Alcentra Ltd

Rating

Rating Type	Rating	Outlook	Last Rating Action
Investment Management Quality Rating	Excellent	Stable	23 Feb 22

Source: Fitch Ratings

Key Rating Drivers

'Excellent' Rating: Alcentra Ltd's 'Excellent' rating reflects the improved investment risk-management function, the clarity and consistency of Alcentra's investment and research processes, the experience and calibre of its personnel, and the support and oversight provided by its institutional owner, The Bank of New York Mellon Corporation (BNY Mellon; AA-/Stable/F1+); specifically in the areas of risk management and technology.

'Excellent' Investment Process: Alcentra's investment processes have clearly articulated objectives, with the strategies demonstrating a very high level of consistency to stated objectives over time. As one of the largest credit managers in Europe, Alcentra has access to multiple sourcing channels within the market and its research is well incorporated in portfolio construction.

'Excellent' Investment Resources: Alcentra's structure is optimal, organised along lines of strategy and geography but leveraging a global research function. The company employs a large number of analysts, allowing a favourable issuer coverage ratio, and has experienced portfolio managers. A major project to upgrade the automation and functionality of the systems is ongoing, and the back office functions have been largely outsourced to BNY Mellon Asset Servicing to improve efficiency.

Alcentra also benefits from the resources of its institutional owner, notably in IT and support services.

'Excellent' Risk Management: The Risk Management category score has been upgraded to 'Excellent' from 'Strong' following recent system upgrades that have increased data availability and integration, allowing for analysis of daily performance and risk for special situation, global loan and multi-credit investments.

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. Risk and compliance is an independent function with reporting lines to BNY Mellon.

'Excellent' 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 positive for the credit profile, in Fitch's view. Client servicing and reporting is sophisticated, reflecting Alcentra's institutional investor base.

'Consistent' Investment Performance: Alcentra's 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 Group had USD41 billion assets under management (AUM) globally at end-2021, with two-thirds of that total managed in Europe. The rating scope is limited to these European operations.

Applicable Criteria

Investment Management Quality Ratings Criteria (Assessing Active, Passive & Alternative Investment Managers, Strategies & Funds) (February 2021)

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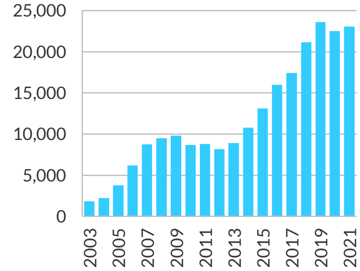
Category Scores

Weight	Category	Score
25%	Investment process	Excellent
25%	Investment resources	Excellent
25%	Risk management	Excellent (from ‘Strong’)
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, accounting for over 80% of total AUM.
Source: Fitch Ratings

European AUM Development

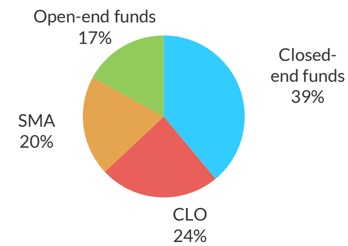
(EURm)



Source: Fitch Ratings, Alcentra

European AUM Breakdown by Product Line

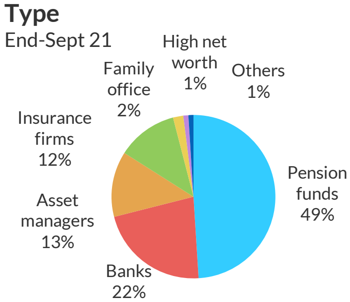
(End-2021)



Source: Fitch Ratings, Alcentra

AUM Breakdown by Investor Type

End-Sept 21



Source: Fitch Ratings, Alcentra

Investment Process [Excellent]

Investment Objectives

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

The investment approach is structured, incorporating layers of oversight to ensure investments are in line with their stated styles and objectives. The investment committees in the loans and direct lending businesses are an example of this oversight. In the structured credit business, decisions are made by the three portfolio managers.

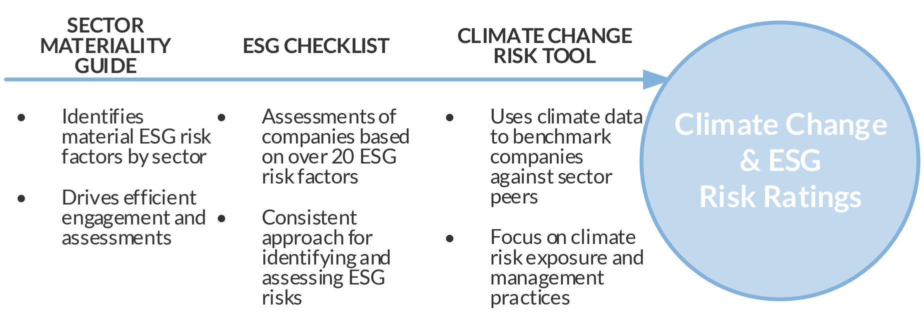
Terms of the investment offerings relative to market standards are well documented, and Fitch considers the liquidity terms specified in open-ended funds as suitable for the strategies.

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 consistency of research capabilities and the discipline and repeatability of the processes as ratings positive.

There is effective sharing of information across teams, which increases the coverage and depth of analysis. Alcentra also established a dedicated responsible investment (RI) team, and RI framework to assess material ESG risks using proprietary scoring.

RI Framework: Initial Assessment



Source: Fitch Ratings, Alcentra

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. Here, 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, 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.

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 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

SOURCING	INTIAL REVIEW	FULL ANALYSIS	INVESTMENT	MONITORING
• Opportunities identified in both the primary and secondary markets • Leverage bank relationships via capital market and trading desks as well as company and sponsor relationships	• Industry analyst creates two-page pre-screener initial review of potential new opportunity • Investment committee decides whether to decline or continue analysis based on pre- screener	• Meet management and review third-party materials • Financial modelling recovery rating, liquidity analysis and internal rating and ESG score • Full deal documentation and covenant review by analyst and legal • Detailed full credit paper presented to the investment committee • Majority approval required from investment committee	• Buy decision delegated to portfolio managers once approved by investment committee	• Daily market call with analysts and PMs to discuss market technicals and company news • Weekly team meetings to discuss sector specific trends • Ad-hoc analyst updates post company results and news, with regular updated to internal credit scores • Quarterly portfolio credit reviews (QPRS)

Source: Fitch Ratings, Alcentra

Investment Decision-Making, Portfolio Construction and Execution

Fitch considers Alcentra's credit investment decision-making to be sound. For senior secured loans, the investment committee – comprising the European and US chief investment officers, portfolio managers, the head of US and European credit research and the head of responsible investing – convene periodically to review credit proposals, with a majority vote required before the decision is delegated to portfolio managers to execute.

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.

Alcentra adheres to a disciplined sell philosophy and 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). 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 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 approval by the three portfolio managers, ensuring consistency of view.

In Fitch's view, performance tracking and attribution analysis is timely and robust for the strategies. Data for the loans business is aggregated and accessible, allowing for enhanced performance measurement, attribution and risk analysis. The direct lending business has a dedicated portfolio monitoring team who have developed a proprietary tool for performance tracking and assessment. The structured credit team monitor portfolio metrics daily, and carry out deal-level analysis on an ongoing basis.

Investment Resources [Excellent]

Staffing

Alcentra operates an optimal structure, organised along lines of strategy and geography; but leveraging a global research function. There is clear segregation of responsibilities between front, middle and back office, technology and compliance. The high level of research integration and use of investment committees mitigate key person dependencies.

Alcentra has experienced and tenured staff. The company had 182 members of staff globally at end-2021, including 81 investment professionals with an average of 15 years' relevant experience.

The company employs a large number of analysts, allowing a favourable issuer coverage ratio of 35–40 loans or high-yield bond issuers per analyst, which is similar to peers. Work is further optimised within the credit research function by tiering credits at the pre-screener phase to determine the level of analytical depth required. The team receives support for inputting data and commentary for simple models from a third-party research and analytics provider – which boosts the team's capacity.

Portfolio managers do not have any administrative responsibilities and focus solely on fund management. Alcentra has a highly experienced dedicated trading team for loans and high yield bonds, with an average of 22 years' experience. In other strategies, portfolio managers (or their delegates), are responsible for trading.

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. The portfolio monitoring team for direct lending provide independent oversight, and there is a dedicated investment-risk manager.

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

There was a senior level departure from the direct lending team in 2021; however, staff turnover overall was fairly low over the same period. For example, there has only been one leaver in the structured credit business in the past eight years.

Staffing Organisation

Alcentra's Global Platform

Division	Number of staff
Investment teams	
Loans & high yield	34
Direct lending	28
Structured credit	7
Special situations	9
Responsible investing	3
Risk, compliance & governance (inc. investment risk)	12
Partner engagement (distribution, product, investor relations)	29
Operations	29
Technology	7
Other	24
Total	182

As at end-**2021**
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. Since 2019, Alcentra has been engaged in a major system upgrade project. The loans, high yield and special situations strategies have been migrated onto the new platform, with the project ongoing for the structured credit and direct-lending strategies. The new platform enhances data accessibility and integration, providing a single system for portfolio monitoring and compliance.

Alcentra's systems include a central data warehouse as well as third-party systems, such as Thetica for structured credit and HedgeMark for Liquid Strategies. Reporting tools include Tableau; investor relations use 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 (an arm's length contract with The Bank of New York Mellon).

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 and Third-Party Service Providers.

The major system upgrade project of the past few years has strengthened pre-trade controls and analytics, improved straight-through processing of trades, enhanced performance and risk analysis though better data availability and integration, and outsourced some back and middle office functions to BNY Asset servicing to improve efficiency. The project is ongoing for the structured finance and direct lending businesses.

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 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.

In 2021 Alcentra engaged a third-party analytics and business intelligence provider to support the operations function. They provide dedicated staff to carry out some middle-office functions, overseen by the Alcentra operations team.

The parent bank (through an arms-length contract) provides back-office services, such as loan settlement. Alcentra also benefits from its institutional owner's resources, notably in IT and support services.

Risk Management [Excellent]

The Risk Management category score has been upgraded to 'Excellent' from 'Strong' to reflect the improvement in portfolio monitoring, measurement and stress testing, which resulted from the upgrade of the system that provides daily performance and risk analysis.

Risk Control

Fitch considers Alcentra's risk control framework as strong, benefitting from the oversight of the parent bank. BNY Mellon's 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 consists of seven members, three of whom are independent. It 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 representatives from both the parent bank's and Alcentra's compliance and risk functions.

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 compliance and operational risk officer both have direct reporting lines 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. Incidents meeting BNY Mellons's materiality threshold are also tracked through BNY Mellon's operational risk-monitoring systems. Near misses are recorded in the error register. In the event of a gap in results, an action plan is in place to enhance and add controls if necessary. Risks are also assessed as part of ICAAP. Operational losses have been negligible.

Risk Framework Approach

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

Portfolio 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, high-yield, and special situations strategies. Reporting is less automated for the structured credit and direct lending strategies pending implementation of the new system; however, this is less of a differentiating factor for these strategies.

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 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 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 exception 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.

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.

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 severe stress on the business. About 70% 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.

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 specialist boutique asset-management companies.

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. Alcentra Group reports that 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.

Investment Performance [Consistent]

Alcentra manages a range of investment products with differing characteristics. The open-ended funds generally performed well over the three-year period to December 2021, 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.

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, or above, the target net return range of 6%–8%.

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

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