AUTORITÉ DES MARCHÉS FINANCIERS

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Key figures for asset management in 2017 - Own funds of asset management companies

Own funds are a key indicator of the financial health and sustainability of the business activity of asset management companies(1). In an encouraging sign, at 31 December 2017 just 22 asset management companies had an own funds shortfall relative to the applicable regulatory requirements, compared with 28 in 2016. At the same time, the number of asset management companies with a capital cushion at least 30% higher than the required level increased 5.1% between 2016 and 2017. This report overviews the own funds and financial health of French asset management companies at 31 December 2017.

Focus on management companies with insufficient own funds

Asset management companies must at all-time have own funds at least equal to their minimum regulatory threshold(2). At end-2017, 3.7% of the target population had an own funds shortfall, the lowest proportion in four years.

Own funds shortfalls can generally be attributed to low or negative net income on the part of management companies in the process of starting up their business activity and thus in a financially fragile period.

The management companies showing an insufficiency in own funds have implemented immediate corrective measures. The large majority carried out a capital increase and, to a lesser extent, introduced Tier 2 own funds (for example, subordinated debt or partner current account).

Own funds shortfall: a majority of asset management companies with low aum and boutique firms

At 31 December 2017, 73.9% of the management funds with an own funds shortfall had less than €150 million in assets under management. Against a backdrop of growing consolidation and heightened competition in the French asset management industry, more and more asset management companies are struggling to attract new investors and achieve sufficient AuM levels. They are also faced with an increase in structural expenses, reflected in a rise in the minimum regulatory threshold and, consequently, a delicate situation in terms of own funds.

Similarly, boutique firms account for a substantial share of management companies with an own funds shortfall. At 31 December 2017 the management companies with insufficient own funds were boutique firms and, to a lesser extent, subsidiaries of investment services providers. A full 4.5% of boutique firms and 4.9% of subsidiaries of investment services providers have insufficient own funds, compared with just 1% of companies that are subsidiaries of credit institutions.

A correlation also exists between the issue of insufficient own funds and the life cycle of the players concerned. The highest shortfall rates were observed at management companies in existence for less than three years (see Table 2).

Focus on management companies with surplus own funds

Owing to the risks stemming from some of their activities (including operational/technical risk, legal risk and the risk of sanctions), most asset management companies have a surplus of own funds sufficient to ensure their financial stability in their various business activities.

At 31 December 2017, 73.6% of asset management companies had a surplus of own funds at least 30% higher than their minimum regulatory threshold. In addition, the larger the cushion of own funds, the higher the share of asset management companies having generated a positive interest income. These figures reflect the robustness and sustainability of the French asset management sector.

The investment of own funds by management companies

The AMF General Regulation(3) and Position-Recommendation No. 2012-19 set out the conditions under which asset management companies are required to invest their regulatory and surplus capital. Regulatory capital must be invested in liquid assets or assets that can be easily converted into cash in the short term and that do not include speculative positions.

An asset management company may decide to invest part of its own funds in investment vehicles failing to comply with the abovementioned conditions but with no substantial risk on its regulatory capital. To do so, among the management company's surplus own funds, it must establish a capital cushion of at least 30% of the minimum regulatory threshold, also invested in liquid assets or assets that are easily convertible into cash in the short term and involving no speculative positions. The concept of the investment of own funds will be specified in the near future as part of Position-Recommendation No. 2012-19.

Modest increase in the share of tier 2 own funds in total own funds

As provided for by the Capital Requirements Regulation (CRR), Tier 2 own funds are equivalent to subordinated debt instruments, on the condition that they fulfil the eligibility conditions set out in the regulation. At end-2017, 18 (or 3.1%) of asset management companies, compared with 23 in 2016, had Tier 2 own funds.

At 31 December 2017 the total amount of own funds declared by management companies stood at €5.6 billion. The total amount of Tier 2 own funds accounted for a larger proportion of total own funds than in 2016 (0.87% in 2017, 0.68% in 2016). In this respect, AMF Position-Recommendation No. 2012-19 stipulates that Tier 2 own funds must not represent more than one-third of Tier 1 own funds.

Variable pay and bonuses taken into account on an antirely discretionary basis when calculating fixed overheads

In 2017, 318 asset management companies, or 54.2% of the target population, reported that they had deducted from the calculation of fixed overheads the amount of variable pay and bonuses on an entirely discretionary basis in accordance with the CRR. For 82.1% of asset management companies, the variable pay and bonuses deducted from the calculation of fixed overheads accounted for under 30% of the total amount of payroll expense in respect of FY 2017 (see Table 3).

Review of concepts and méthodologies

In April 2016 the AMF modified its General Regulation and Position-Recommendation No. 2012-19 so as to take account of the new requirements on own funds stemming from the CRR, to summarise all the applicable principles in this respect, and to specify the conditions

under which an asset management company may invest its own funds. Further methodological provisions will be added at the end of 2018 to Position-Recommendation No. 2012-19, resulting from the findings of the theme-related inspections carried out on the subject in 2018.

Calculating own funds

The CRR provides for a more prudent method of calculating the level of own funds, 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 asset management company'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 asset management companies.

The method used to calculate fixed overheads has 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 asset management companies 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

Asset management companies 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 Commission Delegated Regulation (EU) No. 231/2013 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, additional own funds must be constituted, the amount of which must be tailored and based on a formal analysis to be made available to the AMF.

(1) As was the case at end-2016, the target population comprises 587 asset management companies at 31 December 2017.
(2) The minimum regulatory threshold is defined in Articles 317-2 and 321-10 of the AMF General Regulation.
(3) Articles 317-3 and 321-11 of the AMF General Regulation.

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