Johnston, Shultz and Oshunkentan in Westlaw Today: Managing Complexity — Key Structuring and Diligence Considerations for Management Fee Lines

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Haynes Boone Attorneys **Tim Johnston**, **Brent Shultz** and **Karina Oshunkentan** co-authored an article for *Westlaw Today* examining the growing use of management fee lines in fund finance and the key structuring, collateral and diligence considerations lenders and private equity sponsors should address as these facilities become increasingly sophisticated.

Read an excerpt below:

A management company is the vehicle that manages the operations and investment strategies of the investment funds and houses the employees of the sponsor.

Unlike investment funds that require capital to make investments, management companies require capital to pay for operational expenses and, in cases in which the sponsor has some equity participation in these funds, to fund capital calls of the sponsor or GP commitments. A management fee line is typically documented as a revolving working capital facility.

In this structure, the management company serves as the borrower, with the facility collateralized by the assets of the management company (importantly, the contractual rights to receive management fees from underlying funds). The facility is underwritten based on the cash flows represented by these management fees, which are normally a percentage of managed assets and paid by the managed funds.

The facility may involve multiple entities where fees aggregate up through the management structure. The borrower may be an upper-tier entity, with lower-tier relying advisors or other entities serving as co-borrowers or secured guarantors. Facility size will vary depending on the size of the sponsor, requiring diligence to understand the amount of management fees the management company is entitled to collect.

In addition to traditional management fees, the management company or an affiliate may also receive other fees, including incentive or performance fees and transaction fees that offset against or are payable in addition to management fees.

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Checklist: Key considerations for management fee lines

Structure and parties

• Identify the management company borrower and all intermediate entities in the fee flow

• Determine whether lower-tier advisors or affiliates need to be joined as co-borrowers, guarantors, or pledgors

• Map the full management company structure chart and the path of fee payments from fund to borrower Collateral and security

• Confirm no restrictions on the pledge of management agreements or fees; obtain necessary consents

• Obtain acknowledgment and consent from underlying funds, confirming the pledge and agreeing to direct fee payments into the pledged account

• Obtain an all-asset lien, with primary focus on contractual rights to management fees (accounts) and management agreements (general intangibles)

• Perfect security interest via UCC-1 filing on accounts and general intangibles

• Require a deposit account control agreement over the account into which management fees are paid

• Confirm whether equity interests in investment funds form part of the collateral; if so, ensure proper creation and perfection (including foreign jurisdiction counsel if needed)

Borrowing base and financial terms

• Structure borrowing base as the lesser of anticipated fees and fees collected over the prior period

• Remove projected fees from the borrowing base if payment is disrupted (fund insolvency, contractual suspension or withholding rights, subscription line default restrictions)

• Consider appropriate advance rate given the contractual nature of management fees and investor credit quality

• Include financial covenants such as minimum management fees, minimum AUM, leverage, or net worth

• Include mandatory prepayment mechanics (e.g., percentage of fees received applied to repayment, or annual clean-down)

Reporting and ongoing covenants

• Require compliance certificates delivered shortly after each fee payment date

• Restrict amendments to management agreements, fund LPAs, or side letters that could waive, reduce, or postpone fees

• Require notice of key fund-level events (e.g., investor failure to fund a capital call)

• Covenant requiring all management fees to be paid directly into the pledged deposit account

Due diligence

• *Verify the contractual obligation to pay fees and the entity entitled to receive them via management agreements and LPAs*

• *Confirm frequency and contractual timing of fee payments (quarterly, semi-annual, etc.)*

• *Assess fee structure mechanics, including offsets, reductions, waivers, and performance-based components*

• *Request and review investor side letters for fee discount or waiver arrangements*

• *Evaluate historical financials for actual fees received versus projected fees*

• *Identify existing fund-level credit facilities (subscription lines, NAV lines, hybrid facilities) that may restrict or suspend management fee payments during a default*

• *Consider regulatory implications of pledging management agreements and fees; engage regulatory and fund counsel as appropriate*

To read the full article from *Westlaw Today*, click **here**.