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20 December 2017

Key figures for asset management in 2016 - Own funds of asset management companies

Own funds is a key indicator of the financial health and sustainability of asset management companies (AMCs). As at 31 December 2016, 28 AMCs, representing 4.8% of the French landscape(1), had a regulatory own funds shortfall. As at the same date, 70.2% of French AMCs had a own funds cushion of 30% or more above regulatory requirements. In this piece, we take a look at the own funds status and financial health of AMCs as at 31 December 2016.

Focus on AMCs with a own funds shortfall

Table 1: Number of AMCs with a own funds shortfall

At any given moment, AMCs must have own funds equal to at least their minimum regulatory threshold(3). As at 31 December 2016, 28 AMCs, representing 4.8% of the French landscape, had a regulatory own funds shortfall. The percentage of French AMCs with a regulatory own funds shortfall has been broadly stable over the last three years, ranging from 4.1% to 4.8%.

The main reasons for a own funds shortfall are:

- a small net profit or even a net loss registered by start-up AMCs and financially insecure AMCs;
- an increase in fixed overheads, and thus the minimum regulatory threshold, as a result of changes in the activities performed by the AMC and the related charges incurred.

Immediate remedial measures have been demanded of AMCs with a own funds shortfall. Most of them have carried out a capital increase, and some have introduced Tier 2 own funds (e.g. a subordinated loan).

Fewer AIFM-authorized AMCs with a own funds shortfall

There was a considerable drop between 2014 and 2016 in the share of AMCs with a own fund shortfall that are authorised to operate under the Alternative Investment Fund Managers (AIFM) Directive. In 2016, nearly a third of AMCs with a shortfall were AIFM-authorized, compared with 73.1% in 2014. These figures reflect how companies are now more aware of their own funds requirements, compliance with the additional own funds requirements under the AIFM Directive being one of the criteria for AIFM authorisation.

It should also be remembered that these AMCs are subject to additional own funds requirements in view of the unavoidable operational risks associated with managing AIFs. Indeed, article 317-2 of the AMF's General Regulation states that AMCs' additional own funds must be "of an amount sufficient to cover potential liability risks arising from professional negligence".

Own funds shortfall: a problem in particular for boutique firms and AMCs managing small amounts of assets

Table 2: Number of AMCs with a own funds shortfall in 2016 by AuM

In what is an extremely competitive environment, unavoidable fees result in some companies struggling to attract inflows, which in turn damages their net result and raises their minimum regulatory threshold, thereby causing a own funds shortfall. As at 31 December 2016, 71.4% of AMCs with a own funds shortfall had less than €150m in AuM.

Table 3: Number of AMCs with a own funds shortfall in 2016 by ownership structure

Another recent trend of note is the prevalence of boutique firms among AMCs with a own funds shortfall. Indeed, as at 31 December 2016, 78.6% of AMCs with a own funds shortfall

were boutique firms. On the contrary, there were no AMCs owned by a public entity, an insurance company or a cooperative that had a own funds shortfall as at the same date.

We can also observe that there is no real correlation between a own funds shortfall and the life cycle of an AMC, except for a greater risk in the first three years of business. The lowest percentage of AMCs with a own funds shortfall was among firms aged between three and ten years.

Focus on AMCs with a own funds surplus

Most AMCs have a significant own funds cushion

Table 4: Number of AMCs by own funds cushion

The AMF encourages AMCs to have a own funds surplus in accordance with their activities and associated risks (particularly operational/technical risk, legal and disciplinary risk, and reputational risk) in order to ensure financial stability. As at 31 December 2016, 70.2% of French AMCs had a own funds surplus of 30% or more above the minimum regulatory threshold. The majority of French AMCs therefore possess a robust financial structure that is conducive to business continuity and development.

Link between Financial result and own funds cushion: how do AMCs manage the investment of their own funds?

Table 5: Breakdown of AMCs by financial result and own funds cushion

In 2016, the AMF's General Regulation(5) and Position - Recommendation 2012-19 specified the conditions dictating how AMCs should invest their regulatory (i.e. corresponding to the minimum regulatory threshold) and surplus (i.e. the amount in excess of said minimum threshold) own funds. Own funds must be invested in liquid assets or assets that can easily be converted into cash in the short term and that do not include speculative positions.

However, an AMC may choose to invest some of its surplus own funds in assets that do not meet the above criteria, subject to compliance with the following conditions:

- the AMC has a own funds cushion of at least 30% above the minimum regulatory threshold that is invested in liquid assets or assets that can easily be converted into cash in the short term and that do not include speculative positions;

- any excess own funds above this cushion is invested in assets that do not create a material risk for the company's regulatory own funds.

As at 31 December 2016, of the AMCs that do not possess own funds greater than 130% of the regulatory requirement, 59 recorded a significantly negative or positive financial result, hinting at a own funds investment policy that might not comply with the aforementioned obligation to avoid speculative positions.

Tier 2 own funds accounts for only a tiny proportion of AMCs' total own funds

Tier 2 own funds is equatable to subordinated debt, such as a subordinated loan for example, provided it meets the eligibility criteria laid down in the Capital Requirements Regulation (CRR). In 2016, only 23 AMCs (just 3.9% of the French landscape) had Tier 2 own funds.

The cumulative amount of Tier 2 own funds declared by AMCs as at 31 December 2016 accounted for just 0.68% of their total own funds. AMF Position - Recommendation 2012-19 states that Tier 2 own funds cannot be more than one third of Tier own funds.

Factoring discretionary variable pay and bonuses into the calculation of fixed overheads

Table 6: Breakdown of AMCs by share of payroll expenses represented by variable pay and bonuses deducted when calculating fixed overheads

In 2016, 314 AMCs (or 53.5% of the French landscape) said they had deducted discretionary variable pay and bonuses when calculating fixed overheads in accordance with the CRR. These variable pay components and bonuses deducted from fixed overheads accounted for less than 30% of total 2016 payroll expense for 82% of AMCs.

New concept and methods

In April 2016, the AMF amended its General Regulation and Position - Recommendation 2012-19 to incorporate the new own funds requirements arising from the CRR, harmonise all applicable principles and specify the conditions under which AMCs can invest their own funds.

The presentation of the annual FRA and RAC reports for 2016 has evolved in order to adapt to these regulatory changes. However, analysis of the data provided by AMCs has revealed several misunderstandings on their part, relating not only to the new requirements under the CRR but also some older requirements.

Calculating own funds

The CRR makes provision for an extremely prudent own funds calculation method, which should be kept separate from the accounting calculation. Based on the accounting data in the financial statements, the CRR provides for the following adjustments:

- All dividends and charges, even if they are yet to be paid out, must be immediately deducted from the calculation of Tier 1 own funds;
- Intangible assets and the AMC's relevant holdings in financial sector entities must be deducted from the calculation of Tier 1 own funds;
- No treasury shares can be included in the calculation of Tier 1 own funds;
- Any net loss for the financial year must be immediately incorporated into the calculation of Tier 1 own funds;
- On the contrary, any interim profit can be included in the calculation of Tier 1 own funds only if it has been verified by the AMC's statutory auditor.

Calculating fixed overheads

The CRR outlines the method for calculating fixed overheads for the purpose of determining the minimum own funds requirement for AMCs.

In 2016, the method used to calculate fixed overheads changed from an additive approach (involving the addition of certain income statement items) to a deductive approach, whereby discretionary variable charges are deducted from total operating expenses so that only fixed and recurring costs are retained from one year to the next, thereby arriving at fixed overheads.

However, the list of items that can be deducted from total operating expenses under the CRR is somewhat vague, meaning that AMCs should conduct their own analysis on the income statement items that can be deducted in this way. If AMCs are uncertain as to whether an expense item is deductible, they should retain the item in the calculation of fixed overheads in line with the prudent approach advocated by the CRR.

Additional own funds requirements Under the AIFM Directive

AMCs subject to full application of the AIFM Directive must either have additional own funds equal to at least 0.01% of AIF AuM or take out professional indemnity insurance in accordance with the strict criteria laid down in the EU's Delegated Regulation of 19 December 2012. At present, insurance policies tend not to cover all the wide-ranging risks that should be covered under the terms of the aforementioned regulation. As such, a customised level of additional own funds has been adopted.

Since certain risks that the AMC is supposed to cover are unavoidable, if the value of the managed AIFs is small, a lump sum of at least €15,000 should be put aside for the AIFM Directive's additional own funds requirement. It should also be remembered that an AMC's additional own funds requirement under the AIFM Directive must be tailored and based on a formal analysis to be made available to the AMF.

Source

As part of its monitoring of the asset management sector, the AMF collects annual information forms from asset management companies (AMCs). These forms contain quantitative information about the assets managed and about the revenue and expenses associated with asset management in France. This information enables the Authorisation and Monitoring Department of the AMF's Asset Management Directorate to perform analyses. Although every care is taken when compiling and processing the data, due to the late receipt of some of the forms and possible data entry errors, the analyses may nevertheless contain inaccuracies.

(1) This landscape consists of 587 AMCs as at 31 December 2016.

(2) UCITS and AIFM below thresholds.

(3) The minimum regulatory threshold is set out in articles 312-3 and 317-2 of the AMF's General Regulation.

(4) A financial result is deemed to be insignificant if it is between -2% and +2% of own funds.


(5) Articles 312-4 and 317-3

(6) Payroll expenses consist of wages, salaries and social security charges as well as the variable component of employees' pay.

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