AUTORITÉ DES MARCHÉS FINANCIERS

14 January 2020

Key figures for asset management in 2018 - Own funds of asset management companies

Own funds are a key indicator of the financial health and sustainability of the business activity of portfolio asset management companies. The total amount of own funds declared by asset management companies amounted to €5.5 billion at 31 December 2018.

On this same date, 26 of them[1] had an own funds shortfall relative to the applicable regulatory requirements, which was four more than in 2017. At the same time, the number of asset management companies with a capital buffer at least 30% higher than the required level dropped by 5.8% between 2017 and 2018. This report presents an overview of the own funds and financial health of French portfolio asset management companies at 31 December 2018.

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 portfolio asset management companies have a surplus of own funds sufficient to ensure their financial stability in the various business activities and to enable them to invest part of the own fund surplus in a more dynamic manner.

At 31 December 2018, 69% of portfolio asset management companies had an own fund surplus of at least 30% of their minimum regulatory threshold, compared with 74% in 2017.

Despite the erosion in the capitalisation of management companies linked to the market environment, these figures are the testimony of the robustness and sustainability of the French asset management sector.

Investment of own funds by portfolio asset management companies

For the record, the AMF General Regulation[(2)] and Position-Recommendation No. 2012-19 set out the conditions under which portfolio asset management companies are required to invest their regulatory and surplus capital. Regulatory capital must thus 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.

A portfolio asset management company may decide to invest part of its own funds in investment vehicles that do not comply with the above-mentioned conditions. However, this should not pose a substantial risk to its regulatory capital. To do so, it must create a capital buffer of at least 30% of the minimum regulatory threshold, from among its surplus own funds, also invested in liquid assets or assets that are easily convertible into cash in the short term and involving no speculative positions. AMF Position-Recommendation No. 2012-19 sets out the list of instruments that qualify as a representation of regulatory own funds (and where applicable, that correspond to the ratio of 130% of regulatory own funds defined above).

In this respect, in most cases, we observe a relatively strong correlation between the level of the capital buffer and positive financial results.

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

As provided for by the Capital Requirement Regulation (CRR), Tier 2 own funds are equivalent to subordinated debt instruments provided they fulfil the eligibility conditions set out in this European regulation. The end of 2018, 15 portfolio asset management companies, compared with 18 in 2017, had Tier 2 own funds. This represented 2.5% of the target population.

At 31 December 2018, the total amount of own funds declared by investment management companies stood at €5.5 billion, which was stable compared with 2017 (€5.6 billion). In 2018, the cumulative amount of Tier 2 own funds accounted for a smaller proportion of total own funds than in 2017 (0.80% and 0.87%). It must be recalled that AMF Position-Recommendation No°2012-19 specifies in this respect that Tier 2 own funds must not account for more than one-third of Tier 1 own funds.

At 31 December 2018, no investment management company had additional own funds. In accordance with the CRR, these own funds consist of capital that meet the criteria of articles 52 to 54 of this regulation and share premium account relative to these instruments.

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

In 2018, 324 portfolio asset management companies, representing 54.8% 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 85.5% of asset management companies, the variable pay and bonuses deducted from the calculation of fixed overheads accounted for less than 30% of the total amount of payroll expenses in respect of FY 2018 (see Table 1).

Table 1: Number of portfolio asset management companies according to the share of bonuses and variable pay relative to payroll expenses and according to the volume of assets under management in 2018

Focus on management companies with an own fund shortfall

Table 2: Number of asset management companies with an own fund shortfall between 2014 and 2018

Portfolio asset management companies must at all times have own funds at least equal to their minimum regulatory threshold[3]. At the end of 2018, 4.4% of the target population had an own funds shortfall. Although this proportion was up on 2017, it was relatively stable compared with recent years. The total amount of the own funds shortfall was nearly €15 million at the end of 2018.

It can be noted that own fund shortfalls can generally be attributed to low or negative net income recorded by management companies that are in the process of starting up their business activity and are thus financially fragile at this stage of their development.

Management companies with an own funds shortfall have been obliged to implement immediate corrective measures. The large majority of them therefore carried out a capital increase and, to a lesser extent, introduced Tier 2 own funds (for example subordinated debt).

Own funds shortfall: mostly asset management companies with low assets under management and boutique firms

At 31 December 2018, 65.4% of the portfolio management companies with own funds shortfalls had less than €150 million of assets under management compared with 73.9% in 2017. Against a backdrop of growing consolidation and heightened competition in the French asset management industry, the difficulties related to inflows faced by some players may result in an own fund shortfall. This is compounded by an increase in structural expenses, reflected in a rise in the minimum regulatory threshold and consequently in a tenuous situation in terms of own funds.

There was also a sharp increase in the proportion of management companies with an own funds shortfall with more than €500 million of assets under management: 8.7% in 2017 compared with 23.1% in 2018. For half of them, this increase was due to the spill-over effect of capital requirements as a result of external growth operations. The other cases are due to a poor adjustment of own funds to significantly higher overhead costs. Most of these defects were minor and were immediately corrected.

Boutique firms account for a substantial number management companies with an own funds shortfall. At 31 December 2018, the management companies with insufficient own funds were primarily boutique firms and, to a lesser extent, subsidiaries of investment services providers. The conclusions remain the same, if we refer to the total number of management companies: 5.1% of boutique firms and 4.9% of investment services providers had insufficient own funds compared with barely 2.1% of subsidiaries of credit institutions.

There is also a correlation between the issue of insufficient own funds and the life cycle of the players concerned. The highest shortfall rates were observed for management companies that had been in existence for less than three years (see Table 3).

Table 3: Number of investment management companies with an own funds shortfall according to years in operation in 2018

Review of concept and methodologies

In April 2016, the AMF amended its General Regulation and Position-Recommendation No. 2012-19 in order to take into account the new own fund requirements derived from the CRR, and 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. It must also be noted that further methodological provisions were added at the end of 2018 in this same Position-Recommendation, following the findings of the theme-based inspections carried out on the subject in 2018.

Calculating own funds

The CRR provides for a more prudent method for calculating own funds, which should be kept separate from the accounting calculation. In this respect, the CRR provides for following adjustments based on the accounting data in the financial statements:

- All foreseeable 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 funds;
- No own funds held in Tier 1 own funds may be included in the calculation of Tier 1 own funds;
- Any net loss for the current financial year must be taken immediately into account in the calculation of Tier 1 own funds;
- Conversely, any interim profit can be included in the calculation of Tier 1 own funds only if it has been verified by the management company’s statutory.

Calculating fixed overheads

Today, the CRR defines the method for calculating fixed overheads in order to determine the regulatory minimum threshold applicable to asset management companies.

The method used in calculating fixed overheads has changed from an additive approach (involving addition of certain income statement items) to a deductive approach whereby non-recurring discretionary variable charges are deducted from recurring expenses from one year to another, thereby arriving at fixed overheads.

However, the CRR’s list of items that can be deducted from total operating expenses is somewhat vague, which means that portfolio asset management companies have to conduct their own analysis on the income statement items that can be deducted in this way. If AMCs are not sure whether an expense item is deductible, the AMF encourages them to keep these expenses in their calculation of fixed overheads, in line with the prudent approach advocated by the CRR.

Additional own funds requirements under the AIFM Directive

Portfolio 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 assets under management or take out professional indemnity insurance in accordance with the strict criteria laid down in the o/w AMCs with AIFM approval Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012. However, to date at present, insurance policies tend not to cover the entire scope of the rather 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] The target population consisted of 591 portfolio asset management companies at 31 December 2018.

[2] Articles 317-3 and 321-11 of the AMF General Regulation

[3] The minimum regulatory threshold is defined in Articles 317-2 and 321-10 of the AMF General Regulation.

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