Alcentra Ltd

Rating Type	Rating	Outlook	Last Rating Action
Investment Management Quality Rating	Excellent	Stable	10 August 2018

Key Rating Drivers

Growth Continues: The affirmation of Alcentra Ltd's IMQR in August 2018 reflected the broad stability in processes, staffing and corporate structure. The rating is driven overall by Alcentra's well-defined and robust investment processes, the depth and calibre of investment staff and the high quality support provided by Alcentra's institutional owner. The company has grown and increased the diversity of its products and investors, while increasing human and technology resources. Fitch Ratings expects the risk-management framework to benefit from a project that is underway to align Alcentra's policies and procedures with those of other BNY Mellon boutiques.

Robust Investment Process: The combination of a disciplined credit approval process and a robust investment framework supports Fitch's 'Excellent' score. All credits are subject to a preliminary credit screening followed by more detailed due diligence. In 2017, Alcentra integrated environmental, social and governance indicators into its analysis process. Credit monitoring is continuing, formalised in regular investment committee meetings and portfolio reviews.

Highly Experienced Staff: The number and experience of Alcentra's investment professionals supports Fitch's view that Investment Resources are 'Excellent'. Alcentra added a net 17 staff globally in 2017, notably in support of its direct lending activities and including several senior appointments: Alcentra has moved from a co-chief investment officer structure to a single global chief investment officer, and added an operational risk director. Alcentra has strong relationships with its administrators, custodians and trustees. It also benefits from the oversight, experience and resources, such as IT, legal and human resources, of its institutional owner.

Effective, Independent Risk Management: The risk framework is robust and continuously improving, providing suitable coverage of the main risks and effective, independent risk oversight and controls which supports Fitch's view that risk management is 'Strong'. There are comprehensive policies and procedures in place to ensure compliance with regulatory rules. In 2017, Alcentra hired a senior director to review its risk and compliance framework both in terms of ensuring best practice and aligning policies and procedures with other investment boutiques owned by the BNY Mellon Group. Fitch expects this process to strengthen the risk control environment further.

Consistent Investment Performance: Alcentra's overall investment performance is consistent with its stated investment objectives and investor expectations which supports Fitch's view that the investment performance is 'Consistent'. This reflects both the demonstrably strong performance of the open-ended funds, the consistent performance of the CLOs and the more recent performance history of the direct lending funds, and their respective asset weights.

Sophisticated Client Servicing: Alcentra's strong franchise as one of the largest and longest-established European sub-investment-grade credit asset managers, and its strong and sustained profitability support Fitch's 'Excellent' score. Having the BNY Mellon Group as its institutional owner is a highly positive factor in Fitch's analysis. Client servicing and reporting is very sophisticated, reflecting Alcentra's institutional investor base.

Diversified Sub-Investment-Grade Manager: Alcentra is a diversified sub-investment-grade credit manager with expertise in structured credit, secured loans, direct lending, mezzanine loans, high-yield bonds, special situations and multi-strategy. Alcentra Group had assets under management of USD35.7 billion as of December-2017 globally, split evenly between the US and Europe, with 145 employees globally, 68 of whom are investment professionals.

Category Assessments

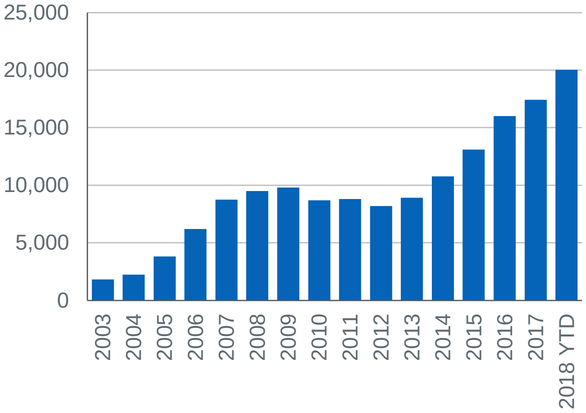
Category	Score
Investment Process	Excellent
Investment Resources	Excellent
Risk Management	Strong
Investment Performance	Consistent
Company and Client Servicing	Excellent

Source: Fitch

Assets Under Management

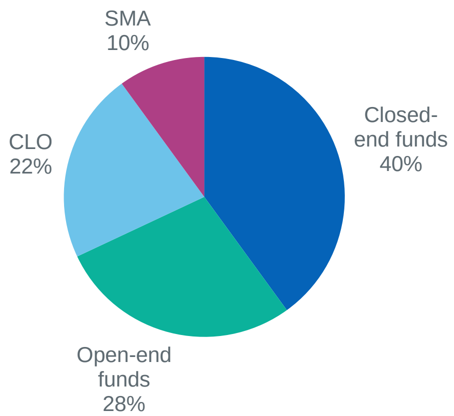
European AUM Development

(EURm)



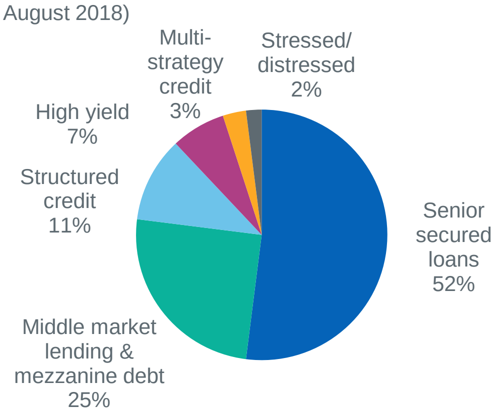
Source: Alcentra

European AUM Breakdown by Product Line
(31 August 2018)



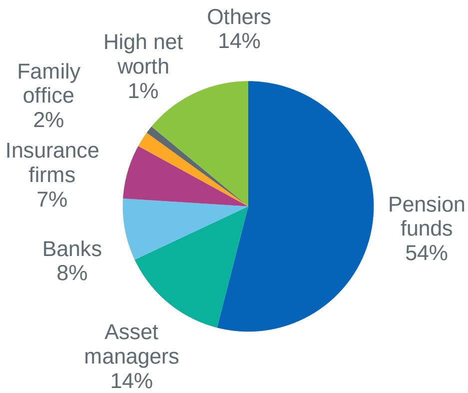
Source: Alcentra

AUM Breakdown by Asset Type
(31 August 2018)



Source: Alcentra

AUM Breakdown by Investor Type
(31 August 2018)

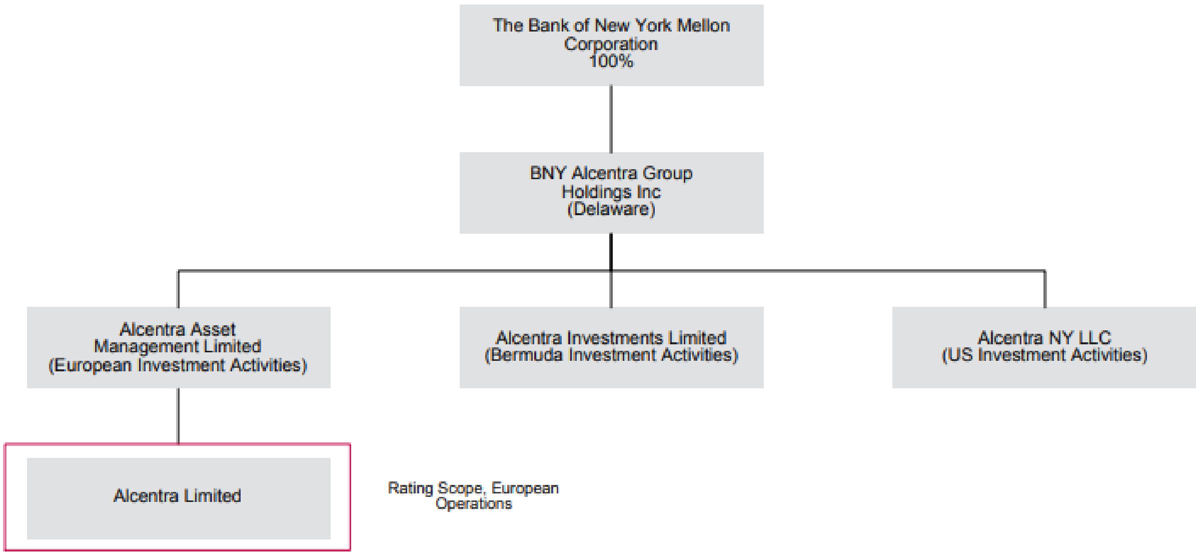


Source: Alcentra

Organization Structure

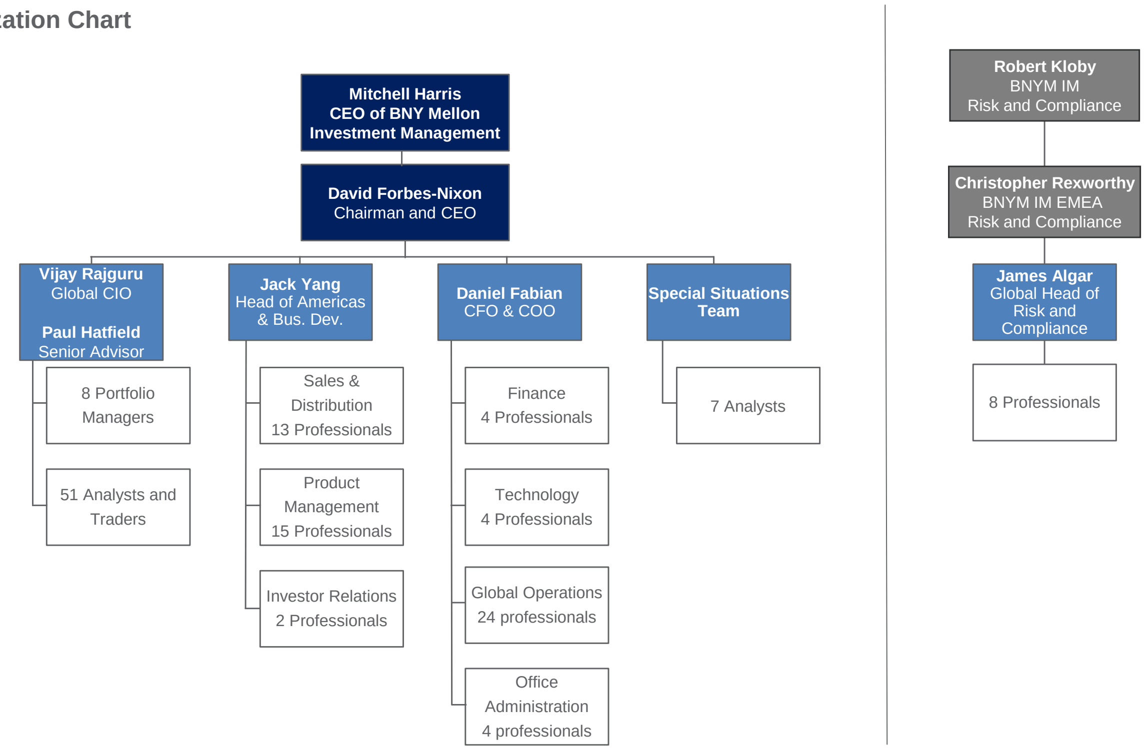
Company Structure

Alcentra Corporate Structure



Source: Fitch, Alcentra

Organization Chart



Source: Alcentra as of December 2017.Includes full time Alcentra employees only

Investment Process

Investment Objectives

All of Alcentra's products have well-defined investment guidelines governed by the relevant documentation. Term sheets and due diligence questionnaires (DDQs) are available where appropriate containing objectives, defined limits and risk budgets. Sufficient details on sources of performance are also provided.

Research Process

Alcentra's research process is based on a robust fundamental bottom-up and top-down framework. The investment committee and sector analysts formulate top-down views based on macroeconomic data which are factored into the assumptions used in Alcentra's bottom-up security analysis. The bottom-up credit research process for loans and high-yield bonds involves three main steps. First, an initial screening, which is documented in a "pre-screener" document for loans considers the high-level characteristics of the transaction being presented, seeking to identify key risks for further analysis. A preliminary investment committee may reject the transaction at this stage, or continue the analysis.

The second step is the full investment due diligence. Credit analysts will meet with management and review third-party materials. Alcentra receives research from multiple third-party research providers. Due to MiFID II Alcentra reviewed research providers and now receives research from around 40 research houses (down from around 50 last year). Information obtained from these sources, along with top-down macro-and sector-specific assumptions, will be factored into the financial analysis. The financial analysis results in the assignment of internal credit, liquidity and recovery ratings which are presented to the investment committee.

The third and final stage (post investment committee approval) involves a full documentation review, led by the primary analyst covering the credit, with support from legal secondees.

Liquidity risk is an important component of Alcentra's credit selection process. At the second stage of the analysis all investments are assigned a liquidity ranking of A to D, based on daily interactions and market intelligence from market dealers.

The direct lending analysis process follows a similar approach, although with more detailed work supporting each step. For structured credit and the special situations funds, the selection process is again similar, combining fundamental and technical analysis, supported by Alcentra's wider credit selection process.

Research reports on loan issuers are typically 10-15 pages long, while those for direct lending opportunities may be up to 20-30 pages long. Research notes for high-yield bonds are typically less in-depth and of two to three pages in length, reflecting greater market-driven time pressure.

There has been increased focus on environmental, social and governance (ESG) factors, which are being incorporated into the research process. Credit research process now includes specific sections on ESG components.

Investment Decision-Making and Portfolio Construction

Alcentra adopts a disciplined investment committee approval process, chaired by the CEO. Committee members have on average more than 20 years' experience. Committees are fully documented and approved by authorised signatories. Portfolio managers have flexibility in managing their respected funds, provided that they meet their pre-defined portfolio construction and risk parameters guidelines. Portfolio managers can only buy securities approved by the investment committee, although actual fund allocation and sell decisions rest with the portfolio managers.

Alcentra adheres to a disciplined sell philosophy, despite its buy-and-hold bias. A sale could be considered if a price target is achieved, if credit deterioration occurs, if relative value is identified elsewhere, or if a sale will benefit diversification requirements.

There is regular individual credit monitoring. Analysts update credit metrics in well-designed spreadsheets according to reporting frequency (typically monthly for loans and quarterly for bonds). These spreadsheets are fully integrated into Everest, which is Alcentra's front-office system. Analysts circulate "flash notes", short email notes sent to all investment staff following an accounts update. Any potential rating changes resulting from the monitoring are sent to the investment committee for consideration.

Underperforming assets, or those with deteriorating credit fundamentals, are placed on a watch list. The investment committee reviews names on the watch list on a monthly basis. The investment committee also conducts full portfolio reviews on a quarterly basis, including details on performance drivers and portfolio composition.

Investment Resources

Staffing

Alcentra's level of staff is appropriate for the number of strategies and the size of AUM, given that the company employs highly experienced executive teams, specialist analyst teams for each strategy and also has sufficient administrative and support resources. Alcentra at the end of 2017 had 145 members of staff globally, up from 128 in 2016. Distinct analyst teams cover secured loans, direct lending and structured credit, typically organised in senior/junior analyst pairings on each entity covered. The firm's five European portfolio managers are highly experienced (average experience 24 years) and have long tenures within the firm. Portfolio managers do not have any administrative responsibilities and focus solely on fund management. In terms of trade execution, Alcentra has three dedicated traders, one for loans and two for high yield bonds.

There was a pool of 35 credit analysts in Europe as of December 2017 (an increase from 30 as of December 2016).The credit analysts have an average of around 13 years' experience. In terms of capacity the number of entities per analyst varies. For example, the number of loan issuers per analyst – typically 20-25 – is slightly lower than the average Fitch has seen across European CLO managers (around 28). The number of issuers covered per analyst reflects the intensity of the work involved and the frequency of reporting.

Alcentra's independent risk management team includes three members. There is a compliance team of three in Europe (six globally). Alcentra has two dedicated in-house lawyers to aid on the legal analysis of transactions.
There is a stable, experienced and growing operations team at Alcentra. Fitch views positively the team structure and the separation of staff by specialism and product type. The Fund Administration team has 24 members (including contractors) dedicated to global products.

Alcentra's technology team currently has four members of staff, which it is planned to increase to six. Alcentra also benefits from the depth of shared knowledge and resources at BNY Mellon, specifically in compliance, risk and distribution.

There has been a good level of staff retention, with little staff turnover (11.7% turnover ratio in 2017). Since the beginning of 2017, Alcentra has added a number of senior professionals across different divisions. Alcentra in 2017 hired Global co-CIO Vijay Rajguru, who is focusing more on day-to-day processes, while the existing Global CIO Paul Hatfield is focusing more on the business development side. Recently Vijay Rajguru became the single global chief investment officer and Paul Hatfield became senior advisor.

Alcentra's Global Platform (145 full time professionals)[a]					
David Forbes-Nixon Chairman and CEO	Vijay Rajguru Global CIO Paul Hatfield Senior Advisor		Jack Yang Head of Americas & Business Development	Daniel Fabian CFO & COO	James Algar Global Head of Compliance & Risk
	European Portfolio Management (3)[b]	European Credit Analysis (35)	Business Development (28)	Fund Administration (24)	Risk and Compliance (8)
	US Portfolio Management (5)	US Credit Analysis (23)	Investor Relations (2)	Office Administration (4)	Technology (4)

[a] Alcentra, 31st December 2017; [b] Excludes David Forbes-Nixon and Vijay Rajguru
Source: Alcentra

Front-Office Workflows and Technology

Fitch views Alcentra's platform as highly integrated with respect to position keeping, trade settlement, administration and front-office functionality.

Everest, Alcentra's primary front-office system, integrates market data feeds and pricing information from providers such as IDC and Markit. Everest is fully customisable to the user, allowing tailored technical and market analysis. Everest offers real-time relative performance analysis, order management and allocation functionality, while remaining customisable for each individual user. In addition to Everest, Alcentra utilises two more front-office systems: Thetica for structured credit, and Bloomberg POINT for high-yield bonds.

All pricing data are acquired from independent third-party sources, including Bloomberg, Markit, IDC and Prism. A formal pricing policy procedure exists, which covers all investments. A pricing committee reviews instances of illiquid and non-traded securities. Standardised templates exist where additional broker quotes are required and analysts/portfolio managers are required to justify a reasonable price to the committee, which has the final decision.

Middle/Back Office Support and Third-Party Service Providers

Alcentra's has clearly defined administrative processes for each strategy. The operations team is aided by the customisable nature of Everest, with Wall Street Office (WSO) as the data repository. WSO, the back-office system serves as the backbone to Alcentra's overall data infrastructure, acting as a central repository for data from various service providers, the basis for all administrative processes and the data store for Everest.

The operations team and risk manager monitor weekly trading exposures and volumes across counterparties via various systems. The operations team also conducts regular monitoring based on key performance indicators (notably the accuracy and timeliness of net asset value (NAV) production), with periodic update calls as necessary.

In terms of third-party service providers, Alcentra selects and monitors counterparties using objective criteria, under a defined new counterparty review process. Relationships with custodians and other third parties are governed by service level agreements (SLAs) and monitored by the operations team. The supervision process of these agreements includes annual on-site due diligence meetings, a service quality assessment, the establishment of an exit plan and regular senior management performance updates.

Risk Management

Risk Control

The board of Alcentra consists of five members, including two independent directors. The board meets quarterly. Alcentra's board delegates responsibility to five core committees including a risk committee. The risk committee meets on a monthly basis. It comprises the head of risk and compliance, the chief financial officer (CFO) and the risk manager and, by invitation, other members of the firm. These may include the chief investment officer (CIO), head of research, head of operations or head of business development.

In addition to board oversight, Alcentra is also subject to oversight by the parent bank. Alcentra's senior management meets with a BNY Mellon oversight committee on a monthly basis and Alcentra's head of risk and compliance has a direct reporting line to BNY Mellon. Alcentra is subject to biennial audits from BNY Mellon's internal audit department. BNY Mellon also conducts more regular, specific reviews on a rotating basis. Alcentra has adopted BNY Mellon policies and procedures in multiple areas, such as conflict of interest management and operational risk.

Risk Monitoring, Measurement and Stress Testing

Alcentra's risk committee has a mandate, as documented in its terms of reference, to review and monitor relevant market risk metrics. Specific topics discussed include absolute or relative performance, concentration risk limits in line with the guidelines of each strategy, liquidity risk and redemption risk. In addition, the risk manager has oversight responsibilities for reviewing the investment risk guidelines within portfolios and has an independent reporting line to the head of risk and compliance. The risk committee has the power to oblige portfolio managers to attend a session to address any potential concerns the committee may have, and to force portfolio managers to reduce single positions and overall portfolio risk (which has been used previously).

Credit risk monitoring is primarily driven by the front office, in terms of the analyst-driven individual credit monitoring and investment committee-driven portfolio monitoring.

Liquidity risk management is driven by the liquidity risk ratings assigned as part of the analysis process. The risk committee reviews aggregate and individual portfolio exposures to these rankings. The European Loan, Structured Credit, and Global Special Situations funds have specific liquidity limits set, monitored regularly by the risk manager and reported to the risk committee. The majority of Alcentra's AUM is in closed-end funds or funds with conservative redemption periods that limit asset-liability mismatches.

Alcentra conducts stress tests on all strategies on an annual basis. Severe scenarios are used which assume increased corporate spreads and default rates, as well as commodity price spikes, and interest-rate and FX stresses. Alcentra looks at the effects of those stresses on portfolio performance and asset liquidity.

On the operational risk side, Alcentra hired Sarah Nowell as head of risk management in 3Q17 to review the risk framework, guidelines and breaches and participate in the pricing, risk and compliance committees. The operational risk management process includes risk control self-assessments by each business area and specific risk assessments undertaken by the risk manager. Risk mitigation action plans are documented, tracked and reported to the board. All incidents are captured and tracked to completion via BNY Mellon's operational risk monitoring systems. Near misses are recorded under the log error report. In case of a gap in results there is an action plan in place to enhance and add controls if necessary. Risks are assessed as part of ICAAP. Operational losses to date have been negligible.

Compliance

There are comprehensive policies and procedures in place to ensure compliance with regulatory rules. The staff adhere to the BNY Mellon personal trading policy. BNY Mellon systems log personal trades, and require a quarterly submission of brokerage statements. Alcentra maintains a restricted trading list, which is built into Everest. It also operates an order allocation policy, which the head of risk and compliance monitors.

Everest contains a pre and post trade compliance system. All CLO constraints are built into WSO. Alcentra's operations team produces shadow NAVs for all relevant products, which are reconciled to the administrator-produced NAV. Before trading, portfolio managers run a trade scenario, which may be reviewed by the operations team to ensure that investment guidelines are not breached. The operations team review all trades on a post trade basis.

Alignment of Interest

Fitch believes that members of staff are well compensated. Alcentra's remuneration policies are aligned with those of BNY Mellon, which are reviewed by the latter's remuneration committee. A long-term incentive plan invests in Alcentra products, providing a strong alignment of interest between staff and investors. Several Alcentra employees personally invest in Alcentra products, which is monitored and approved by BNY Mellon's ethics committee. There is a new share ownership plan for senior employees.

Risk Framework

Risk Framework (Risk Strategy & Appetite)					
Governance and Oversight					
Investment Risk Strategic Risk Operational Risk Fiduciary Risk Corporate Market, Credit, Liquidity Risk	**Risk Identification** • Risk events • RCSA • Fund documentation • Market practice • Scenario analysis	**Risk Assessment & Measurement** • Consistent methodology • Quantitative and Qualitative • Risk capital	**Risk Management & Mitigation** • Internal limits/where appropriate • Control enhancement	**Monitoring & Reporting** • Agreed metric • Key indicators • MI • Escalation and oversight	Covered by the Investment Risk framework Covered by the Corporate Risk framework

Source: Alcentra

Investment Performance

Alcentra manages a range of investment products with differing characteristics. The open-ended funds have performed well. The largest of these funds within the rating scope (a loan fund) has generated strong performance over a prolonged period of time both in nominal and risk-adjusted terms. Furthermore, this fund has demonstrated strong downside protection in stressed market conditions.

All debt tranches of Alcentra's pre-crisis CLOs paid in full, demonstrating good performance for debt-holders and all post crisis CLOs are performing with equity returns above peer medians in almost all cases. The direct lending strategies are more recent, but Alcentra's middle-market experience is significantly longer (dating back to 1998). Public information on comparable funds and strategies is limited, but Fitch believes the returns generated by the direct lending funds are in line with market averages such as private debt metrics published by Preqin.

Taking into consideration both the demonstrably strong performance of the open-ended funds, the consistent performance of the CLOs and the more recent performance history of the direct lending funds, and their respective asset weights, Fitch considers Alcentra's overall investment performance consistent with its stated investment objectives and investor expectations.

Company and Client Servicing

Market Presence and Franchise

Alcentra is a diversified sub-investment-grade credit manager with expertise in structured credit, secured loans, direct lending, mezzanine loans, high-yield bonds, special situations and multi-strategy.

We consider Alcentra a large asset manager relative to peer credit specialists; compared with the broader universe of asset managers (across product and provider types) we consider it medium-sized. We believe that the size Alcentra has achieved and its growth presents a challenge to the firm: to retain its entrepreneurial roots and investment flexibility while stepping up to become a scale player. This challenge is mitigated by the success with which Alcentra has absorbed inflows and launched new products to date.

Financial Stability

Alcentra is highly profitable with a substantial amount of cash on balance sheet which would mitigate the effect of severe stress on the business. We estimate that Alcentra would be able to sustain operations even under a severe stress scenario (represented by a 50% outflow in our analysis). However, this scenario is unlikely given that more than half of Alcentra’s AUM is in closed-end vehicles, which do not incur material liquidity risk and provide relative fee income stability. Alcentra does not have any debt and holds capital well in excess of regulatory requirements. There is no large single client concentration among Alcentra's investors and they are well diversified by type. It has over 400 investors in total, approximately equally split between the US and Europe.

Alcentra is 100% owned by BNY Mellon (AA-/Stable/F1+). BNY Mellon regularly provides capital support and seed money for Alcentra products, showing its commitment to the firm. Alcentra benefits from BNY Mellon's extensive resources, particularly in distribution capabilities, legal, compliance and IT matters. Alcentra has full investment autonomy and operates as one of BNY Mellon's 12 specialist boutique asset management companies.

Alcentra manages a number of funds and segregated mandates. Currently the product line is 1/3 in open-ended funds, 1/3 in CLOs and 1/3 in direct lending. Structured credit business is global now and is the fastest growing part of business after direct lending. Direct lending strategies have reached EUR5.7 billion in 2017 from EUR4.9 billion in 2016. European (open-ended) loan strategy now exceeds EUR3 billion in AUM. Alcentra manages a total of nine European CLO2.0s. This year the supply of CLOs is expected to increase in Europe, as the previous 5% risk retention requirement for US CLO managers has been removed. Alcentra is diversifying away from CLOs into other products.

In 2017 Alcentra raised EUR3 billion in new capital in Europe. Alcentra launched a structured credit closed-end fund and continues to build the direct lending and multi-credit products. The team believes that stressed and distressed debt will offer great opportunities on both the investment and capital raising side.

Experience

The Alcentra Group was established in 2002 in the US through the acquisition (by the Alchemy Group and the founding partners) of Imperial Credit Asset Management from Imperial Credit Industries Inc, and of Barclays Capital Asset Management from Barclays Bank Plc in March 2003 in Europe. In 2005, the Alchemy Group and Alcentra Group management and employees sold a combined 80% holding in the Alcentra Group to BNY Mellon. BNY Mellon subsequently increased its ownership of Alcentra to 100% over several years. Alcentra has made two team acquisitions in the last five years. It acquired the structured credit team of Meriten in 2014 and the high-yield bond team of Standish in 2013.

Client Servicing

Client servicing and reporting is very sophisticated reflecting the pension funds' requirement for detailed information to cover regulatory reporting needs. Over the past year, Alcentra has increased the number of reports it provides to investors given the high levels of interaction with pension funds, which require detailed information for the DDQs and compliance reporting. Alcentra does not produce performance data in a Global Investment Performance Standards (GIPS) compliant format, except for its high-yield bond funds.

Alcentra maintains a dedicated web-based portal for clients to access reporting. Reporting is of a good standard with a broad range of metrics covered (eg spreads, leverage, coverage, sector and maturity) alongside monthly portfolio manager commentary.

Related Research and Criteria

Investment Management Quality Ratings Criteria (March 2017)

Analysts

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