Alcentra Ltd

Rating

Rating Type	Rating	Outlook	Last Rating Action
Investment Management Quality Rating	Excellent	Stable	25 January 2021

Source: Fitch Ratings

Key Rating Drivers

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

The rating scope is limited to the European operations of Alcentra, accounting for around two-thirds of the business by assets under management (AUM) as of end-2020.

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 each strategy, and robust decision-making processes.

Investment Resources: Alcentra's investment resources provide a very strong fit with its investment objectives. The company employs a large number of analysts, allowing a favourable issuer coverage ratio, and has experienced portfolio managers. Alcentra also benefits from the resources of its institutional owner, notably in IT and support services.

Alcentra is engaged in a major system upgrade project. Significant progress was made in 2020 addressing the largest segment of Alcentra's AUM. This has increased the efficiency of Alcentra's fund-related processes (such as cash and foreign exchange (FX) management), delivered enhanced portfolio attribution analysis and enhanced overall system integration. Fitch anticipates Alcentra will complete this project for other asset classes in 2021.

Risk Management: Fitch 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 BNY Mellon. Investment risk and corporate governance are effective functions, with a reporting line to the president, who is also the chief operations officer.

Investment Performance: Alcentra's investment vehicles have consistently delivered on their stated investment objectives and investor expectations. No funds suspended redemptions in 2020, despite the market stress period.

Company & Client Servicing: Alcentra has a strong franchise as one of the largest and longest-established European sub-investment-grade credit asset managers. Having BNY Mellon 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 AUM of USD43 billion at December 2020 globally, with two-thirds of that total managed in Europe. The firm had 180 employees, including 81 investment professionals at end-2020.

Applicable Criteria

Investment Management Quality Ratings (February 2020)

Analysts

Alastair Sewell, CFA
+44 20 3530 1147
alastair.sewell@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.

Fitch considers the liquidity terms specified in Alcentra's open-end funds as suitable for the strategies. Alcentra was able to meet redemption requests, despite the market stress, and did not need to suspend redemptions in any funds. This contrasts with the broader market where numerous funds suspended redemptions, particularly in the high yield bond segments (see: Global Mutual Fund Redemption Suspensions Highlight Liquidity Mismatches, published June 2020).

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 the effective sharing of information across teams, which increases the coverage and depth of analysis, as positive for the credit profile.

Fitch considers the loan investment process as 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 then 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 two 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, and seeks to identify key risks for further analysis. If approved, the credit moves to full analysis.

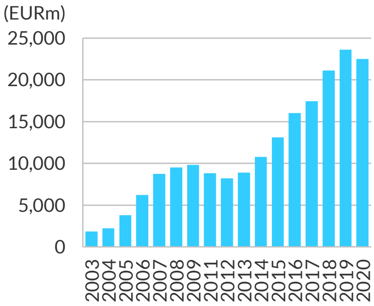
The second step is the full investment due diligence. Credit analysts will meet with Alcentra's management and review third-party materials. Information obtained from these sources, along with top-down macro-and sector-specific assumptions, will be factored into the financial analysis, which is presented to the investment committee, including an Alcentra rating on the issuer's credit quality and a recovery rating.

Credit analysts also determine ESG scores for each issuer, with distinct scores for 'Environment', 'Governance' and 'Social' factors. These scores, and the supporting analysis, are documented in a specific section of the investment memo presented to the investment committee. Alcentra pursues an exclusion strategy, resulting in some issuer declines in 2020 on ESG factors.

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 of Alcentra's core credit analysts and therefore the team will conduct its own issuer research and due diligence.

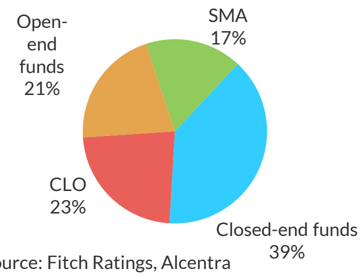
European AUM Development



Source: Fitch Ratings, Alcentra

European AUM Breakdown by Product Line

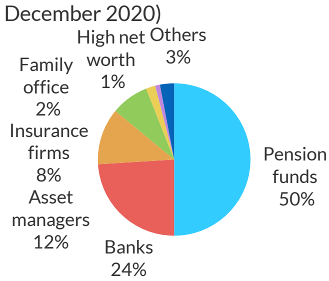
(31 December 2020)



Source: Fitch Ratings, Alcentra

AUM Breakdown by Investor Type

(31 December 2020)

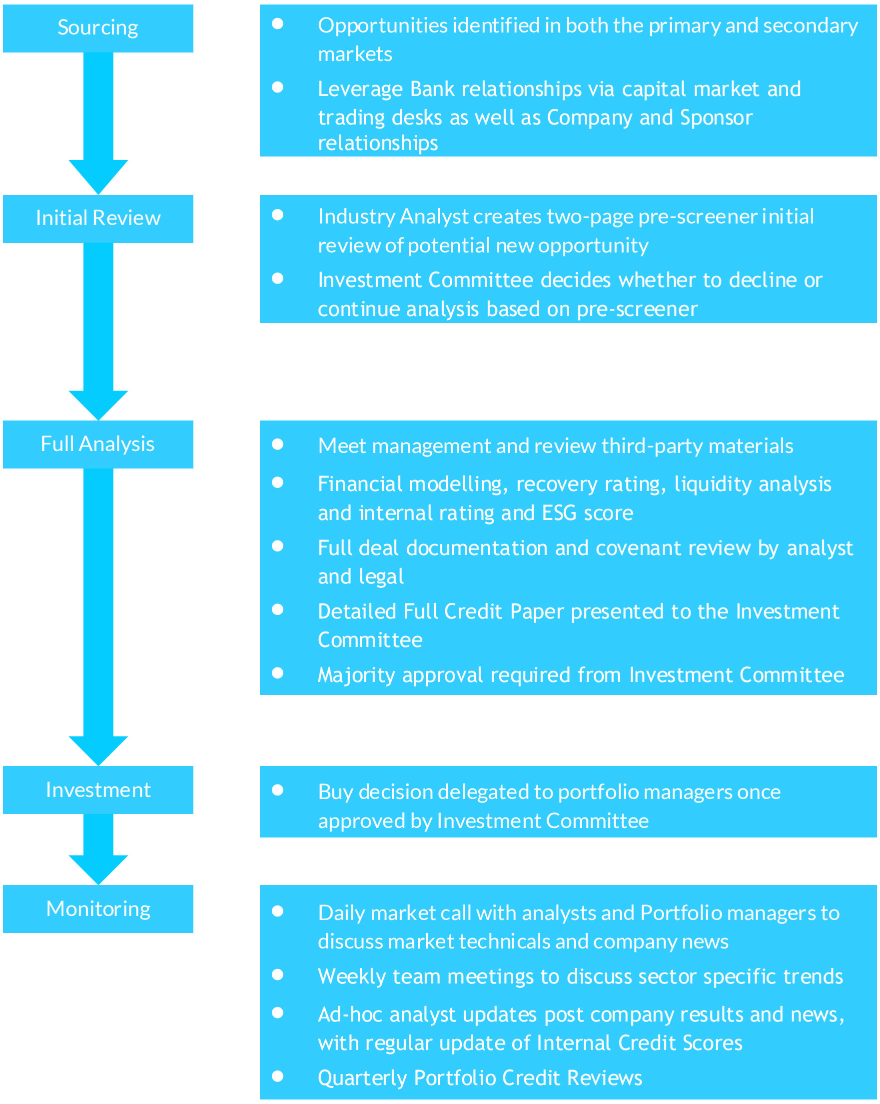


Source: Fitch Ratings, Alcentra

The Alcentra structured credit investment process integrates human and technological resources effectively. The team models CLO portfolios daily, based on bespoke loan-specific assumptions. The team bases these assumptions on Alcentra's credit views and on information provided by third-party CLO managers and the team's own assessment of CLO positioning. The analytical team reviews these model outputs, along with known CLO manager behavioural traits and market developments in making investment recommendations.

Credit Due Diligence and Approval Process

Investment Process



Source: Fitch Ratings, Alcentra

Investment Decision-Making and Portfolio Construction

Fitch considers Alcentra's credit investment decision-making to be sound. For senior secured loans, the European loan investment committee (comprising the chief executive officer (CEO), chief investment officer, portfolio managers, the head of European credit, the head of portfolio monitoring and the 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 parameter 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). Analysts circulate "flash notes" – short email notes sent to all investment staff following an account 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 co-heads of the strategy, ensuring consistency of view.

Investment Resources (Excellent)

Staffing

Fitch considers the "fit" between Alcentra's staff and its investment strategies to be strong. Alcentra had 181 members of staff globally at end-2020, up from 166 at end-September 2019, equating to staff growth of around 9%. The number of employees increased at a faster rate than AUM growth between end-September 2019 and end-2020, 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 appointed a new CEO in 2020. The former CEO now focuses exclusively on the special situations strategy. Fitch considers the new CEO as extremely competent, with extensive relevant experience, demonstrating Alcentra's ability to make good senior-level appointments and to manage succession effectively.

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.

The company has a high number of experienced credit analysts. Research analysts have an average of over 10 years' experience. The number of entities per analyst varies, with an average of 30–35 loans/high-yield bond issuers per analyst, which is similar to peers.

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. Alcentra has a dedicated investment risk manager. Fitch believes this will benefit Alcentra's overall risk framework, along with systems enhancements, and allow better performance attribution.

Fitch views the team structure and the separation of staff by specialism and product type as positive for the credit profile. Some functions are outsourced to the parent bank, including loan closing. Alcentra also benefits from the depth of shared knowledge and resources at the parent bank, specifically in compliance, risk, HR and distribution.

Staffing Organisation

Alcentra's Global Platform

Division	Number of staff
Investment teams	
European loans & high yield	16
US loans & high yield	20
European direct lending	22
US direct lending	4
Structured credit	8
Special situations	11
Risk and compliance (inc. investment risk)	11
Partner engagement (distribution, product, investor relations)	40
Global operations	31
Technology	6
Other	11

As at end-2020
Source: Fitch Ratings, Alcentra

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. Alcentra is engaged in a major systems upgrade. Progress on the project was delayed in 2020, both due to the coronavirus pandemic and due to the scale and complexity of the project. Nonetheless, objectives were achieved for the loans and special situations strategies, with further progress to be made on high yield, structured credit and direct lending in 2021. While the shift to working from home initially added pressure for staff and systems, the overall move to a home-working environment had limited overall disruption.

Alcentra's systems are built around a central data warehouse. This data warehouse is integrated with third-party systems, such as Thetica for structured credit and HedgeMark for the special situations strategy. Reporting is through Tableau and investor relations through Salesforce. The primary front-office system is Allvue, which portfolio managers use for managing Alcentra's investment vehicles. Allvue feeds data to and from the back office (at the parent bank).

Key developments in 2020 included enhanced cash and FX management for the loan and special situations funds, the deployment of a risk and performance attribution tool and pre- and post-trade compliance testing for all strategies.

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 or 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's middle office team oversees the back office and runs the transaction management of the funds – for example, net asset value (NAV) oversight. Relationships with key third parties are governed by service level agreements 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.

The parent bank provides back-office services, such as loan settlement.

Risk Management (Strong)

Risk Control

Fitch considers Alcentra's risk control framework as strong, benefiting from the oversight of the parent bank. BNY Mellon policies and procedures have been adopted for operational risk, compliance monitoring and surveillance.

The overall risk framework is reinforced by an independent investment risk management function that reviews key risk metrics and undertakes overall risk analysis at portfolio level as well as a corporate governance function supporting Board and Committee governance, including compliance with policies and regulation.

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/chief operations officer, 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.

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 through 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 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.

The investment risk function carries out periodic stress testing for market, credit and liquidity risk; and provides reports to quarterly risk and performance meetings. Alcentra's major system upgrade has enabled more frequent, timely and detailed investment risk reporting for the loans and special situations strategies. However, reporting is less automated for the high-yield, structured credit and direct lending strategies – although this will change after implementation of the new system in 2021.

Liquidity risk management is driven by the liquidity risk ratings assigned as part of the analysis process. The investment risk function monitors portfolio and asset liquidity for suitability to fund type and redemption profile, and risks such as client concentrations are also monitored.

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 Allvue. It also operates an order allocation policy, which the global head of risk and compliance monitors.

Allvue contains a pre- and post-trade compliance system. Automated pre- and post-trade checks have been implemented for all collateralised loan obligations (CLOs) and loan funds as part of the major system upgrade.

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 share ownership plan for senior employees.

Investment Performance (Consistent)

Alcentra manages a range of investment products with differing characteristics. The open-ended funds generally performed well over the five-year period to December 2020, with more recent performance being in line with relevant indices.

Specifically, the largest of these funds within the rating scope (a European loan fund) has outperformed its index since inception; however, gross performance in 2020 lagged behind its reference index. This was attributed to the fund holding more cash in April than the negative credit selection. No open-ended funds suspended redemptions in 2020, despite the market turmoil triggered by the pandemic.

All rated debt tranches of Alcentra's CLOs have been paid in full, demonstrating good performance for debt-holders. The direct lending strategies are more recent (2013), but Alcentra's middle-market experience is significantly longer (dating back to 2004). Public information on comparable funds and strategies is limited, although the internal rate of return is in line with the target net return of 6%–8%.

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 manager with deep market access and established industry relationships compared to peer credit specialists. Alcentra is a medium-sized asset manager.

Financial Stability

Alcentra is majority owned by BNY Mellon. The bank 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 the balance sheet, which would mitigate the effect of severe stress on the business. About 79% of Alcentra's AUM in Europe is in closed-end vehicles, which do not incur material liquidity risk and which 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 Alchemy Group's acquisition (with 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 issue up to 20% of the outstanding shares as non-voting equity and align senior Alcentra employees with the overall franchise. To date, Alcentra Group says only a portion of this potential allotment of shares has been issued by Alcentra under this arrangement.

Client Servicing

Client servicing and reporting is sophisticated, reflecting pension funds' requirements 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-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.