Alcentra Ltd

Rating

Rating Type	Rating	Outlook	Last Rating Action
Investment Management Quality Rating	Excellent	Stable	24 July 23

Applicable Criteria

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

Analysts

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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 USD33 billion of assets under management (AUM) at end-3Q23.

'Excellent' Investment Process: The manager's investment process is clearly defined with consistent sources of risk and return relative to investment objectives over time. It has access to multiple sourcing channels within the market as one of the largest credit managers in Europe. The research process is well-defined, disciplined and incorporated into portfolio construction.

'Excellent' Investment Resources: Alcentra operates an optimal structure, which is organised along lines of strategy and geography, while leveraging a global research function. The investment and operations teams are well-resourced. A large number of analysts allow for a favourable issuer coverage ratio, and the portfolio managers have a high level of experience.

It continues to invest in its platform resources, for example, through bolstering the technology team, and establishing a portfolio analytics function to enhance performance and reporting, business and data-engineering analysis. Back-office functions have largely been outsourced to BNY Mellon Asset Servicing to improve efficiency.

'Excellent' Risk Management: Alcentra has a robust risk and control framework, in Fitch's view. Risk management is organised into compliance, operational risk, investment risk and anti-money-laundering functions, with reporting lines to the board of Alcentra and Benefit Street Partners.

Fitch believes 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. The integration with BSP following Alcentra's acquisition by Franklin Templeton (FT) has led to improved scale and synergies, for example, with the complementary credit research function. Client servicing and reporting is sophisticated, reflecting Alcentra's institutional investor base.

'Consistent' Investment Performance: The manager'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. Its business has been combined with BSP to form one of the world's largest alternative credit asset managers with an aggregate USD77 billion AUM at end-1Q23. Alcentra's ultimate owner is FT, which had AUM of more than USD1.4 trillion, including USD257 billion in alternative investments, at end-1H23.

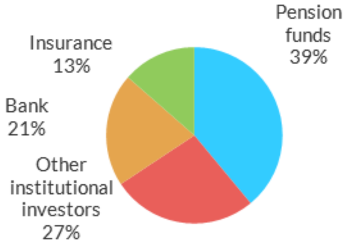
Category Scores

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

AUM Breakdown by Investor

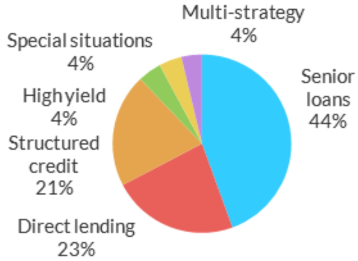
End Sept-2023



Source: Fitch Ratings, Alcentra

AUM Breakdown by Strategy

End Sept-2023



Source: Fitch Ratings, Alcentra

Investment Process

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 approach is structured, incorporating layers of oversight to ensure portfolio positioning is in line with 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 two portfolio managers with input from the wider investment team.

Portfolio positioning and risk monitoring is incorporated in the investment process, contributing to the 'Excellent' score in this category. 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, processes are well developed and consistently applied. Fitch views the consistency of research capabilities, and the discipline and repeatability of the processes as rating positive.

There is effective sharing of information across teams, which increases the coverage and depth of analysis. Alcentra and BSP has a well-resourced and scalable platform, in Fitch's view. The combined platform had about 45 liquid credit analysts and 30 sector-focused research analysts at end-1Q23, which we view as appropriate for its AUM and number of strategies covered.

Investment Process

Fitch considers the loan investment process to be disciplined and thorough. The process is based on a comprehensive 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 has two main steps. An initial review considers high-level characteristics of a transaction including a preliminary ESG risk assessment, summary and proposal, where the investment committee decides whether to proceed.

If approved, a detailed fundamental credit analysis is carried out. This second step involves financial and liquidity analysis, stress-testing, competitive positioning, ESG risk, management and sponsor assessments, and documentation review.

The output to the research process is a paper including an internal credit rating, a climate change and ESG risk rating, and a recommendation for consideration from 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 compliance restrictions) and interact with Alcentra's core credit research team. However, they are not bound by the views of the credit team, nor are they limited by the credit team's coverage.

The Alcentra structured credit investment process embeds 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 CLO manager behavioural traits and market developments, when making investment recommendations. The research process has been consistent over time, which is positive for the rating.

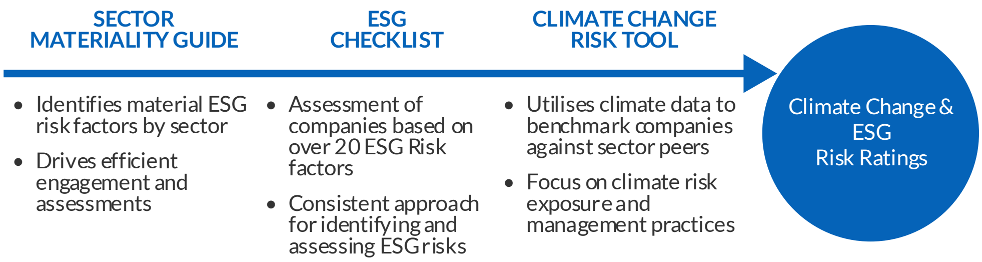
Direct lending is structured to optimise sector and region expertise, and promote best practice through standardisation.

ESG Investment Framework

The responsible investment team has grown and remains well integrated in the investment processes. The team applies the responsible investment framework to assess material environmental, social and governance (ESG) risks using proprietary scoring, in collaboration with the investment teams.

An ESG checklist and other related tools are being integrated into Allview, its portfolio management system, as part of a company-wide data integration project.

Responsible Investment Framework: Initial Assessment



Source: Fitch Ratings, Alcentra

Portfolio monitoring and positioning completes the investment process cycle. Bottom-up credit monitoring and top-down market views are considered against specified categories, such as credit quality, liquidity or relative value.

In direct lending, a dedicated portfolio monitoring team, which is independent from the investment team, uses proprietary tools to track key performance indicators, ratios and valuations. In Fitch's view, the research processes are robust.

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 senior members of the portfolio management, credit research and responsible investments teams – meet periodically to review credit proposals, with a majority vote required before a decision is delegated to portfolio managers.

Committees are fully documented and approved by authorised signatories. Portfolio managers have flexibility in managing their respected funds, provided they meet their 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 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 is timely and robust for the strategies. Data for the loans business are aggregated and accessible, allowing for enhanced performance measurement, attribution and risk analysis. The direct lending portfolio monitoring team use a proprietary tool for performance tracking and assessment. The structured credit team monitors portfolio metrics daily and carries out deal level analysis on an ongoing basis.

Investment Resources

Staffing

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

Alcentra has an experienced workforce. The company had 168 employees globally at end-1Q23, including 59 investment professionals. Following the FT acquisition and integration with BSP, the combined platform is one of the world's largest alternative credit asset managers by AUM.

The Alcentra-BSP platform has 411 employees, including 173 investment professionals with an average of 17 years' credit investing experience as of end-1H23. This is a sector-leading AUM and strategy/investment professional ratio, as well as credit investment experience, by Fitch estimates.

Credit research benefits from 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 similar to peers.

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

In Fitch's view, the risk management team is well structured with defined roles and adequate staffing levels. It is organised into compliance, anti-money laundering, operational and investment risk.

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 systems include a central data warehouse. In addition, it uses third-party systems, such as 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 for managing Alcentra's investment vehicles. Allvue feeds data to and from the back office through an arm's length contract with BNYM.

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 BNYM Asset Servicing to improve efficiency.

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 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

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.

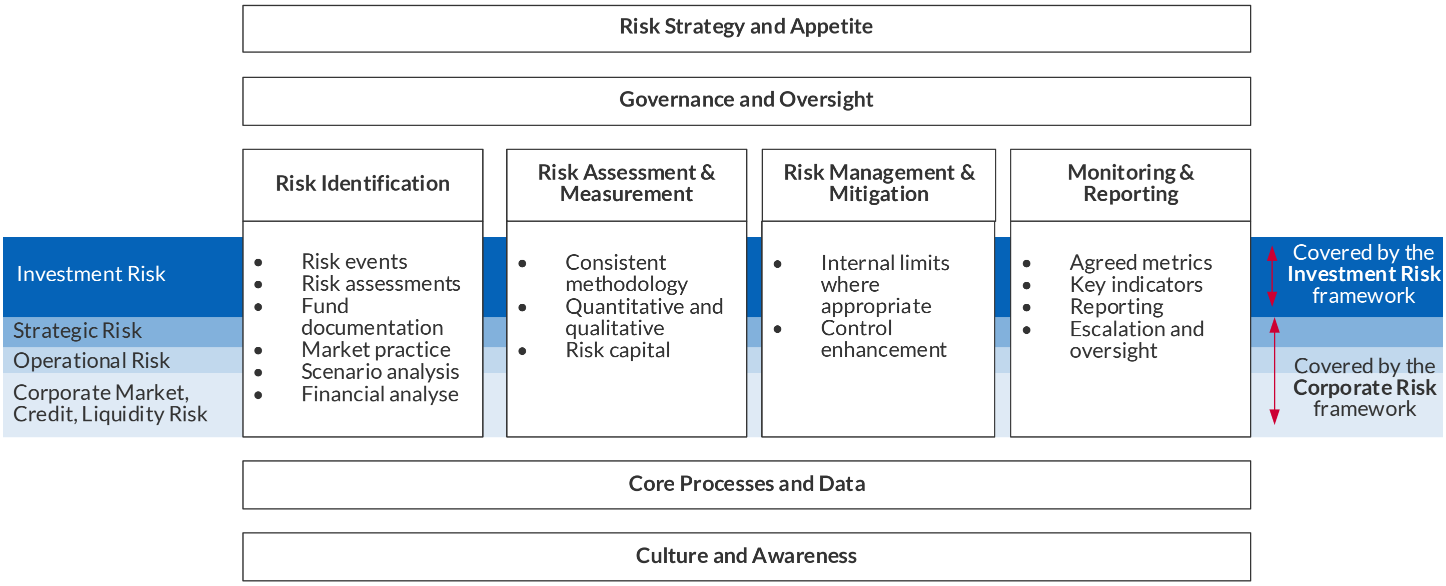
Policies are well documented and there is good oversight provided by Alcentra's risk committee as well as at the quarterly risk and performance meeting.

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

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 carries out periodic stress testing for market, credit and liquidity risk and provides reports to quarterly risk and performance meetings.

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. Most of Alcentra's AUM is in closed-end funds or funds with conservative redemption periods that limit asset-liability mismatches.

Compliance

The compliance function supports monitoring, advisory, policy and procedures, and regulatory aspects. There are comprehensive policies and procedures to ensure compliance with regulatory rules, and appropriate surveillance is carried out to test first-line controls, such as best execution and personal account dealing. Results are reported to the risk committee.

Monitoring undertakes thematic risk-based reviews with annual assessments for ethics, market abuse and marketing.

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.

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 reviews all trades on a post-trade exception basis.

Alignment of Interest

In Fitch's view, the incentive structure promotes alignment of interest with investors. Remuneration for members of staff is competitive and a long-term incentive plan invests in Alcentra products, providing a balance between long- and short-term compensation linked to risk-adjusted performance.

Company and Client Servicing

Market Presence and Franchise

The Alcentra-BSP combined platform is one of the largest alternative 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.

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 USD1.4 trillion as at end-1H23. It has a good record of acquiring and integrating asset management businesses, and 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' 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.

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

Alcentra manages a range of investment products with differing characteristics. The open-ended funds generally performed well in the three years to end-1Q23, 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. The direct lending strategies delivered internal rates of return in line with, or above, their target net return range of 6%-10% depending on vintage as at end-2022. The structured credit funds demonstrate strong risk-adjusted returns over multiple time periods.

SOLICITATION & PARTICIPATION STATUS

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.

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