Q&A with Peter Glaser

Direct lending

Peter Glaser

Peter is head of European Direct Lending at Alcentra, a BNY Mellon Investment Management firm, a role he has held since May 2018. He is also a member of the firm's Executive Management Committee and chairman of the European Direct Lending Investment Committee. Before joining the company, Peter was a partner at KKR, where he built and headed the firm's sponsor finance business. Prior to that, Peter was a managing director at Barclays Capital, where he led the company's US leveraged finance origination and execution and financial sponsor client coverage activities. He received his MBA from Harvard Business School and a BA from the University of Pennsylvania.

Why did you choose to pursue a career in asset management?

The industry has a lot of fascinating elements. Our job can be similar to that of a detective: we like investigating operating models, sectors, management teams, and owners. It's all about learning how a business works, which involves a good deal of intellectual curiosity. If you enjoy engaging different parts of the brain to assemble the pieces of a puzzle, then it can be very enjoyable. What's more, it's nice to wake up each day knowing that you will explore something different.

What's your role?

Our team specialises in direct lending[1]. This is typically done in a fund format, and we act as the manager of those funds on behalf of our limited partners. Our aim is to originate, perform due diligence on, invest in and monitor downside-protected credit capital with attractive risk-adjusted returns. This covers the lifetime of a loan, which can be up to seven years, so we underwrite and structure our loans with a long-term perspective. We're typically a sole or lead lender and offer illiquid strategies to our investors. To protect capital over the life of an illiquid fund, it's vital for direct-lending managers to perform careful due diligence and, for large platforms like ours, to engage in bilateral negotiations around credit agreements before any capital is advanced.

Can you describe the strengths of your team in direct lending?

We launched our platform in Europe in 2012-2013 when direct lending first started in Europe, so we've been a part of this asset class from the beginning. As a result, we have deep experience, extensive relationship networks and a history of performance for investors who are seeking this type of risk-return construction. There are 35 people in the team, who are wholly dedicated to the direct-lending strategy. This represents a deep well of experience in origination, investing, portfolio monitoring, portfolio structuring, and operations.

What's the broad appeal of direct lending for investors?

The yield achieved for the risk undertaken is attractive in a low interest rate environment. There are fairly substantial yields available, particularly relative to the downside protection we provide as a largely senior secured first lien lender – in other words, we are typically first in line to be paid if the borrower defaults. The trade-off for a premium return to broadly syndicated loans is liquidity, and investors have to be patient about getting their money back. If you invest in liquid credit markets, you can sell a position when things may be moving in the wrong direction. With direct lending, we don't have that flexibility. Hence the importance of good underwriting and active management of portfolio positions. However, given the potential returns relative to the risk-free rates available, plus an appropriate premium compared to liquid credit strategies, investors do get paid for that illiquidity. It is also worth noting that we offer floating rate loans, so inflation protection is built into our returns.

[1] Direct lending is a form of corporate debt provision in which institutional lenders other than banks make loans to companies without intermediaries such as investment banks or brokers.

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Can you describe your management approach?

There should be nothing particularly dramatic about direct lending – you just need to achieve targeted returns, limit the downside and safeguard your capital as much as possible. Through our broad origination network, we evaluate each potential transaction to identify those that make the most sense for our strategy, investing only in those with appropriate risk/return characteristics. It also involves vigorous monitoring efforts and making seasoned judgements to protect that capital during the life of a loan. You've got to be very good at blocking and tackling when executing a strategy!

We have a pan-European footprint including separate teams that focus on the various European regions. Team members are natives of the countries they cover, which helps with the development of local networks and client relationships. In our case, this tends to mean private equity firms that buy and sell companies. These owners provide equity, and we supply the debt.

In terms of risk, what potential safeguards do you have in place?

Protecting against risk in the direct lending space starts with sourcing good opportunities from a broad network. The next, vital step is to filter such transactions through reliable underwriting processes and standards, undertaking robust due diligence in order to understand the risks and structure the transaction around them. The focus must be on the right sectors, compelling business models, the best management teams, and the most reliable business owners. Once you're comfortable with the level of risk being underwritten, it's essential to document the deal with a credit agreement that protects capital over the life of the loan.

What socially responsible factors do you consider when making investment decisions?

ESG considerations are an integral part of our underwriting process. Each time we go to our investment committee, which is at least twice during every investment process, we submit an evaluation which includes analysis around each of the environmental, social and governance considerations. In tandem with this, we have a separate ESG committee that provides an additional and firm-wide perspective on ESG matters.

To help in our evaluation, we ask a broad range of questions and make many informational requests during the underwriting process. We continue this ESG evaluation on a regular basis when we're the lender with questionnaires and through dialogue with management and owners. While we don't have the same influence as company owners, we try to use our position as a sole or lead lender to ask the right questions and influence outcomes that can positively impact ESG issues. Ultimately, if there is too much ESG risk involved, we won't make the investment.

What's your view on the current market environment and the near-term outlook for the business?

2020 has been an unusual year, to say the least. The pandemic resulted in the first downturn experienced by direct lending in Europe. This industry only started in Europe around 2013, and we saw sustained economic growth throughout most of that period. As such, this is the first real test of the market. I'm pleased to say the strategy has performed as designed and quite well, at least for us. While challenging, various participants such as our borrowers and our team have become used to operating in the current environment. In addition, there remain compelling new opportunities to invest capital, which tends to be a good sign about the outlook. Of course, macroeconomic uncertainty remains – the impact of Brexit or the direction the pandemic will take, for example.

When you're not solving financial puzzles, can you tell us about life outside of the office?

My wife and I live in London, but our kids are back in the US: one is in college, and the other is in graduate school. We like to travel and very much enjoy the city – focussed on the latter these days with the pandemic-related travel restrictions! It's much more about experiences and trying to do interesting things at this stage of our lives.

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