investment committee, with views formulated on the basis of publically available research. This stage of the process also includes an analysis of the credit metrics and financial forecasts of the company. Alcentra uses a standardised financial model in which the transaction case is compared against a flat EBITDA case and a proprietary Alcentra case, as appropriate. Analysts also produce a recovery rate estimate.

The second, bottom-up step of the analysis examines the capital structure of the transaction, both at the hold-co and op-co level, and transaction security rights and obligations. This analysis is complemented by meetings with the management of the company, and by a review of all the loan documentation, using external counsel as appropriate. Fitch notes that Alcentra benefits from very good access to management, a function both of its size and established and typically long-term relationships with invested companies. The output of the analysis is a 15-20 page credit report, which includes the outputs of the financial models, the recovery analysis, and an internal credit rating. This is presented to the investment committee by the analyst and a sponsoring portfolio manager.

The investment committee comprises the following senior staff, as detailed in *Table 3* below:

- Committee-based preliminary and final credit approval; portfolio managers take investment decisions.

Table 3. Investment Committee Membership

Committee Member	Role	Industry Experience (Years)
David Forbes-Nixon	CEO/ Chairman & Committee Chair	23
Paul Hatfiled	CIO	22
Graham Rainbow	Senior Portfolio Manager	17
Graeme Delaney-Smith	Mezzanine Debt Portfolio Manager	14
Damien Miller	Special Situations Portfolio Manager	14
Kevin Lennon	Senior Analyst & Head of Credit	20
Richard Samuel	Senior Analyst	20

Source: Alcentra

At both the preliminary and final stage, the committee decision will either be an approval, a decline, or a decision to commence coverage. If the outcome of the committee is to commence coverage then the credit will be monitored, but will require further analysis before an investment is considered. Committee decisions are documented and signed off by authorised signatories.

For the special situation fund, the selection process combines fundamental and technical analysis, the former component being largely supported by Alcentra's wider credit selection process. The technical analysis component is driven more by key individuals, notably the portfolio manager. The asset selection process for the structured credit fund incorporates price screening (with a focus on tranches priced below 50%) a fundamental review, and stress tests of the structures through Intex.

Relative Value Analysis

Alcentra assess relative value in the CLOs and Mezzanine funds through loan pricing feeds (see *Technology* below), which assist portfolio managers and the credit committee in making investment and disposal decisions.

In the case of the special situation fund, which is actively traded (one trade a day on average), relative value assessments are primarily driven by the experience and trading skills of portfolio managers, reflecting the still limited liquidity in the sub-investment-grade market.

Portfolio and Risk Management

Alcentra is primarily a fundamental buy-and-hold investor, which is reflected in its portfolio and risk management practices. It is more opportunistic with the funds, resulting in a more trading/relative-value-focussed approach, in-line with the investment objectives of the funds.

- Relative value assessed through price feeds and portfolio manager judgments, formalised at the investment committee.

- Largely a buy-and-hold approach except the funds, which are more trading/relative-value oriented.

- Portfolios are not overly diversified in general, with sizable top positions in line with strong opinions of credit research.

- Presence of dedicated work-out specialist to support credit analysts; complemented by knowledge and experience of seniors.

- Risk management embedded in the selection and monitoring processes, relying on technology and firm-wide reporting.

- Asset-level credit risk monitoring based on monthly financial monitoring of individual issuers, maintenance of a watchlist, and semi-annual full portfolio reviews.

Portfolio Construction

Alcentra's portfolio construction process places particular emphasis on ensuring opportunities are properly sized. This means that the company has not sought over-diversification and top positions therefore tend to be reasonably large, reflecting strong confidence in their credit standing, based on the fundamental analysis described above. This is particularly true for the mezzanine funds, which have approximately 15-20 positions. A formal allocation policy, based on available cash and fund characteristics, has been implemented since 2008.

Trading and Work-Out

Alcentra has good access to the secondary market through established relationships with leading bank trading desks and other market participants. However, Alcentra remains primarily a fundamental buy-and-hold investor, albeit with more active trading of the total return and special situations funds.

Alcentra maintains a dedicated work-out specialist on-staff, along with one analyst purely dedicated to distressed assets (and the special situations fund). The role of the work-out specialist is to manage the watch list and to guide the work-out process, should Alcentra decide to go through that process (4 transactions were in work-out as of July 2010). Further support in a work-out situation is provided by the senior management team and other portfolio managers.

Risk Monitoring

Given that the majority of the assets consist of closed-end vehicles (CLOs or mezzanine limited partnerships), risk monitoring essentially focuses on credit risk. Liquidity and market risk however remain relevant for the total return portfolios.

Credit risk management is driven by the company's initial selection and ongoing monitoring processes. As such, credit risk management is largely first-level (driven by the work of front-office personnel), with the administration team providing a second level of control over trading and CLO test compliance (using WSO). Reports from the front-office and administration teams provide senior management with good oversight of the business. While Alcentra has sufficient portfolio risk analytics for the nature of its business, Fitch perceives the potential for Alcentra to further develop portfolio-level investment risk analysis tools for the total return funds, focussing on both key credit and market risk indicators. The agency notes that subsequent to the rating review, Alcentra has implemented the Everest system (see *Technology*), which Fitch understands is a front to back office trading and portfolio analytics system. Fitch takes comfort from the overall risk management role, effectively enacted by the CIO; nonetheless, it believes that the addition of a dedicated, independent risk management function could provide a further indication to investors of the strength of Alcentra's risk management practices.

Alcentra's portfolio is under constant supervision and analysis, allowing quick reaction to market trends. In the context of continued low primary flow, the surveillance process has become more intensive and rigorous at every stage. On a daily basis, the CLO portfolios are monitored by the administration team to evaluate the impact of any purchases, sales, rating actions, prepayments etc on the portfolio. All changes that affect the portfolio are reported on an ongoing basis to the portfolio manager, but formalised in thrice-weekly morning meetings. Credit market issues, portfolio trends and news flows are discussed at these meetings. Two weekly packs, one for CLOs and one for funds, are produced and circulated throughout the firm. They provide all positions and key metrics across portfolios, offering a systematic tool to supervise the business.

On a monthly basis, updated credit metrics on each asset are input into well designed, individual monitoring spreadsheets. These allow for comparison of ongoing results against budget and for relative performance analysis between companies. Individual loan models are also updated and trends analysed. Short

summaries (known as “flash notes”) detailing key aspects of each company’s performance over the month are circulated to the team, as a means to efficiently communicate performance information and to avoid any shocks at the quarterly portfolio reviews. Where deterioration has been detected, the “flash note” is more detailed, and further action may be taken as warranted, including a full re-analysis of the due diligence package.

On a quarterly basis updated budget figures are reviewed against current and historical credit metrics. With this information, analysts complete a formal quarterly review of all assets and present an appropriate update of the rating to the credit committee. Alcentra uses rating scales to reflect credit, liquidity, and recovery. Credit is scored from ‘1’ to ‘5’, with 1 being the highest, liquidity from ‘A’ to ‘D’, and recovery as a percentage. As soon as an asset is downgraded to ‘3’, it is placed on the watch list. Of the approximately 160 credits Alcentra has under surveillance (as of July 2010), 29 were on the watch list.

- Investment, fund allocation, and sell decisions are the responsibility of the portfolio managers.

While Alcentra’s stated investment style is buy and hold for CLOs and mezzanine funds, a disciplined sell philosophy is adhered to. Investments are considered for sale if a spread price target is achieved, if credit deterioration is experienced, if relative value is identified, or if the sale will benefit portfolio diversification. The sell decision resides with the portfolio manager, and no committee approval is required. The portfolio manager is also responsible for sourcing best execution on the intended trade.

Liquidity can represent a relevant risk for funds and Alcentra aims to limit asset liability mismatches through conservative redemption terms. Funding has become a secondary issue as funds now have very limited leverage (through total return swaps for the special situation fund or a credit facility for the mezzanine fund).

Investment Administration

Alcentra’s investment administration capabilities are, in Fitch’s opinion, best-in-class in Europe. It has a strong team in place, a well developed and overseen relationship with the trustee on all its CLOs, the use of the industry standard loan administrative tool, and good supplemental investor reporting in the case of CLOs.

Reporting & Communication

Alcentra is committed to delivering timely and transparent information to all investors. In the case of CLOs and mezzanine funds, trustee reports are complemented by portfolio commentaries which typically include an overview of the diversity of the portfolio, a comment on any trends in portfolio metrics and a brief outlook for the portfolio. Additionally, prices are provided on all positions in the portfolio. In Fitch’s opinion, these reports provide a concise and timely insight to investors. All trustee reports are distributed by the trustee, and are also available through Alcentra’s web site at www.alcentra.com. On the web site, investors can also access offering circulars, and the latest prices on all positions, which are updated monthly. Alcentra actively engages with investor requests for further information, as demonstrated by the strengthening of its marketing team (see *Staffing* above), and through its commitment to treating all investors equally (evidenced by the use of its web site as the main tool for distributing any additional information). Supplemental reporting is also provided on the funds.

- Concise and relevant supplemental reporting, produced to complement trustee reports accessed via dedicated investor web site.

- Marketing materials refined and consolidated in 2010; targeted investor education reports added.

In 2010 Alcentra launched a number of marketing initiatives. These included the re-development and coordination of all of the company’s marketing materials and the launch of thought-leadership articles. The first of these provided investors with a primer on the leveraged loan industry and investment, along with an overview of Alcentra’s capabilities. Fitch views positively the enhancements Alcentra has made to its investor communication activities, further demonstrating its commitment to - and already high level of - transparency.

Administration

Loan settlements are a function of the administration team, where detailed checklists for loan settlement and loan legal documentation are prepared (and regularly updated) and are followed in detail. The administration team is responsible for back-office controls, such as daily cash reconciliation with the trustee. The depth of experience and the clear separation of duties and responsibilities in the administration team ensure the effectiveness of these operational controls.

- Administrative capability based on WSO and documented procedures that are well adhered to.

All of Alcentra’s CLO and fund portfolios are set up and modelled in WSO, as the industry standard loan administrative software solution. WSO was rolled out in 2001 as the core administrative system, and has been used on every vehicle since then. The latest versions of WSO are installed and operational for all CLOs, resulting in operational efficiencies. Credit funds are monitored from an administrative perspective via a combination of customised extracts from WSO and Excel models, which include models used to tie out net asset values with fund administrators. Alcentra currently employs a contractor to custom build various analytics in its funds. Procedures governing all aspects of WSO usage are maintained and updated frequently. Fitch notes that the team adheres to these procedures closely.

- Scalability of processes demonstrated through integration of acquired CLOs to Alcentra’s platform.
- Close relationship with same trustee for all of Alcentra’s CLOs facilitates information flows.

The addition of the acquired CLOs (several in the US and one in Europe to date) provided a useful test of the scalability and efficiency of Alcentra’s administrative capabilities. The increase in CLOs under management over the years and the addition of alternate structures (ie funds and managed accounts) demonstrates the scalability of the platform. Fitch understands that the acquired CLOs were integrated to Alcentra’s systems in a minimal time period, therefore demonstrating the efficiency of its administrative procedures.

Trustee relationships are well developed and Alcentra’s systems are well integrated with trustee systems. Alcentra uses BNY Mellon Global Corporate Trust as the trustee on all of its European transactions. As a result, Alcentra is a leading client and has a long relationship with the trustee which results in it receiving a good service from the trustee. Furthermore, as the trustee also runs WSO as its main administrative tool, the interaction with Alcentra is seamless. The administration team is the key point of contact with the trustee. Principal account balances are tied-out with the trustee daily, while other account balances are reconciled twice weekly. In addition to cash balances, the administration team maintains a log of unsettled trades, which are reconciled daily with the trustee.

More recurrent procedures on loans, such as rollovers or pay-downs, have been streamlined, through the use of tools such as WSO Data and WSO Fax. Valuation on loans is provided by Markit.

Technology

Alcentra’s technology provides an adequate match to the current requirements of the business. Its main tools are WSO for asset administration, complemented by spreadsheet-based solutions for asset analysis and Intex for equity tranche valuation. The agency notes some room for improvement in the integration between Alcentra’s back-/middle-office and front-office systems.

- Front-office credit research tools largely spreadsheet-based, complemented by Intex for the structured credit fund.

Subsequent to completing its rating analysis of Alcentra, Fitch notes that Alcentra has acquired Everest, a software solution provided by Black Mountain. Fitch understands that this system links front to middle and back office systems and provides real time relative performance analysis. It also has pre-trade compliance testing, order management and allocation functionality. The addition of this system has not been factored into Alcentra’s scores.

Front-Office Systems

Given the nature of the sub-investment-grade instruments it manages, Alcentra has not historically operated a front-to-back office trading or portfolio management

system. Instead, its IT requirements were primarily met through its core system for portfolio monitoring and loan administration, ie WSO. WSO acts as the data repository for information downloaded to front-office systems, notably for the spreadsheet-based portfolio manager information packs prepared weekly. These packs provide snapshots of key metric performance and portfolio diversity and form the basis for the supplemental portfolio manager commentary reports. Fitch understands that the recently implemented Everest system will effectively provide a front to back office trading and portfolio management system.

Other front-office systems include the asset monitoring spreadsheets that are updated with monthly and quarterly account and budget information on every asset and used for performance monitoring and relative value analysis. Alcentra's models for individual assets are standardised, proprietary, spreadsheet-based tools used for scenario analysis (see *Portfolio and Risk Management* above). The spreadsheets used for credit research (modelling) and surveillance are adequate for Alcentra's requirements and are complemented by the portfolio analysis provided through WSO. On the liability side, Alcentra does not use a proprietary cash flow model for stress testing structures. It does, however, have Intex, which is currently used to value the equity of its CLOs under management and in the structured credit fund, along with related pieces of software recently added to complement Intex by streamlining structured credit analysis.

Middle- and Back-Office Systems

WSO is used across all vehicles, and was implemented in 2001. It provides a complete suite of CDO administrative modules, all of which are implemented and tested. These include risk management functions that allow for the tracking of the size of all positions across the portfolio, detailed asset and portfolio tracking functions and cash balance reconciliation functions. In addition to the standard modules (compliance, reporting, etc), Alcentra operates a number of custom WSO modules, provided in response to the company's specific requirements. Alcentra has installed the latest version of all modules of WSO and has implemented automated interfaces with loan data providers.

Comprehensive reporting functionality, integral to trustee reconciliation, is provided through WSO at individual asset, as well as portfolio and enterprise-wide levels. Additionally, Alcentra subscribes to Markit for third-party prices on its loans under management. Alcentra has integrated, automatic price feeds from Markit to WSO, thus providing more responsive reporting.

In 2010 Alcentra added a dedicated customer relationship management tool (Pivotal), linked to the systems operated by BNY Mellon.

Data Management & Integration

WSO serves as a backbone to Alcentra's overall data infrastructure acting as the central repository for data from various service providers, the basis for all administrative processes and the data source for front-office applications. With respect to position keeping, trade settlement and administration, Fitch views Alcentra's platform as highly integrated.

Until 2010 Alcentra had not set up dedicated central databases or streamlined query tools for credit research, monitoring and reporting, which were essentially spreadsheet-based. However, the agency considers Alcentra's existing systems as adequate for the current scale of the business. Fitch notes that some of Alcentra's peers have begun to implement centralised databases for front-office applications, bringing together data from administrative systems, portfolio management tools and asset surveillance systems. Fitch will monitor Alcentra's progress in rolling out the Everest trading and portfolio analytics system which was implemented in Q310.

- All CLOs and funds are set up and monitored via WSO, which has been implemented since 2001.
- Fund administration largely automated through systems and data feeds acquired.

- Data architecture based on WSO which drives administrative processes and provides data to front-office analysis tools.

- Front to back office trading and portfolio management system, Everest, implemented and being rolled out in 2010.

IT Security

Alcentra does not have an in-house IT support team, preferring instead to outsource this function and concentrate on its core competency in portfolio management. Since 2002, Alcentra has used a consultant to provide all IT support, co-ordinated by the office manager. Consultants are used regularly to produce bespoke reports and to aid in development projects. Appropriate disaster recovery systems are in place, including a disaster recovery centre located in Kent, daily tape back-ups of all core systems, and off-site mirror servers.

Appendix 1

Table 4. European CLOs under Management (as of July 2010)

Name	Closing	Structure	Primary asset type	Original size (EURm)
Jubilee CDO II	Jun 02	Cash flow	European high yield (HY) loans	460
Jubilee CDO III	Dec 03	Cash flow	European HY loans	350
Jubilee CDO VI	Jul 04	Cash flow	European HY loans	410
Hamlet	Mar 05	Cash flow	European HY loans	300
Jubilee CDO V	May 05	Cash flow	European HY loans	555
Wood Street CLO I	Sept 05	Cash flow	European HY loans	460
Wood Street CLO II	Feb 06	Cash flow	European HY loans	400
Wood Street CLO III	May 06	Cash flow	European HY loans	550
Jubilee CDO VI	Jul 06	Cash flow	European HY loans	400
Jubilee CDO VII	Oct 06	Cash flow	European HY loans	500
Wood Street CLO IV	Dec 06	Cash flow	European HY loans	550
Jubilee CDO I - R	Mar 07	Cash flow	European HY loans	900
Wood Street CLO V	May 07	Cash flow	European HY loans	500
Wood Street CLO VI	Aug 07	Cash flow	European HY loans	325
Jubilee CDO VIII	Dec 07	Cash flow	European HY loans	400
ECF Financing CLO B.V.	Mar 08	Cash flow	European HY loans	380
Jubilee CDO IX	Jun 08	Cash flow	European HY loans	372
Silver Birch CLO I B.V.	Jun 10	Cash flow	European HY loans	270

N.B. Jubilee CDO I was called in December 2006 at a 12.1% internal rate of return to the equity holders
Source: Alcentra

Table 5. European Funds under Management (as of July 2010)

Name	Closing	Structure	Primary asset type	Size (EURm)
European Credit Fund	Nov 04	Irish Fund	European HY loans	205
Mezzanine Fund I	May 05	Jersey LP	Mezzanine	254
Managed Accounts	Mar 07, Jun 09	Accounts	European HY loans	77
Alcentra Group Special Situations Fund	Nov 07	Irish Fund	European HY loans	105
Mezzanine Fund II	Dec 07	Jersey LP	Mezzanine	273
Alcentra European Loan Fund	Jul 09		European HY loans	47
Alcentra Structured Credit Opportunity Fund	Sep 09		CLO tranches	18

Source: Alcentra

Appendix 2

Staffing Summary

	Background highlights
<p>David Forbes-Nixon Chairman and CEO 23 years' industry experience 13 years' company tenure</p>	<ul style="list-style-type: none"> • Founding member of Alcentra, Chairman, CEO. • Previously Global Head and CIO of BCAM, which he set up, along with the par loan trading business. • Director of the Loan Market Association (LMA) and chair of the LMA valuation committee from its inception in 1996 until 1999. • Three years at Bankers Trust as Vice President and Head of leveraged loan distribution. • Five years at Chemical Bank in structured finance and loan syndication. • BSc (Hons.) in Chemical Engineering from Birmingham University.
<p>Paul Hatfield CIO 22 years' industry experience 12 years' company tenure</p>	<ul style="list-style-type: none"> • CIO • Previously Senior Analyst at Intermediate Capital Group, covering building products and construction, aerospace and consumer credits. • Six years at Deutsche Bank (DB) in the London and New York leveraged finance teams. • Previously mezzanine and development capital loan portfolio manager at FennoScandia Bank. • Trained as an accountant at Arthur Andersen. • BA (hons.) in Economics from Cambridge University.
<p>Graham Rainbow Executive Director and Senior CLO Portfolio Manager 17 years' industry experience Two years' company tenure</p>	<ul style="list-style-type: none"> • CLO portfolio manager. • Previously, co-head of the leveraged syndicate desk at Barclays Capital, responsible for underwriting senior, second lien, and mezzanine LBO debt. • 13 years at Barclays Capital in loan trading, credit and sales before joining the Leveraged Finance team in 1998. • BSc (Hons.) in Management Science from Warwick University and an MBA from Warwick Business School.
<p>Graeme Delaney-Smith Executive Director and Head of Mezzanine Investments 14 years' industry experience Six years' company tenure</p>	<ul style="list-style-type: none"> • Mezzanine fund portfolio manager. • Previously Senior Deal Executive at ICG. • Five years at Royal Bank of Scotland (RBS), latterly in the leveraged finance team. • MBA from Heriott Watt University Business School, Edinburgh. • Degree from Napier University and a chartered accountant (CA).
<p>Robert Bennett CFO & COO 19 years' industry experience Seven years' company tenure</p>	<ul style="list-style-type: none"> • Responsible for group finance. • Previously Finance Director, Compliance Officer and Company Secretary for Baffin (UK) Ltd, a property fund manager. • Ten years in the financial markets divisions of Binder Hamlyn and Arthur Andersen. • BSc (Hons.) in Mathematics from Bristol University, and a Chartered Accountant.
<p>Simon Perry Managing Director 22 years industry experience 15 months company tenure</p>	<ul style="list-style-type: none"> • Responsible for the business development team covering Europe, Middle East and Asia ex Japan. • From 2000 to 2009, Simon was involved in the development of the European CLO market, heading the European CLO business at UBS Investment Bank from 2005 and prior to this holding the same role at CIBC and Natixis. • Before this, Simon was part of the cross asset class derivatives marketing team at CSFP, at the time, the derivatives specialists within Credit Suisse. • Simon is a graduate in Mechanical Engineering from Bath University.
<p>James Algar Executive Director and Co-Head Transaction Management and Chief Compliance Officer 27 years' industry experience 13 years' company tenure</p>	<ul style="list-style-type: none"> • Head of Administration team and Head of Compliance. • Original member of the Alcentra team, having joined from BCAM. • Previously Associate Director in transaction management team at BCAM. • Five years at HSBC Investment Bank in specialised finance support. • Further nine years' experience within financial services.
<p>Kevin Lennon Executive Director and Head of Credit 20 years' industry experience Nine years' company tenure</p>	<ul style="list-style-type: none"> • Head of credit and senior analyst covering the food and beverage, retail and leisure and entertainment sectors. • Previously senior industrial analyst at BCAM and leveraged finance analyst at Fitch Ratings. • Worked for 10 years at Natwest Bank, latterly in the head office credit committee.
<p>Stuart Medlen Executive Director and Co-Head Transaction Management 10 years' industry experience Six years' company tenure</p>	<ul style="list-style-type: none"> • Responsible for CDO portfolio monitoring, trustee oversight and interaction with other third parties. • Previously worked as an Assistant Treasurer for JP Morgan's Institutional Trust Services for four years. • BA (Hons) Literature and History from the University of Greenwich.
<p>Hiram Hamilton Executive Director and Head of Credit Structuring 12 years' industry experience Two year's company tenure</p>	<ul style="list-style-type: none"> • Responsible for credit structuring, cash flow modelling and equity valuation. • Previously Head of CDOs at Morgan Stanley in London where he structured and originated various credit arbitrage vehicles over an eight-year period. • Began his career as an analyst at Prudential Securities in the asset-backed securities group.

Source: Alcentra

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