Asset Manager Ratings
UK
Rating Report

European Credit Management Limited (ECM)

Asset Manager Rating

Rating Criteria

Source: Fitch

'M2' Description

Asset managers in this group have earned high scores in most areas of assessment. Such organisations are generally stable, well-capitalised investment management companies with a track record of profitability. Organisations at this rating level are run by highly experienced, tenured management teams supported by experienced front-, middle-, and back-office staff. The organisational infrastructure includes strong risk management and internal control functions, which are integrated in the day-to-day portfolio management processes. Portfolio management processes are consistently applied and supported with frequent investment analysis and monitoring, forming a disciplined approach for making buy, sell or hold decisions. At this rating level, organisations will have strong investment administration capabilities, as reflected in the level of investor services and the quality of investor reporting. All core processes are supported with integrated technology resources, complemented with good analytical and decision-support.

Analysts

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Rating Rationale

- The London-based investment activities of European Credit Management Limited (ECM) are assigned an 'M2+' asset manager rating. Since 2 October 2008, the rating has been placed on Rating Watch Evolving, reflecting the ongoing uncertainty regarding the future shape of Evergreen Investments and its affiliate programme to which ECM belongs, following Wells Fargo's acquisition of Wachovia on 31 December 2008.
- ECM's credit business franchise has proved fairly resilient and the company remains profitable despite challenging market conditions, a reflection of the quality of the senior management team and strong relationships established with a long-term, relatively stable investor base. In Fitch's view, ECM's multi-specialist approach to credit management places the company in a better position, relative to other asset management companies, to take advantage of a potential upturn in the credit market. ECM benefits from the stability and depth of staffing resources, and a robust IT and operational infrastructure.
- Assets under management shrank significantly in 2008 to EUR13bn from EUR22bn in 2007, reflecting a fall in net asset value (NAV) due to spread widening rather than massive client outflows. Some products have suffered particularly, such as those specialised in ABS, financial debt or leveraged loans. The level of leverage – via repo financing and total return swap facilities - have been significantly reduced, from already modest levels, and all efforts have been made to secure the remaining financing. As early as March 2008, ECM also initiated discussion with investors to allow *in specie* redemptions into unleveraged products, via capital injections from investors offsetting financing. So far, EUR2.2bn of new capital has been raised. These initiatives show the proactivity of management and operational robustness of the firm, compared to its peers.
- Over the short to medium term, ECM faces challenges in transitioning portions of its business model, historically focused on leveraged products using repo funding towards unleveraged products and segregated mandates. In this respect, ECM needs to continue the smooth deleveraging of its MTN programmes to sustainable levels, through repo unwinding and asset transfers into unleveraged funds. Research resources (modelling and monitoring tools and analytical staff) can be strengthened in an environment of rising default rates while ECM also needs to demonstrate shareholder value to ensure full commitment of its new parent. Overall, the '+' modifier emphasises ECM's strong investment process and investment administration capabilities.

Manager Profile

European Credit Management Limited

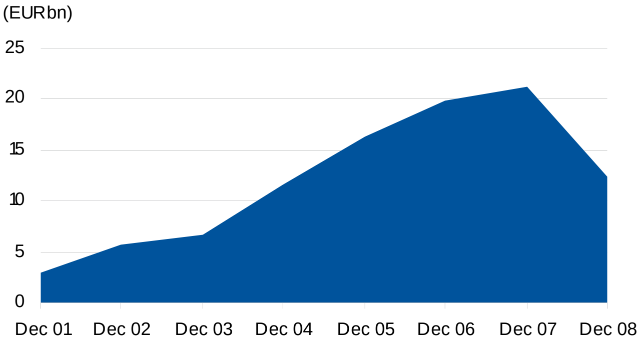
Founded in 1999, ECM is authorised and regulated by the UK's Financial Services Authority. Owned by its founders and senior management until January 2007, ECM is now majority-owned by Wachovia Corp. It employs approximately 180 people and manages around EUR13bn of assets in 28 portfolios. Product offerings include bespoke medium-term notes or pooled funds. ECM has a rigorous investment process, focused on the credit quality of individual investments. All investments are made on a duration and currency-neutral basis, through the use of swaps.

It offers diversified or specialised portfolios of European fixed income credit securities (ABS, loans, investment grade and high yield bonds). The company began using credit derivatives to enhance its portfolio management strategies in 2005 and launched a pure relative value product in 2006. Portfolios can be leveraged via cash funding or synthetically. More recently, unleveraged products have been launched.

Address	34 Grosvenor Street London W1K 4QU	**Ownership**	70% Wachovia 30% partners, employees and other minority shareholders
Company contact	Joe Biernat	**CEO**	Steven Blakey
Website	www.europeancredit.com	**CIO**	Stephen Zinser
Type of organisation	Investment management firm	**Chief investment strategist**	Joe Biernat
Year founded	1999	**Head of research**	Frances Hutchinson
Domicile, place of incorporation	UK	**CFO**	Jeremy Wrigley
Registration(s)/jurisdiction(s)	FSA UCITS 3 SICAV MTN programmes under Luxembourg law	**No. of investment professionals** **No. of employees**	40 179

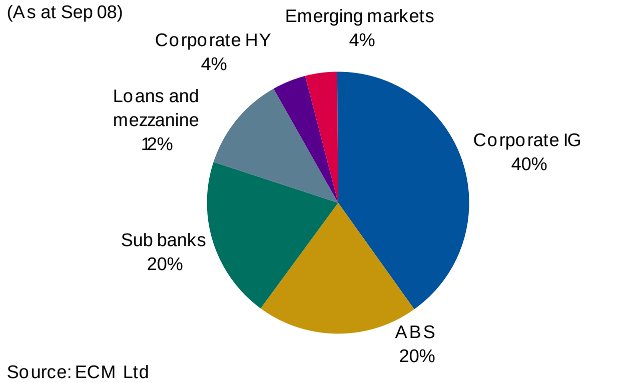
Assets Under Management

AUM Growth



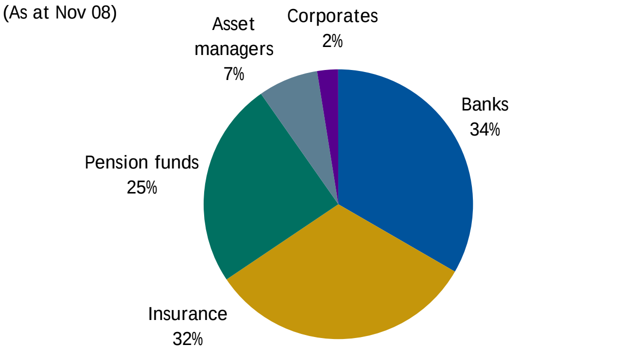
Source: ECM Ltd

AUM Breakdown by Asset Type



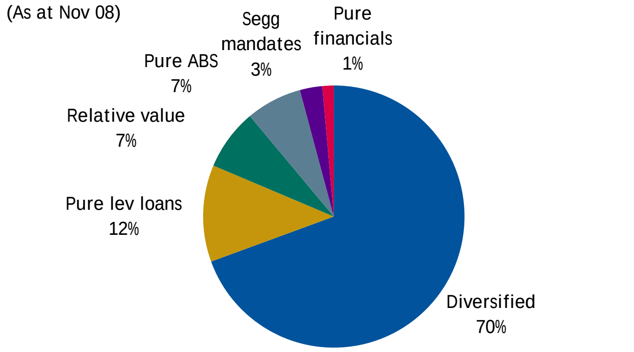
Source: ECM Ltd

AUM Breakdown by Client Type



Source: ECM Ltd

Asset Breakdown by Product Types



Source: ECM Ltd

European Credit Management Limited (ECM) Limited

Key Rating Drivers	Rating
	M2+

Strengths

- Resilient business franchise, with an exclusive focus on the entire spectrum of European credit
- Diversified and long-term institutional investor base
- Quality and involvement of the senior management team
- Staffing depth and stability; overall experience
- Substantial and robust IT and operational infrastructure

Challenges

- To ensure commitment of the new ultimate parent, Wells Fargo
- To transition part of the business model toward unleveraged products and segregated mandates, positioning the firm for recovery
- To retain existing relationships with clients and lenders
- To ensure that research resources match the need for increased monitoring tools and analytical staff in an environment of rising default rates, particularly in the area of leveraged loans and ABS

Company & Staffing	Score
	2.25

- A private company until 2007, now 70%-owned by Evergreen Investments, part of Wells Fargo (rated ‘AA/F1+’)
- Sound governance structure (funds and company)
- Controlled business strategy with adherence to core competencies – development toward unleveraged products and segregated mandates as a response to the changing nature of credit markets
- Diversified and long-term investor base - AUM down by 40% in 2008 due to mark-to-market impact and EUR1.9bn outflows
- Continued good level of profitability despite lower AUM numbers and reduction in performance fees
- Seasoned and committed management team, which has demonstrated its quality through successful strategic initiatives in 2008
- Overall superior staffing depth, specifically in infrastructure support and investor relations functions, with potential for growth in research given breadth of coverage and challenging credit market conditions
- Stability of overall team

Risk Management & Controls — 2.50

- Risk management framework, including an independent function covering investment and operational risk, a compliance team, a comprehensive monthly risk management committee and Wachovia’s internal audit
- Control organisation highly embedded in day-to-day operations and integrated in technology
- Tight monitoring of the fund administration operations
- In light of recent events, heightened monitoring of liquidity, funding, credits at risk and valuation
- Ongoing development of quantitative risk metrics, alongside allocation limits used to date - VaR for regulatory purposes

Portfolio Management — 1.75

- Focus on the full spectrum of European credit markets — i.e., investment grade, high yield, ABS and leveraged loans
- Massive deleveraging via repo unwinding and *in specie* redemptions into unleveraged products
- Stable and clearly articulated investment process consistently implemented and adhered to, emphasising fundamental management of credit with a total return focus, complemented since 2006 by relative value credit strategies
- Investment accountability expected to be enhanced in the near term with the assignment of portfolio managers to specific funds
- New portfolio review committee, diversified portfolio management team and ad hoc allocation and P&L reports
- Thorough and easily accessible credit research inputs
- Increased focus recently on asset monitoring via refined watch lists and regular screening committees
- Room for more research resources (modelling and monitoring tools and analytical staff) in an environment of rising default rates is on the agenda
- Excellent trading capabilities and access to market, including leveraged loans

Investment Administration — 2.00

- High level of transparency via full GIPS compliance, access to portfolio positions and availability of comprehensive tailor-made investor reporting - further transparency during times of crisis
- Standard investor reporting is of reasonably good quality, giving more emphasis to qualitative information than to quantitative indicators - strengthened reporting capabilities with dedicated and automated querying tool
- Highly disciplined process for price capture and valuation – focus on “clean” mark-to-market valuation
- Operations proved robust in the context of high transaction volumes from repo unwinding and asset transfers into unleveraged programmes via *in specie* redemptions
- Continuity of relationships with the main administrator (CACEIS) ,prime broker (Barclays) and other third party service providers

Technology	1.75

- Automated tool for order pre-allocation and pre-trade checks
- Architecture developed around three booking systems for swaps, cash instruments and leveraged loans
- Middle-office platform able to handle high transaction volumes (including OTCs) due to dedicated matching and reconciliation systems
- Centralisation of data with easy firm-wide access via a dedicated internal reporting tool
- Documented business and technology continuity planning with yearly tests

Company & Staffing

Shareholding & Financial Standing

ECM was founded in England in 1999 by three experienced individuals who were, until January 2007, the majority shareholders, alongside a group of key employees and the German life insurance company Gothaer Life (9.9% of the ordinary shares).

In January 2007, ECM's shareholders agreed to sell in total 70% of their stakes to Evergreen, the asset management arm of Wachovia Corp. (the fourth-largest US banking company with total assets of USD720bn as at June 2007, while current top management maintains a minority share. The shareholder agreement plans that, by 2012, Wachovia will own 100% of ECM Ltd. As of December 2008, Wachovia, through its treasury division, was still a large investor in ECM's products.

On 29 September 2008, Wachovia Corporation's Long-Term Issuer Default Rating was lowered to 'BB-' from 'A+', following Citigroup's intention to acquire the sole bank operations and therefore dismantle the group. On 03 October 2008, Wells Fargo announced the acquisition of the whole of Wachovia Corporation, whose rating was raised back to 'A+'/Rating Watch Positive from 'BB-'. Following the effective acquisition, the rating was upgraded to AA and withdrawn (on 2 January 2009). To date, day-to-day cooperation with the parent company has only concerned marketing in the US, technology and second-level risk management. Fitch therefore expects limited impact from Wachovia's events on ECM's day-to-day operations. So far, the agency has no indication of Wells Fargo's long term commitment to ECM, even though business synergies do exist and early indications seem to point toward explicit backing and involvement. Fitch will continue to monitor developments regarding ECM shareholder commitment.

ECM is a very profitable company with average management fees of 40bps on client assets, slightly lower than previously (50bps in 2007) and performance fees payable on all funds. Recent years have seen a steady growth of operating profit driven by a growth in AUM and commensurate increases in expenses, predominantly on staff. In 2008, given mark-to-market pressures, AUM dropped significantly and performances plunged below hurdle rates. As a consequence, net turnover was down 20% yoy. Nevertheless, the firm remained profitable and breakeven would be reached at approximately EUR9bn (vs. EUR13bn currently), which leaves headroom. Notably, Fitch has not identified any cost cutting or downsizing plans, unlike many of its peers. The liquidity position of ECM looks adequate with cash on balance sheet equating to approximately one year of expenses.

The investor base – exclusively institutional – is very diversified, with 349 clients across 40 countries and primarily long-term investors (mainly banks, insurance companies and pension funds). Investors have proved rather stable so far, with ECM reporting EUR1.9bn of outflows in 2008, principally from banks. The top five investors (including Wachovia) represent less than 30% of assets. Despite its focus on one asset class (overall credit), ECM has appeared somewhat resilient, benefiting from a core investor population that is predominantly long-term oriented, with a lower mark-to-market sensitivity and from products that are long term by construction (medium-term notes vehicles). Finally, the assets sold in a capital protected form, most of which delevered last year, never represented more than 10% of the total company assets.

Experience in the Asset Management Industry

Since its inception, ECM has specialised in the management of European credit securities. This includes all of Europe and, to a limited extent, securities originating in the Middle East and Africa. Securities managed are bonds, primarily investment grade, divided across a number of asset classes, including corporate bonds, bank capital, asset-backed securities, European emerging markets and leveraged loans. All assets are hedged systematically against interest rate and currency risks through swaps and leverage is employed to a reasonable degree (up to three times) using repo, synthetic instruments (total return swaps) or bank lines. Recently, in light of last year's events, the decision was made to significantly lower portfolios' leverage and to offer investors with *in specie* redemptions and transfer into unleveraged funds (so far achieved for EUR 2.2bn from ABS, leveraged loans and low investment-grade portfolios). It is also worth noting that six funds are effectively closed to redemptions. ECM is currently adjusting its business model toward unleveraged products, funds and segregated accounts, which will have numerous implications on product design, liquidity conditions and operations. Despite the market turbulence and drop in assets and number of clients, ECM's operations – including staff – remained largely stable, with less than 10% turnover over 2008 and no significant restructuring or downsizing.

This exclusive focus on pan-European credits has allowed ECM to explore in depth all the opportunities offered across the credit sub-asset classes (including non-investment grade issuers, bank loans, ABS) through a diverse approach (long only, leveraged or unleveraged, and relative value long/ short trading). It should position the firm well to exploit yield and capital appreciation in the relevant sub-asset classes in which investors may show renewed interest. The critical mass of ECM (EUR13bn of AUM, EUR16bn of assets including leverage) also provides a unique competitive advantage in terms of quality and adequacy of operations (see *Investment Administration* and *Technology* sections).

ECM manages 10 diversified products (six MTN programmes, among which one unleveraged version, and four UCITS III sub-funds), 13 focused products (six ABS, one bank capital and six loans and mezzanine, all MTN programmes, among which six unleveraged versions), two long/ short products (both MTN programmes) and two segregated accounts. While it has been approached by investment banks in the past, ECM has never managed structured credit in the form of CDOs or similar and has therefore avoided the turmoil in that sector.

Corporate Independence & Governance

The board of ECM only includes executive directors and shareholder representatives, without independent memberships. However, more than half the members of the boards of the various fund vehicles consist of independent directors. The governance structure also encompasses the administrator (CACEIS Bank Luxembourg) and the auditor (Deloitte & Touche), both playing an active role.

Wachovia's participation in the governance of the company includes four strategic board meetings covering strategic decisions, a monthly risk management committee (see *Risk Management and Control* section) and internal audit (the first audit took place in 2008).

The asset manager remains largely independent from any third parties in all respects, including investment policy, control functions, counterparty selection and marketing. Relationships with service providers such as custodians, administrative agents and prime brokers and with market counterparties are based on quality of services in the best interests of investors. Since its foundation, the only significant change was the replacement of Bear Stearns by Barclays as prime broker in 2003. Otherwise, continuity has been maintained in terms of the administrator, prime broker and auditor.

Overall, Fitch views positively the governance structure ECM has put in place and the recent evolutions further to Wachovia's acquisition.

Staffing

Senior management consists of highly experienced people, with strong backgrounds in credit markets. The only change since the foundation of the firm occurred in November 2005 when one of the three founders departed. In conjunction with this departure, and without material impact on the operational platform and the investment process, the company adopted a new management structure, the two other founders becoming CEO and CIO, respectively. ECM's senior management has been heavily involved throughout the crisis and demonstrated strong initiative in areas such as deleveraging, client relationships and *in specie* redemptions where strategic decisions were made.

All staff have very strong industry backgrounds and deep experience. As investment decisions are based on a consensus approach, teamwork (ensuring homogeneity of deal processing) and information sharing, staff replacement is less of a concern than in highly decentralised organisations. Nevertheless, given the size of the company, this risk remains and is properly mitigated thanks to a second layer of senior people that have been trained within ECM. Overall, staff turnover has been fairly low among key staff with a handful of departures since the creation of the company in 1999, including more recently. Some staff reallocations have been made to temporarily reinforce the treasury team, where deleveraging has created a significant workload given massive repo unwinding.

ECM has put in place one of the largest diversified credit teams in the European fund management industry with 40 investment professionals, among which are the CIO and the chief investment strategist. Given the scope of the investment universe and the likelihood of more challenging and differentiated credit markets, Fitch continues to note the potential for more hires in research, which experienced several departures, albeit mostly junior staff.

The infrastructure support team consists of 115 people, covering pricing, reporting, operations, technology, compliance and, more recently, risk management. It is worth noting the emphasis put on the system development and pricing areas, where ECM has continuously invested in resources to build a robust, dedicated and autonomous platform (see *Technology* section). Recently, ECM embarked on an outsourcing project for IT specifications and developments in a very controlled way, keeping strategic resources in-house.

Particular emphasis was also placed on the development of a strong client relationship management team of 31 (partly composed of consultants). This function played a key role throughout 2008, responding very adequately to a critical need for increased communication and client servicing in a context of asset transfers and deleveraging.

All staff have significant banking or fund management experience and junior personnel are regularly hired and trained to help mitigate potential turnover risk and manage career development. 10 staff have joined ECM's support functions since end-2007. This is clearly an area where significant investments continue to be made, highlighting the emphasis placed by ECM on its supporting platform.

Control and compliance also benefit from experienced resources. A function dedicated to risk management was created in 2007, reporting to the CEO and to Evergreen's head of risk management and consisting of one staff member, with good experience in credit risk management.

Headcount
(As of November 2008)

Senior management	**4**
Portfolio management	**26**
Bonds	14
Loans	8
Treasury	4
Credit research	**11**
Corporates	7
ABS	2
Financials	2
Pricing and reporting	**22**
Operations	**18**

Systems	**12+7 contractors**

Source: ECM Ltd

Risk Management & Controls

Control Organisation

ECM has set up a control organisation that is highly embedded in the day-to-day operations and supported by a robust IT infrastructure. Supervision is predominantly undertaken by the weekly investment committee, the monthly operating committee and the recently set-up monthly risk management committee. Numerous risk reports are also produced automatically without any manual intervention and circulated throughout the firm. Being focused on one asset class and one type of risk (credit), all managed by two desks (bonds and loans), risk management supervision is largely streamlined and the exhaustive monitoring of all trading activities (as well as limits) is adequate despite ECM's size.

Since 2007, Fitch has noted greater emphasis being placed on a second level of controls, beyond mere regulatory compliance (which has been covered by a dedicated staff since ECM's foundation). For example, while ECM has not set a fully-fledged internal control or audit function, it will be subject to Wachovia's audit. Furthermore, the risk management function and committee further ensure second level supervision.

Operational Risk Management

ECM has given due consideration to key operational risks. Mitigation is ensured by the thorough documentation of key operational procedures and by proper supervision through regular meetings. Several committees, well documented and involving most departments, allow for rapid and systematic circulation of information. The control and monitoring of operational risk is increasingly covered by Wachovia's audit resources. As already mentioned, the focus of the whole organisation on one asset class and one investment process still offsets the growing operational complexity in terms of size, number of funds and staff. ECM has not, to date, conducted an exhaustive risk-mapping exercise.

Most of ECM's programmes use Credit Agricole Investor Services Bank Luxembourg (CACEIS) as custodian and administrator and Barclays Capital Securities as prime broker. Alongside a disciplined selection process, those third parties are thoroughly monitored through regular meetings and day-to-day reconciliations (see *Technology* and *Investment Administration* sections). ECM appears quite demanding regarding the quality of the services provided, notably in terms of position keeping and pricing. Fitch views positively the existence of long-term stable relationships with ECM's key service providers. In 2008, a comprehensive service level agreement was finalised and further initiatives have been launched to mutualise back-office tasks between ECM and CACEIS.

Compliance and Controls

ECM is authorised and regulated by the FSA and has a complete compliance manual, made available to all members of staff on the intranet and updated when necessary. Compliance issues are given due consideration under the responsibility of a highly experienced compliance officer who reports directly to the board. To answer the specific confidentiality issues raised by the management of leveraged loans, adequate procedures have been set up – notably physical separation of staff. Neither does its ownership by the Wachovia group raise particular concerns, given that the parent company only invests in pooled vehicles and given the very modest volumes ECM trades with its parent's brokerage arm.

The controlling procedures at ECM benefit from the strong reporting capabilities of the IT platform (see *Technology* section), which covers all trading activity and all positions, and therefore ensures exhaustive coverage. All information is accessible to a wide number of people within the organisation through the intranet.

Regarding trading activities and potential compliance issues therein, sophisticated, automated and fair allocation rules have been coded in the order management system. As ECM manages predominantly pooled vehicles, conflicts of interest between investors remain a remote issue. Should more segregated accounts be managed, more formal controls – notably for fair allocation on less liquid assets such as loans – would need to be undertaken. Furthermore, any transaction not completed within one business day is immediately reported to portfolio management, and all orders that are not reconfirmed are automatically cancelled unless documented. However, no formal control is performed on intra-day operations. Direct transfers between funds are strictly forbidden and shorting is subject to various compliance restrictions.

All the restrictions presented in the Base Prospectus of each vehicle and all detailed internal limits (allocation, concentration, rating) are formalised in a comprehensive internal document maintained by the compliance officer. The full range of investment guidelines for each portfolio is coded into the order management system, which allows for pre-trade compliance checks by the portfolio managers. As mentioned, daily ex-post monitoring is ensured by the publication of risk reports. The system also provides warnings when a limit is about to be breached.

Control of the adherence to the approved list of market counterparties is embedded into the automated deal order management system, and trades with unapproved counterparties are systematically blocked. A report on volumes transacted with each counterparty is available on a real-time basis.

Valuation and pricing of the assets and notes is the responsibility of CACEIS Bank. ECM is one source of valuation data for CACEIS Bank and this data is subject to appropriate controls by the product control group, which maintains independent price sources (data providers or market makers) at the issue level and ultimately reviews prices with portfolio managers. Loans and credit derivatives are priced using recognised data providers. While matrix pricing is applied for interim valuations, a full marking to market is done for subscription and redemption purposes. A list of pricing contributors is implemented at a security level and priorities are set to select the most accurate providers. Valuations for all investment vehicles are reviewed independently by the administrative agent in Luxembourg and reconciliation is undertaken using procedures that are clearly defined: a security price list is sent on a monthly basis and checked by the fund administrator (who makes the final decision), balance sheets are thoroughly reconciled and bond prices[1] cross-checked. A report detailing price sources and potential overrides (subject to strict procedures) is part of the package reviewed during each risk management committee. The valuation procedure developed by ECM over the years has proven particularly robust during the recent liquidity crisis, which has challenged those managers that rely solely on generic/public data providers.

Investment and Liquidity Risk Management

Funds' risks are essentially limited to spread and default risks by virtue of hedging mechanisms and are subject to numerous portfolio security restrictions. Interest rate and currency risks are monitored at a granular level by the "market risk management" team, using swaps and forwards. The hedges are reviewed in real time, with interest rates and currency risk reports produced by the supporting application.

[1] The Luxembourg vehicles issue notes that are fixed-income products, deliver semi-annual coupon and whose clean price can vary throughout time

As the investment strategy of most of ECM's funds is rather straightforward, the simple but detailed internal limits - allocation, concentration, rating - provide an adequate risk budget framework. Some dimensions of risks, like spread duration, are not explicitly limited but are increasingly considered within day-to-day portfolio management via adequate reports. Portfolio metrics, such as volatility, value-at-risk (VaR) or stress testing, are not yet monitored as part of the risk management organisation, since each fund is designed with a certain level of credit quality (as expressed by the Fitch fund rating) as opposed to a level of absolute risk. Nevertheless, VaR is now calculated for regulatory purposes on the SICAV and is to be rolled out for other products. Detailed breakdown analysis, for portfolio construction purposes, might also be produced in the near future. The VaR is computed using RiskMetrics, maintained at CACEIS.

Performance and profits and losses (P&L) are regularly reviewed by portfolio management and product control, notably during the newly established portfolio review committee (see *Portfolio Management* section) and reports have been developed to split performance sources in a granular way (carry, roll down and spread move impacts as well as cost of hedging or funding), although on an absolute basis, i.e. not yet against any market reference. Contributions can also be broken down by asset type, sector, rating or country. This development allows for a more refined understanding of performance drivers, which ultimately serves as a risk management tool.

The company has a list of authorised counterparties for bonds, swaps and repos that is reviewed periodically. To mitigate counterparty/funding risks, ECM requires bonds to be settled against payment through Euroclear, diversifies repo providers (currently 13 with no more than 25% of exposure to one name) and has set strict exposure limits for swap counterparties. Any new counterparty must be approved by two directors and the custodian (CAISBL); it is impossible to book a transaction prior to the counterparty being set up in the order management system. Repo and swap master agreements are monitored and negotiated by the portfolio management group with input from the CIO.

Liquidity and funding risk monitoring has always been given due consideration as ECM invests in less liquid assets, such as non senior ABS or loans, with leverage. 2008 has clearly been a challenging year for the firm. This risk could be mitigated, during more benign times, through the diversification achieved in portfolios, the multiplicity of repo counterparties – 13 active currently - and the bimonthly liquidity offered in most programmes. In 2008, once term funding for the leveraged loan portfolios was renegotiated and secured via total return swaps, radical decisions were taken to significantly reduced leverage across programmes, via repo unwinding (justifying temporary staffing strengthening the treasury desk) and *in specie* redemptions. A detailed monitoring of the funding headroom has also been systematised in the portfolio review and risk management committee. The recent liquidity crisis has clearly been a test for all leveraged credit managers and Fitch considers that ECM's active and relatively more conservative strategy has proven its relevance.

The total exposures to each issue are reviewed daily. There are no specific rules regarding maximum aggregated holdings - apart from the rules guiding holdings in each individual portfolio - but maximum group-wide aggregated holdings are monitored and evaluated on a case-by-case basis by the investment committee. ECM also regularly monitors the percentage of its holdings of any issue (e.g, the proportion that ECM holds of an issue), without formal limits however.

Portfolio Management

Clarity and Stability

ECM's investment process has remained virtually unchanged since the foundation of the company in 1999. Overall, as a fundamental credit manager, it emphasises qualitative inputs over quantitative ones to identify credits that can provide yield and capital appreciation. The consensus, research driven, total return-oriented process relies on a team of credit analysts for issuer selection and monitoring and on a team of bond traders for implementation and market monitoring. Swap and repos traders are responsible for the hedging and financing of the trades. The relative value strategy, implemented by the corporate bond traders, is somewhat autonomous, relying on its own technical inputs. In the course of 2008, several modifications have been implemented, mainly a more formal and autonomous allocation sub-process for the diversified programmes, a reengineered portfolio review process, with further plans to assign portfolio responsibilities to individual portfolio managers to increase accountability. ECM will continue to strive to preserve capital and credit quality of its portfolios while reducing or maintaining leverage at modest levels. Focus will be placed on fundamental credit selection for unleveraged credit funds. The firm plans to adapt the investment process where appropriate to new business requirements and changing market conditions.

Research and Inputs

ECM's investment process is a combination of top-down macro-economic and market views and bottom-up credit selection. The portfolio managers combine their knowledge of the market with analysis produced by the research department to reach a consensus on investment decisions. Dedicated staff has been set up to oversee the allocation process of diversified portfolios. Inputs from the research department are consistent and well documented, be they full credit reports on new issues or short portfolio reviews on holdings. They are all stored in a dedicated research library (Research Suite) to facilitate communication of research recommendations to portfolio managers. Inputs for relative value strategies also include various arbitrage screeners (basis, curve, pair trades) provided by brokers or based on internal tools.

The research department benefits from an internal access database to centralise all research outputs. Different review lists are monitored and were refined last year to focus on critical issues (support for banks, for example). The ABS research also benefits from ABSXchange, a third party monitoring database and application, as well as bespoke spreadsheets for each transaction, where a scoring system is used to codify credit and extension risk. The research and monitoring of loans, the outputs of which are formalised in an internal rating system, is disciplined. It benefits from strong experience and established relationships of senior staff with private equity sponsors and arranging banks. Deals are reviewed monthly with the corporate analysts with the exception of transactions where public debt is also issued.

The loan monitoring process is characterised by the same degree of discipline and supervision and operates in close relation with the public research team to form company, sector or industry views. Where public debt is also issued (approximately 15 of 120 loan names), for compliance reasons, the leveraged loan portfolio management team takes full responsibility for monitoring these names.

In a context of increasing idiosyncratic risks, Fitch identified room to strengthen research resources such as modelling and monitoring tools and analytical staff. Seven full-time corporate research analysts cover the highly credit-intensive leveraged loan portfolio of 105 non-public loan names (EUR4bn), conducting monthly review meetings together with the leveraged loan portfolio management team. Two ABS analysts cover 400 tranches of European ABS, for which the automation of the surveillance remains a challenge due to the disparate reporting standards. While this is mitigated by the use of ABSXchange and individual monitoring spreadsheets for each ABS issue, the absence of a central surveillance database system results in an increased workload on analysts. Fitch notes that senior management has already initiated a recruitment process for several analysts with rather senior backgrounds.

Decision-Making Process

The decision-making process per se is highly disciplined and very cohesive and the recent evolutions mentioned above should improve its flexibility, which is critical in volatile markets. The formal weekly investment committee attended by the portfolio managers, research department and risk management, which used to play a central role, has been supplemented by a restricted bi-weekly portfolio review committee. While the former has become more informative than decisional, the latter is key in determining asset allocation and risk parameters (leverage, spread duration and overall credit quality).

Sub-committees by sub-asset class (corporate, high yield, ABS, bank capital, European emerging markets and leveraged loans) continues to meet ahead of the main committees to discuss rating actions, corporate events and issuance and to review transactions, pending decisions and the watch lists (see below). All investment committee and portfolio review committee meetings are minuted. The relative value strategies (curve paired, index, basis or capital structure trades), which require more reactivity, are managed in a more autonomous way.

Monitoring and Pricing

The portfolio managers can monitor portfolios on Finacle Treasury and MIS (transaction and position repository), which enable them to look at the investment limits of each category, including rating, industry, country and asset class exposures. Numerous reports have also been developed to present different exposures and sensitivity analysis and P&L analysis. All of this constitutes the basis for the various committees. Portfolios are marked-to-market daily for interest rate movements and weekly for spread movements. For monitoring purposes and client reporting, the P&L analysis has been enhanced to allow for breakdown analysis but attribution analysis could still be more refined when it comes to distinguishing asset class, leverage, spread duration and the impact of security bets relative to market indices.

Trading and Access to Markets

All transactions are carried out by portfolio managers/traders, executing deals on bonds, but also entering into repos and swap agreements to leverage portfolios and hedge foreign exchange and interest rate risks. ECM does not use electronic trading platforms. It benefits from wide access to the market, a function of its size and market presence. This facilitates the sourcing of less liquid instruments such as loans, for instance, at the peak of the market, characterised by fierce competition on the primary market. Similarly, the hiring of a dedicated loan trader in 2007 provides an edge in trading from a total return perspective in a volatile market.

Investment Administration

Reporting & Communication

Overall, ECM offers a great level of transparency to investors, notably in difficult times. Among other things, reports and positions are available via a secure website, GIPS compliance certification for all portfolios has been audited since 2002, composite performances are widely used in client reporting and several indices, truly representative of the credit markets, are disclosed against portfolios' performances (only for fixed-rate reference MTNs). Responsibility for the production of reporting documents is clearly defined and is independent of portfolio management. Client retention in 2008 has been largely achieved thanks to efforts of transparency, including exhaustive portfolio review with investors.

ECM provides a standard monthly reporting document to all investors, which summarises investment performance (vs. Euribor and different market indices), main breakdowns and details of the investment strategy. Performance analysis, historical evolutions and quantitative indicators are not disclosed but can be produced on demand. ECM is able to tailor reports to specific needs (IFRS, look through for Basel II compliance, etc) via its flexible and integrated reporting system (Knowledge Warehouse, see below). Performance analysis has been improved with a contribution breakdown by asset class split, not yet relative to market indexes. Overall, investor reporting appears of reasonably good quality, although giving more importance to qualitative, simple and static information.

Administration

Since 1999, ECM has accumulated a strong tailor-making experience, having launched funds, MTN programmes and segregated accounts under different jurisdictions. It has also worked with different investment banks to propose note programmes with principal protection and has developed liability-driven investment and various portable alpha solutions - this tailor-making capacity clearly being part of ECM's business proposal. Overall, ECM exhibits strong discipline in creating and maintaining products throughout their administrative life. The manager benefits from the focus on the credit asset class and on a limited number of investment vehicles. Nevertheless, a lot of efforts have been put into offering investors the possibility to transfer assets from the leveraged programmes into unleveraged ones via *in specie* redemptions. The concerned investors have to provide further capital, allowing unwinding of the repo financing. Since March 2008, when the first *in specie* redemption took place, EUR4bn has been transferred in this manner from ABS, leveraged loans and low investment grade diversified programmes. Operationally, ECM has had to deploy extensive resources, in a project mode, to set up the new programmes, define vertical slice of the portfolio – ensuring fair treatment of investors – and book the different transactions at the note and asset level. The transfer of assets has been conducted under the close supervision of the auditors.

Cash flow management is closely monitored to optimise the leverage policy through repo transactions, under the responsibility of three treasury traders. All new note issuance or subscription is integrated into the position-keeping systems by the dedicated investor servicing team and directly communicated to the trading desk for adequate hedging[2]. The resources in place (staff and systems) clearly offer security and scalability, which has been critical in the context of the recent deleveraging and asset transfer.

Operational procedures for transactions benefit from the quality of the IT platform (see below) and from the focus on just a few portfolios, service providers and types of instruments (essentially bonds, repos, interest rate swaps and credit derivatives). The operational platform is therefore capable of handling high volumes of transaction (50,000 trades in 2007, 68,000 in 2008, reflecting the intense trading activity stemming from the deleveraging and asset transfer). ECM manages 28 portfolios and deals with three custodians.

Valuations of portfolios and of notes are undertaken by a dedicated group within ECM but ultimately under the responsibility of the administrator (CACEIS Bank). The process is currently run twice a month as per offering circulars and is largely industrialised (around 90% of prices from data vendors, the rest directly from market makers), with numerous controls undertaken and automated communication to investors. Nevertheless, the recent liquidity stress has imposed further price checking by the product control and portfolio management teams. Compared to its peers, ECM is better equipped to capture and cross-check prices, being less dependent on generic public data providers. As already mentioned, a project is underway to mutualise valuation tasks and resources between ECM and CACEIS, without jeopardising controls and independence of valuation, which Fitch will carefully monitor.

[2] Investors can choose the currency and duration of the notes they purchase. Since the portfolios of assets are systematically hedged back to Euribor, proper hedges must be placed to obtain exposure to the desired currency and duration

Technology

Front Office

ECM has integrated all of its in-house systems, which can be accessed via the intranet. A well-staffed in-house system development team is continually enhancing the systems and the interfaces with Finacle Treasury, Front Arena and Wall Street Office, so that they meet ECM's needs. Finacle Treasury is used to monitor the interest and currency risks of the portfolios and is the central position-keeping tool for cash instruments as well as swaps and repos. Front Arena is used to monitor synthetic instruments such as credit default swaps and total return swaps. Wall Street Office is the portfolio management system for bank loans. An in-house management information system (MIS) is interfaced with these position-keeping applications and allows portfolio managers to analyse their portfolios in relation to the attributes of the underlying securities (rating, industry, country risk and asset class) on a real-time basis and to monitor investment limits. It is also the central repository for trade information and is connected with the P&L systems and reconciliations, as well as matching engines. The three booking systems are virtually transparent for users, the flexibility and user interface being provided by ad hoc proprietary developments.

ECM has developed its own order management system named Deal Order System, directly interfaced with the three position-keeping systems. Sophisticated allocation algorithms have been coded and are transparent to traders, while maintaining the audit trail. An additional module has been recently developed to address the specifics of relative value trading. Trading and affirmation systems have also been used since last year for currency (with Barclays) and for CDS (T Zero for affirmation within Bloomberg).

Middle and Back Office

Confirmations with counterparties are largely automated through Omgeo for bond trades, Markitwire for swaps, T-Zero feeding DTCC for credit derivatives and Trax2 for repos. The specifics of the loan markets prevent the use of electronic matching but ECM is involved in the market initiatives that are looking to address this issue. Order matching is therefore currently done via email and physical mail and subject to second level controls by the administrator. Reconciliation with prime brokers is done automatically and daily using Intellimatch for cash accounts and movements and securities. Intellimatch is in the process of being deployed for all reconciliations (for static security data recently, for example). Collateral reconciliation with market counterparties also benefits from the same degree of automation. Working predominantly with one sub-custodian, ECM can leverage on a dedicated live feed for the exchange of instructions, positions and cash reports and payments. Full reconciliation with the administrator (CAIBSL) of cash and security records is also performed twice a month by the department responsible for valuation. The platform in place, which leverages off all the systems available in the market, allows ECM to deal with in excess of 70,000 trades per year and 1,700 securities with a very high level of straight-through processing.

Data Management

All data are centralised in a few repositories and can be accessed via a dedicated reporting engine transparent to end users (Knowledge Warehouse) where numerous standard report templates are made available for external or internal purposes. As far as prices are concerned, ECM has set up a master source (CreditPrice), which collects data from providers and market counterparties. The control of this data is clearly under the responsibility of the product control department and all applications (valuation, P&L, reporting) are fed from it, without exception. Overall, the data structure appears extremely robust and well organised, ensuring consistency and scalability. Data are easily accessible to all staff through web-based applications and user friendly querying tools built into the MS Office environment.

Integration

All the applications are largely interfaced with limited manual intervention. All in-house applications are based on the same architecture and technology and therefore are easily connected to each other. Alongside Front Arena and Finacle Treasury, the external middle-office systems – DTCC, Swapswire, Omgeo, Intellimatch – are largely integrated in the infrastructure.

The manner in which the infrastructure and interfaces have been developed also makes them fairly independent from the booking systems, which eventually could be replaced by one single system. A project for an Enterprise Application Integration (EAI) layer is still underway to facilitate this interoperability.

IT Security

ECM has thorough and state-of-the-art business continuity plans, with extensive daily back-up procedures and alternative emergency sites, with desks fully operational and systems replicated. A full business continuity test is regularly carried out. All developments are carried out by a dedicated IT team and an IT committee has been set up to prioritise and supervise developments at the firm level. As mentioned, developments and specification design are to be outsourced to specialised providers. Fitch will continue to check that strategic decision-making and intellectual capital will continue to be maintained in-house. Overall, IT security appears of great quality.

The following managed portfolios of assets have been assigned Bond Fund Credit and Volatility Ratings and are subject to monthly surveillance by Fitch:

Asset Backed Europe S.A. (ABE)

Investment Grade Europe S.A. (IGE)

European Credit (Luxembourg) S.A. (ECL)

Diversified European Credit S.A. (DEC)

Corporate Credit (Europe) S.A. (CCE)

Pan European Credit S.A. (PEC)

ELBE sub-fund of European Credit Fund SICAV

Diversified Financials Europe S.A. (DFE)

Relative European Value SA (REV)

Appendix A

Key Personnel Staffing Summary[a]

	Background highlights
Steven Blakey (Founder & Chief Executive Officer) – Nine years with ECM	Steven Blakey was formerly head of the International Credit Business at Merrill Lynch. He developed the use of swaps and derivatives as a method of managing risk in a large dollar trading portfolio and was responsible for underwriting the first bonds to originate from Eastern and Central European countries. Mr. Blakey was also a key driver in the development of a fertile market for mid-investment grade securities several years before the inception of the single currency. He is a graduate of Bristol University and Barrister-at-Law.
Stephen Zinser (Founder & Chief Investment Officer) – Nine years with ECM	Stephen Zinser was responsible for overseeing European credit intensive new issues and asset-backed securities at Merrill Lynch in London. His experience covers European structured finance and asset securitisation, investment grade and high yield corporates and the Middle Eastern and Eastern European emerging markets. Before joining Merrill Lynch in 1993, Mr. Zinser was Director of Loan Syndications at Chase Investment Bank in London. He is a graduate of Cornell University.
Joe Biernat (Chief Investment Strategist) – Eight years with ECM	In 2000, Joe Biernat joined ECM from Paribas where he served as Global Head of Credit Research. Previously, he worked at Deutsche Bank and Merrill Lynch, as head of Credit Research specialising on the European markets. He is Chairman of The CFA Society of the UK. He holds an MBA from Rensselaer Polytechnic Institute, a BA from Gettysburg College and is a Chartered Financial Analyst.
Jeremy Wrigley (Chief Financial Officer) – Nine years with ECM	Jeremy Wrigley was CFO of Merrill Lynch's global credit business where he developed risk controls and reporting techniques for large dollar trading portfolios. He was also responsible for an operation settling large volumes across a wide variety of currencies and instruments. Mr. Wrigley is a chartered accountant and a graduate of Newcastle-on-Tyne University.

[a] Staffing summaries are of key senior employees at ECM
Source: ECM