

Alcentra Ltd

Key Rating Drivers

‘Excellent’ Rating: Alcentra Ltd’s rating reflects the clarity and consistency of the investment and research processes, the experience and calibre of its personnel, the strong risk management framework with independent oversight and controls, and the enlarged credit asset management franchise. It also reflects the enhanced investment resources gained through its integration with Benefit Street Partners (BSP). The rating scope is limited to its European operations, which had USD32 billion of assets under management (AUM) at end-1H24.

‘Excellent’ Investment Process: The firm’s investment process is well-defined and consistently aligns sources of risk and return with its long-term investment objectives. It is one of Europe’s largest credit managers and benefits from diverse sourcing channels within the market. Its research methodology is systematic, integral to portfolio construction and replicable across portfolios.

‘Excellent’ Investment Resources: Alcentra operates an optimal structure that is organised by strategy and geography, while leveraging a global research function. The investment and operations teams are well-resourced. A large number of analysts allow for ample coverage per issuer and portfolio managers have a high level of experience. Alcentra continues to invest in its platform resources, notably by expanding its technology team. These efforts aim to enhance performance and reporting, as well as business and data engineering analysis.

Back-office functions have largely been outsourced to BNY Mellon Asset Servicing.

‘Excellent’ Risk Management: Fitch Ratings believes Alcentra has a robust risk and control framework. Risk management is organised into compliance, operational risk, investment risk and anti-money laundering functions, with reporting lines to the chief executive and the board. We believe Alcentra’s risk framework provides independent oversight and controls, with comprehensive policies and procedures to ensure compliance with regulatory rules.

‘Excellent’ Company and Client Servicing: Alcentra has a strong franchise as one of the largest and longest-established European sub-investment-grade credit asset managers. Having Franklin Templeton (FT) as its institutional owner is a positive rating factor. The integration with BSP has improved scale and synergies, for example, through a complementary credit research function and improved portfolio analytics capabilities. Client servicing and reporting are sophisticated, reflecting Alcentra’s institutional investor base.

‘Consistent’ Investment Performance: Investment vehicles have consistently delivered on their stated investment objectives and investor expectations.

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 had AUM of USD32 billion and 215 employees, including 60 investment professionals, at end-1H24.

FT, Alcentra’s ultimate owner, had more than USD1.6 trillion AUM, including USD254 billion in alternative investments, as at June 2024.

Rating

Rating Type	Rating	Outlook	Last Rating Action
Investment Management Quality Rating	Excellent	Stable	8 August 2024

Source: Fitch Ratings

Applicable Criteria

[Investment Management Quality Ratings Criteria \(March 2024\)](#)

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Category Scores

Weight	Category	Score
25%	Investment Process	Excellent
25%	Investment Resources	Excellent
25%	Risk Management	Excellent
15%	Company and Client Servicing	Excellent
10%	Investment Performance	Consistent

Note: The category scores result from an asset weighted average of the scores obtained in loans and collateralised loan obligations (CLOs), high yield, structured credit and direct lending products.

Source: Fitch Ratings

Investment Process (Excellent)

Investment Objectives

Alcentra’s products have clearly defined investment objectives, with portfolio investments demonstrating a high level of consistency with their objectives through market cycles.

The investment strategy is systematic, incorporating several layers of oversight to ensure portfolio positioning adheres to the stated styles and objectives. The investment committees within the loans and direct lending sectors exemplify this oversight. In the structured credit strategy, decisions are made by the two portfolio managers, with contributions from the broader investment team.

The integration of portfolio positioning and risk monitoring within the investment process contributes to the ‘Excellent’ score in this category. The terms of the investment offerings are thoroughly documented and Fitch considers the liquidity terms specified for open-ended funds to be suitable for the respective strategies.

Research Process

Alcentra’s research processes are specifically tailored to each relevant asset class. They are well-established and consistently executed across strategies. The systematic and repeatable nature of the research processes is a positive rating factor.

Effective information sharing across teams enhances the coverage and depth of analysis. Alcentra and BSP operate a well-resourced and scalable platform, in Fitch’s view. At end-1Q24, the combined platform had about 45 liquid credit and 30 sector-focused research analysts. Fitch deems this staffing level suitable for the AUM and the variety of strategies.

Investment Process

Fitch considers Alcentra’s loan investment process to be disciplined and thorough, grounded in a comprehensive bottom-up and top-down framework. The investment committee and sector analysts develop top-down views based on macroeconomic data, which are then integrated into the assumptions used in Alcentra’s bottom-up security analysis.

The bottom-up credit research process for loans and high-yield bonds consists of two primary stages. Initially, a high-level review assesses the fundamental characteristics of a transaction, including a preliminary environmental, social and governance (ESG) risk evaluation, summary and proposal. At that stage, the investment committee decides whether to proceed.

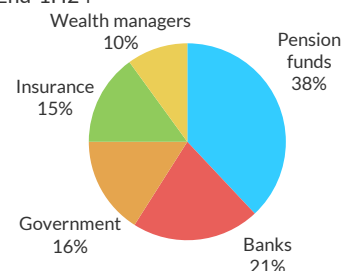
If the proposal is approved, a detailed fundamental credit analysis is conducted. This second stage includes financial and liquidity analysis, stress-testing, competitive positioning, ESG risk assessment, management and sponsor evaluations, and a review of documentation.

The output of the research process is a report that includes an internal credit rating, a climate change and ESG risk rating, and a recommendation for consideration by the investment committee.

The investment processes for direct lending, structured credit, special situations, secured loans, and multi-strategy are tailored to each strategy. All strategies can leverage and interact with

AUM Breakdown by Investor

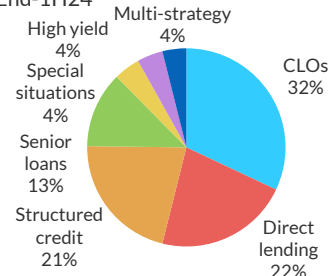
End-1H24



Source: Fitch Ratings, Alcentra

AUM Breakdown by Strategy

End-1H24



Source: Fitch Ratings, Alcentra

Alcentra’s core credit research team, within the limits of compliance restrictions. However, they are not obligated to follow the credit team’s perspectives or confined by its coverage.

The Alcentra structured credit investment process incorporates relative value assessments using proprietary systems that compare collateral, structure, documentation, manager and cash metrics. The analytical team reviews these model outputs, along with known behavioral traits of CLO managers and market trends, when making investment recommendations. The consistency of the research process over time is rating positive.

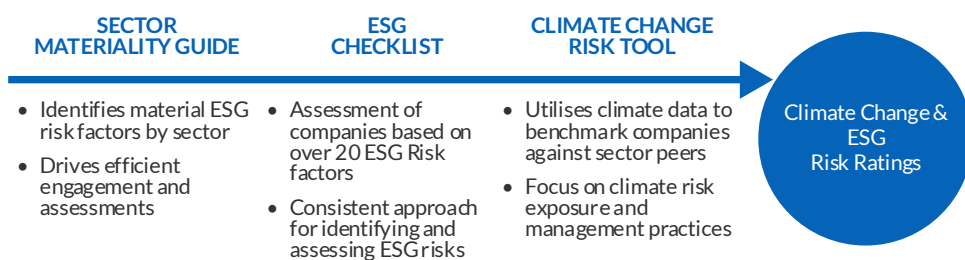
The direct lending approach is designed to optimise expertise in specific sectors and regions while promoting best practices through standardisation.

ESG Investment Framework

The responsible investment team is well integrated in the investment processes. The team applies the responsible investment framework to assess material ESG risks using proprietary scoring, in collaboration with the investment teams.

An ESG checklist and accompanying tools have been incorporated into Allview, the portfolio management system, which Fitch believes enhances the workflow.

Responsible Investment Framework: Initial Assessment



Source: Fitch Ratings, Alcentra

The investment process cycle is concluded with portfolio monitoring and positioning. Both bottom-up credit monitoring and top-down market perspectives are evaluated against specified categories, such as credit quality, liquidity, and relative value.

In direct lending, a dedicated portfolio monitoring team, which operates independently from the investment team, uses proprietary tools to track key performance indicators, ratios and valuations. In our view, the research processes are robust.

Investment Decision-Making, Portfolio Construction and Execution

Fitch views Alcentra’s credit investment decision-making process to be sound. For senior secured loans, the investment committee – comprising senior members of the portfolio management, credit research and responsible investments teams – meets periodically to evaluate credit proposals. A majority vote is required before decisions are delegated to portfolio managers.

Committees are thoroughly documented and approved by authorised signatories. Portfolio managers have flexibility in managing their funds, provided they adhere to the defined portfolio construction and risk parameter guidelines. Portfolio managers can only buy securities approved by the investment committee.

Alcentra adheres to a disciplined sell philosophy and there is regular individual credit monitoring. Analysts update credit metrics in proprietary spreadsheets according to reporting frequency (typically monthly for loans and quarterly for bonds). Any potential rating changes resulting from the monitoring are submitted to the investment committee for consideration.

Underperforming assets, or those with deteriorating credit fundamentals, are placed on a watch list, which the investment committee reviews 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 is similar, 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 approval by the two portfolio managers, in consultation with the wider investment team to ensure consistency.

In Fitch's view, performance tracking and attribution analysis for these strategies are timely and robust. Data for the loans business are aggregated and accessible, facilitating enhanced performance measurement, attribution and risk analysis. The direct lending portfolio monitoring team uses a proprietary tool for performance tracking and assessment, while the structured credit team monitors portfolio metrics daily and conducts deal-level analysis.

Investment Resources (Excellent)

Staffing

Alcentra's operation framework is organised by strategy and geography, while leveraging a global research function. There is clear segregation of responsibilities between the front, middle and back offices, technology and compliance. The high level of integration in research and the use of investment committees help mitigate key-person risk.

Alcentra has an experienced workforce. The company had 215 employees globally at end-1H24, including 60 investment professionals. Following the FT acquisition and integration with BSP, the combined platform has become one of the world's largest alternative credit asset managers by AUM.

The Alcentra-BSP platform has 460 employees, including 170 investment professionals with an average of 17 years' credit investing experience as of end-1Q24. This is a sector-leading AUM and strategy/investment professional ratio, as well as credit investment experience, by Fitch estimates.

Credit research is carried out by a large team of analysts, with a combined total of about 45 liquid-credit analysts, including 30 sector-focused research analysts. The issuer coverage ratio of about 60 loans or high-yield bond issuers per analyst is comparable to industry peers.

The team receives support for inputting data and commentary for simple models from an office in Hyderabad, which boosts the team's capacity. Portfolio managers do not have any administrative responsibilities and focus solely on fund management.

Alcentra has a more experienced team than peers. Senior sector heads typically have between 15 and 30 years' experience, with senior management having close to 40 years.

Fitch views the risk management team as well-structured, with clearly defined roles and adequate staffing levels. The team is organised into compliance, anti-money laundering, operational, and investment risk divisions.

Front-Office Workflows and Technology

Fitch views Alcentra's platform as well integrated in terms of position-keeping, trade settlement, administration and front-office functionality. The platform enhances data accessibility and integration, providing a single system for portfolio monitoring and compliance.

Alcentra's infrastructure comprises a central data warehouse and integrates third-party systems like Valitana for structured credit and HedgeMark for liquid strategies. Reporting tools include Tableau and the investor relations team uses Salesforce. The primary front-office system is Allvue, which portfolio managers use to manage Alcentra's investment vehicles. Allvue enables data exchange with the back office through an arms-length contract with BNY Mellon.

Pricing data are sourced from independent third-party sources, including Bloomberg, and Markit. A formal pricing policy procedure 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 and Third-Party Service Providers

Alcentra's middle office has good staffing capacity and is well organised by function, namely trade operations, business solutions, investment guidelines and analytics, CLO operations, and liquidity management. Some back- and middle-office functions are outsourced to BNY Mellon to improve efficiency.

A middle-office team oversees the back office and runs the transaction management of the funds – for example, net asset value (NAV) oversight. Relationships with third parties are governed by service-level agreements and monitored by Alcentra Operations. The supervision process of these agreements includes annual on-site due diligence meetings, a service quality assessment, an exit plan and regular senior management performance updates.

Risk Management (Excellent)

Fitch scores the risk management function as 'Excellent', driven by its independence, organisation, good capacity and oversight. Risk is organised into compliance, operational risk, Investment risk and anti-money laundering, and policies are well documented.

Risk Control

The Alcentra risk management model has three lines of defence, with risk and compliance as the second line. Risk management is integrated into the portfolio construction process through investment committees and regular performance and risk attribution reporting.

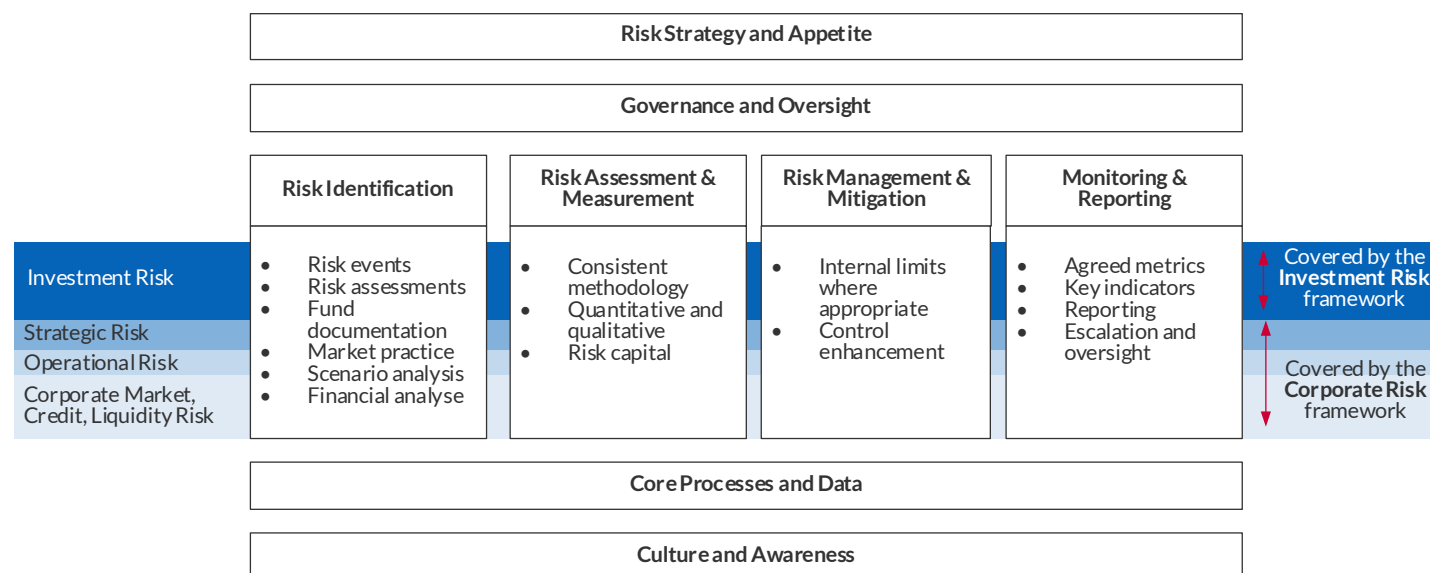
Policies are well documented and there is good oversight provided by Alcentra's risk committee as well as at the quarterly risk and performance meeting.

The operational risk-management process includes risk control self-assessments (RCSAs) 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. Near misses are recorded in the error register. In the event of a gap in results, controls can be enhanced and added if necessary. RCSAs are performed annually or more frequently following trigger events.

Risks are assessed as part of the internal capital and risk assessment process and operational losses in the review period were negligible.

Risk Framework Approach

Risk Management



Note: Investment risk is covered by the investment risk framework, strategic, operational, and corporate market, credit and liquidity risks are covered by the corporate risk framework.

Source: Fitch Ratings, Alcentra

Corporate Governance and Internal Control

Fitch views Alcentra’s rotation policy for board members as sound, with the board having five members, including one independent director. There is no term limit for executive directors serving on the board.

The independent non-executive director is responsible for ensuring proper and independent supervision of the executive directors’ performance. As part of a regular board effectiveness review, the independent non-executive director evaluates the performance of the board, its committees, and individual directors in consultation with the BSP chief operating officer. This is done without the executive directors being present.

Portfolio Monitoring, Measurement and Stress-Testing

Credit risk monitoring is driven by the front office, with individual credit monitoring and portfolio monitoring driven by analysts and investment committees, respectively.

The investment risk function performs periodic stress testing for market, credit and liquidity risk, providing reports to quarterly risk and performance meetings.

Liquidity risk management is guided by liquidity risk ratings assigned during the analysis process. The investment risk function monitors portfolio and asset liquidity to ensure suitability to fund type and redemption profile, while also monitoring risks such as client concentrations.

The European loan, structured credit, and global special situations funds have specific liquidity limits that are regularly monitored by the risk manager and reported to the risk committee. Most of Alcentra’s AUM is in closed-end funds or funds with conservative redemption periods, which limit asset-liability mismatches.

Compliance

Fitch views Alcentra’s compliance function as robust, supporting monitoring, advisory, policy and procedures, and regulatory aspects. Comprehensive policies and procedures are in place to ensure compliance with regulatory rules, and appropriate surveillance is conducted to test first-

line controls, such as best execution and personal account dealing. Results are reported to the risk committee.

The compliance team undertakes thematic risk-based reviews with annual assessments covering ethics, market abuse, and marketing.

Alcentra maintains a restricted trading list, integrated into Allvue. An order allocation policy is monitored by the global head of risk and compliance.

Alcentra's operations team produces shadow NAVs for all relevant products, which are reconciled with the administrator-produced NAV. Before trading, portfolio managers run a trade scenario, which may be reviewed by the operations team to ensure investment guidelines are not breached. The operations team reviews all trades on a post-trade exception basis.

Company and Client Servicing (Excellent)

Market Presence and Franchise

The Alcentra-BSP combined platform is one of the largest alternative credit managers by AUM demonstrating solid expertise in areas such as structured credit, secured loans, direct lending, mezzanine loans, high-yield bonds, special situations and multi-strategy.

Fitch considers Alcentra a manager with deeper market access and more established industry relationships than the average for peer credit specialists.

Financial Stability

Alcentra was acquired by Franklin Resources, Inc., a global investment management organisation operating as FT, in November 2022. FT is one of the world's largest investment managers with AUM of USD1.6 trillion as at end-1H24. Alcentra has achieved synergies in operations and credit research since the acquisition.

As a standalone entity, Alcentra is not dependent on its parent for financial stability in Fitch's view. Alcentra is highly profitable with a substantial amount of cash on the balance sheet, which would mitigate the effect of a severe stress on the business. Most of its AUM in Europe 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.

Alcentra benefits from FT's extensive resources and we view the parent's 'A/A2' ratings from nationally recognised statistical rating organisations as positive for financial stability.

Industry Experience

The Alcentra group was established in 2002, with the combined platform having an average 17 years' credit investing experience, which is high for the sector. The senior team has worked together for over 20 years, averaging 30 years' experience. This results in Fitch's highest score for tenure and relevant experience in this category.

Alignment of Interests with Investors

Fitch views Alcentra's alignment of interests as good, characterised by balanced long-term and short-term compensation structures linked to the fund's risk-adjusted performance. Alcentra allows for general partner commitments in funds and provides opportunities for staff to invest as part of the incentives package, further enhancing this alignment.

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, including 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.

Investment Performance (Consistent)

Alcentra manages a range of investment products with differing characteristics. The open-ended funds generally performed well in the three years to end-1Q24, achieving returns above their benchmarks and targets.

The largest of these funds within the rating scope (a European loan fund) has outperformed its index since inception, with a higher Sharpe ratio, a measure of risk-adjusted relative returns.

All rated debt tranches of Alcentra's CLOs have been paid in full, demonstrating good performance for debt holders. As of end-2023, the direct lending strategies delivered internal rates of return in line with, or above, their target net return of 4%-10%, depending on vintage. The structured credit funds demonstrate strong risk-adjusted returns over multiple time periods.

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