FitchRatings

Alcentra Ltd

Rating

Rating Type	Rating	Outlook	Last Rating Action
Investment management quality rating	Excellent	Stable	18-December-2019

Source: Fitch Ratings

Key Rating Drivers

'Excellent' Rating: The 'Excellent' rating reflects Alcentra Ltd.'s (Alcentra's) well-defined investment processes, the depth and calibre of its personnel, and the support provided by Alcentra's institutional owner, The Bank of New York Mellon Corporation (AA-/stable/F1+).

The rating scope is limited to the European operations of Alcentra, accounting for two-thirds of the business by AUM.

Investment Process: Alcentra's investment processes meet Fitch Ratings' criteria for a score of 'Excellent', driven by their clearly articulated investment objectives, thorough research processes tailored to the specifics of the strategy, and robust decision-making processes.

Investment Resources: Alcentra investment resources represent a very strong fit with its investment objectives. Human resources comprise a deep analyst pool allowing a favourable issuer coverage ratio and experienced portfolio managers. Alcentra also benefits from the resources of its institutional owner, notably in IT and support services.

Alcentra is in the process of outsourcing its back office operations, and streamlining its investment platform, a major project due for completion in 2020.

Risk Management: Fitch Ratings believes Alcentra's risk framework provides independent oversight and controls. There are comprehensive policies and procedures in place to ensure compliance with regulatory rules. Operational risk has reporting lines to The Bank of New York Mellon Corporation (BNY Mellon). Investment risk is an evolving but effective function, with a reporting line to the CFO.

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 the long-term performance of the open-ended funds, the strong performance of the closed-end funds, and the performance of the CLOs as measured by principal repayments for debt holders and equity returns.

Company & Client Servicing: Alcentra has a strong franchise as one of the largest and longest-established European sub-investment-grade credit asset managers. Having the BNY Mellon Group as its institutional owner is a positive factor in Fitch's view. Client servicing and reporting is sophisticated, reflecting Alcentra's institutional investor base.

Profile: Alcentra is a diversified sub-investment-grade credit manager with expertise in structured credit, senior loans, direct lending, high-yield bonds, special situations and multi-strategy. Alcentra Group had assets under management (AUM) of USD40.3 billion at September-2019 globally, with two-thirds of that total managed in Europe. The firm had 166 employees, including 74 investment professionals at the same date.

Applicable Criteria

Investment Management Quality Ratings (March 2017)

Analysts

Carmen Fraser
+44 20 3530 2623
carmen.fraser@fitchratings.com

Abis Soetan
+44 20 3530 1311
abis.soetan@fitchratings.com

Category Scores

Category	Score
Investment process	Excellent
Investment resources	Excellent
Risk management	Strong
Investment performance	Consistent
Company and client servicing	Excellent

Source: Fitch Ratings

Investment Process (Excellent)

Investment Objectives

Alcentra's products have well-defined investment guidelines governed by relevant documentation. Investment objectives have been consistently applied through market cycles with no style drift.

Research Process

Alcentra's research processes are tailored to the relevant asset class. In all cases the research process is well developed and consistently applied. Fitch views as a rating positive the effective sharing of information across teams, increasing the coverage and depth of analysis.

Fitch considers the loan investment process disciplined and thorough. The process is based on a 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.

The second step is the full investment due diligence. Credit analysts will meet with management and review third-party materials. Information obtained from these sources, along with top-down macro-and sector-specific assumptions, will be factored into the financial analysis which is presented to the investment committee.

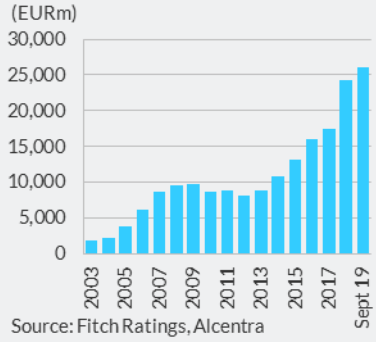
The third and final stage (post-investment committee approval) involves a full documentation review, led by the primary analyst covering the credit, with support from legal secondees.

The investment processes for direct lending, structured credit and special situations are tailored to the specifics of the strategy. All three of these strategies can leverage (to the extent permissible under applicable compliance restrictions) and interact with Alcentra's core credit research team; however, they are not necessarily bound by the views of the credit team, nor are they limited by the credit team's coverage.

The entities covered by the Alcentra direct lending team may not be in the existing coverage universe of Alcentra's core credit analysts and therefore the team will conduct its own issuer research and due diligence.

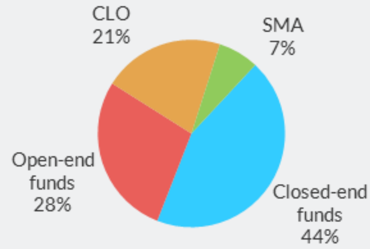
The Alcentra structured credit team considers the central Alcentra credit views in forming its own specific subordination assumptions, but will also consider information provided by third-party CLO managers and based onthe structured credit team's assessment of universe-wide CLO positioning.

European AUM Development



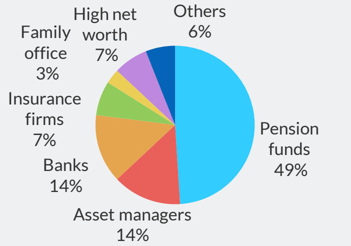
Source: Fitch Ratings, Alcentra

European AUM Breakdown by Product Line
(30 September 2019)



Source: Fitch Ratings, Alcentra

AUM Breakdown by Investor Type
(30 June 2019)



Source: Fitch Ratings, Alcentra

Credit Due Diligence and Approval Process

Stage 1	Initial review	• Industry Analyst creates "Pre-Screener"
	Preliminary committee	• Decision to decline or continue analysis
Stage 2	Detailed due diligence	• Meet management and review third party materials
	Full analysis	• Financial models, recovery rating and internal rating score
	Final committee	• Majority approval by Investment Committee • Buy decisions delegated to PMs
Stage 3	Final execution	• Full document review by Analyst and legal secondee

Note: Grey blocks illustrate a full meeting of the Investment Committee
Source: Alcentra

Investment Decision-Making and Portfolio Construction

Fitch considers Alcentra's credit investment decision-making sound, with the process tailored to each strategy. For senior secured loans, the European loan investment committee (comprising the CEO, Co-CIO, portfolio managers, the Head of European Credit, and the Head of Portfolio Monitoring and Deputy Head of European Credit) convenes periodically to review credit proposals, with a majority vote needed to approve any given issuer.

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. 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 might 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.

The direct lending process adopts a similar process, with decisions on issuer eligibility made at the weekly investment committee, complemented by quarterly portfolio reviews and full re-underwriting of each exposure. The structured credit process requires a dual approval by the two lead portfolio managers for the strategy, ensuring consistency of view.

Investment Resources (Excellent)

Staffing

Fitch considers the “fit” between Alcentra’s staff and its investment strategies Strong. Alcentra had 166 members of staff globally at end-September 2019, up from 145 at end-June 2017, equating to staff growth of around 15% worldwide. The number of employees increased at a faster rate than AUM growth in 2018, resulting in an improved ratio of staff to AUM. Distinct analyst teams cover secured loans, direct lending and structured credit, typically organised in senior/junior analyst pairings on each entity covered, resulting in a clear separation of responsibilities.

Alcentra experienced some senior-level turnover in 2019: the CIO left the firm and was replaced with two internal promotions (to Co-CIO). We do not expect the changes in senior management to cause disruption to the investment process. This is because the firm’s European portfolio managers are highly experienced (for example, the lead portfolio manager for loans has 26 years’ experience) and have long tenures within the firm.

Portfolio managers do not have any administrative responsibilities and focus solely on fund management. Alcentra has a dedicated trader in Europe for loans and high yield bonds. In other strategies, portfolio managers (or their delegates), are responsible for trading.

In Fitch’s opinion, the number and experience of credit analysts is high. Analysts have an average of over 10 years’ experience. In terms of capacity the number of entities per analyst varies, with an average of 25-30 loans / high yield bond issuers per analyst. The number of issuers covered per analyst reflects the intensity of the work involved and the frequency of reporting.

The risk management function is adequately staffed and integrated into the parent Bank’s risk management framework. There are dedicated specialists in governance, legal, operational and investment risk. There is limited staff cover in investment risk, with a single individual performing the function, though supported by the operational risk team.

Fitch views positively the team structure and the separation of staff by specialism and product type. Fund Administration is in the process of being outsourced to BNY Mellon, which should improve the capacity and specialism of the function if successfully implemented. The project to outsource fund administration is due for completion in 2020.

Alcentra also benefits from the depth of shared knowledge and resources at BNY Mellon, specifically in compliance, risk and distribution.

Staffing Organisation

Alcentra’s Global Platform (166 full time professionals)

Division	Number of staff
European portfolio management	10
European credit analysts	36
US portfolio management	6
US credit analysts	22
Financial administration	6
Business development	30
Investor relations	3
Fund administration	32
Risk & compliance	12
Office administration	4
Technology	5

Source: Fitch Ratings, Alcentra, 3Q19

Front-Office Workflows and Technology

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

Everest, Alcentra's primary front-office system has recently been upgraded to allow straight-through allocation, investment guideline compliance and processing of trades across Loan and Special Situation Strategies. 2020 will see Alcentra's remaining strategies being onboarded on the updated platform. Everest integrates data feeds to and from Alcentra's back office provider. In addition to Everest, Alcentra utilises two more front-office systems: Thetica for structured credit, and Charles River Development (CRD) for high-yield bonds. The latter will be phased out in favour of Everest in 2020.

Pricing data is sourced from independent third-party sources, including Bloomberg, and Markit. 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 & Third Party Service Providers.

Alcentra has outsourced its back office operations across Loans and Special Situations Strategies. The remaining strategies are set to be completed in 2020. This is part of a major Strategic Change Project which will entail back office tasks being outsourced (such as cash and position reconciliations).

Alcentra will retain a Middle Office team to oversee the back office and run the transaction management of the funds(for example NAV oversight, CLO admin oversight, Closed Ended administration, fund investment guideline coding and monitoring, fund hedging, liquidity management, audit oversight and the set-up of new funds). Relationships with key third parties are governed by service level agreements (SLAs) and monitored by Alcentra Global Operations 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 (Strong)

Risk Control

Fitch considers Alcentra's risk control framework Strong overall, benefiting from the oversight of the parent bank. Operational risk processes are Strong, and well integrated with the parent bank. Investment risk has, historically been controlled at the first line of defence by portfolio managers and credit analysts, with oversight from the parent bank's investment management risk committee. Alcentra appointed a dedicated investment risk manager in 2018, reporting to the President/COO, thus establishing a truly independent investment risk management function. Fitch considers this a positive development for the overall risk framework.

Alcentra's board (consisting of five members, of whom two are independent) sets the overall risk framework, delegating responsibility for risk management to Alcentra's global risk and compliance committee (GRCC). The GRCC meets on a monthly basis. It comprises the head of risk and compliance, the President/COO, a representative from the parent bank and, by invitation, other members of the firm.

Alcentra is 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.

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 the event of a gap in results there is an action plan in place to enhance and add controls if necessary. Risks are also assessed as part of ICAAP. Operational losses to date have been negligible.

Risk Monitoring, Measurement & Stress Testing

Credit risk monitoring is primarily driven by the front office, with analyst-driven individual credit monitoring and investment committee-driven portfolio monitoring. In addition, the investment risk manager produces quarterly risk reporting for the GRCC, portfolio managers, and, where applicable to fund boards. These reports include results of the investment compliance monitoring (and escalations) and stress tests. The GRCC 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. This power has occasionally been exercised.

Alcentra is implementing a new investment risk system, due for delivery in 1Q20. This new system will enable bespoke risk reporting and greater frequency (monthly) of standardised risk reporting.

Liquidity risk management is driven by the liquidity risk ratings assigned as part of the analysis process. The investment risk function 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.

Compliance

There are comprehensive policies and procedures in place to ensure compliance with regulatory rules. The staff adheres 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, monitored and approved by BNY Mellon's ethics committee. There is a new share ownership plan for senior employees.

Investment Performance (Consistent)

Alcentra manages a range of investment products with differing characteristics. The open-ended funds have generally performed well, delivering returns consistent with investor expectations. This performance is underpinned by Alcentra's credit selection process, which has resulted in a low default rate. Alcentra's average loss rate in 2003–2018 was 0.47% annually, compared with 1.17% for a widely-considered loan index. The largest of these funds within the rating scope (a European loan fund) has outperformed its index since inception; however, over more recent periods (2018 & 1H19) its gross performance has lagged reference index performance, although when the index is adjusted for currency effects, the fund's performance has been broadly in line with the index.

All debt tranches of Alcentra's pre-crisis CLOs have been paid in full, demonstrating good performance for debt-holders, and all post-crisis CLOs are performing with equity returns above peer medians in most 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.

The structured credit funds demonstrate strong risk-adjusted returns over multiple time periods.

Company and Client Servicing (Excellent)

Market Presence and Franchise

Alcentra is one of the largest sub-investment-grade credit managers by AUM. The firm has expertise in structured credit, secured loans, direct lending, mezzanine loans, high-yield bonds, special situations and multi-strategy.

We consider Alcentra a recognised manager with deep market access and established industry relationships relative to peer credit specialists. Compared with the broader universe of asset managers (across product and provider types), we consider it medium-sized.

Financial Stability

Alcentra is majority owned by BNY Mellon (AA-/Stable/F1+). BNY Mellon has a record of providing capital support and seed money for Alcentra products, showing its commitment to the firm.

Alcentra also 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 specialist boutique asset management companies.

Alcentra is highly profitable with a substantial amount of cash on balance sheet which would mitigate the effect of severe stress on the business. About 85% 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 wholesale debt and holds capital well in excess of regulatory requirements.

Industry 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, and from April 2014 to June 2017 BNY Mellon held 100% of the shares of BNY Alcentra Group Holdings, Inc. Since 2017 Alcentra has had the option to buy back up to 20% of the outstanding shares as non-voting equity and align senior Alcentra employees with the overall franchise. To date, the Group says only a portion of this potential allotment of shares has been purchased by Alcentra under this arrangement.

Client Servicing

Client servicing and reporting is very sophisticated, reflecting the pension funds' requirement for detailed information to cover regulatory reporting needs. There is a dedicated web-based portal for clients to access reporting. Reporting is of a good standard with a broad range of metrics covered (such as spreads, leverage, coverage, sector and maturity) alongside monthly portfolio manager commentary. Alcentra does not produce performance data in a Global Investment Performance Standards (GIPS)-compliant format, except for its high-yield bond funds.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.