

Pauline Modjeski of **Horizon** discusses how, in the wake of Bear Stearns and Lehman Brothers, the industry is increasingly aware of the importance of cash management

The importance of cash control



Pauline Modjeski is president of **Horizon Cash Management LLC**. She has been with Horizon since its inception in 1991. Prior to being named president in 2008, she directed the firm's financial operations and oversaw all compliance and regulatory matters. In 2008, she was named one of 20 'Rising Stars in Hedge Funds'.

As the hedge fund market continues to rally and the outlook for the future of the industry becomes evermore optimistic, fund managers – and their investors – are today placing more emphasis on transparency and liquidity than ever before. As a result, the importance of managing cash to best effect is becoming an increasingly prominent one.

With industry awareness of the importance of cash management continuing to grow, Pauline Modjeski, president of Horizon Cash Management, explains why choosing the right cash management specialist is now more important than ever and why active, rather than passive, management of cash reserves provides benefits that are particularly meaningful to fund managers in today's low interest rate environment.

HFMWeek (HFM): Why is hiring a cash management specialist important to fund managers?

Pauline Modjeski (PM): It's important to remember – yet often overlooked – that at any given time, a significant proportion of a fund's assets will be held in cash. Depending on the fund's strategy, cash reserves can represent anywhere from 20-80% of total assets under management. For larger funds, cash can often be tens or hundreds of millions of dollars. Cash matters. As such, in the same way that a fund manager would hire an administrator to calculate the fund's NAV or a lawyer to put together the fund's offering document, they should also make certain that they have a specialist looking after their cash balances. Not only is it smart to retain an outside expert to manage cash, organisations such as the MFA (Managed Funds Association) and the President's Working Group (PWG) have endorsed the use of objective, non-conflicted outside firms managing a fund's cash reserves as a best practice for fund managers.

HFM: What should a fund manager look for when hiring a cash manager?

PM: As in any instance in which you contract with an outside party to provide a vital service, it's important to identify providers with demonstrated expertise in their field, proven leadership and an established track record. In addition, we believe the main factors to consider when searching for a cash management specialist are best summed by what is sometimes referred to as

TLC: transparency, liquidity and control.

In terms of transparency, the questions you need to ask are: Do you know where your cash is being invested? Do you know where the securities are being held? Do you receive daily reports on holdings, yield and money movements, or do you have to wait until end-of-month or end-of-quarter to learn where your monies have been invested?

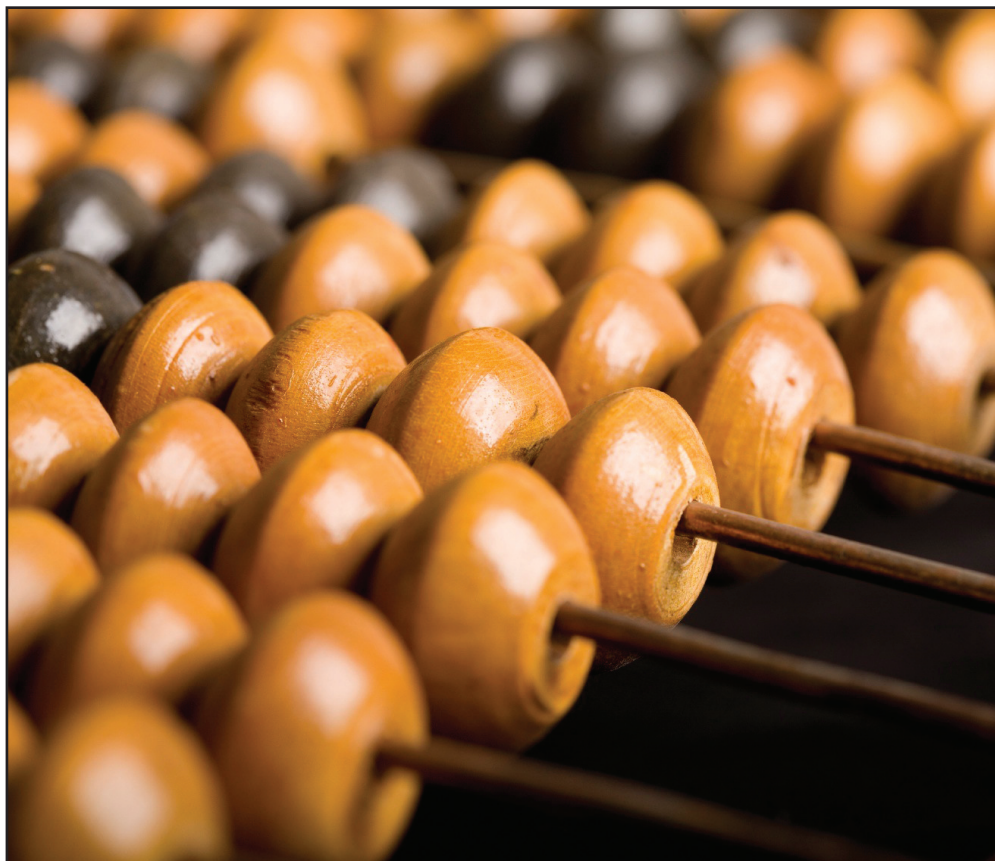
Liquidity is a hugely important issue to fund managers and their investors. Over the past year and a half, we've seen countless examples of what happens when liquidity dries up and a fund's cash assets are frozen. For fund managers, cash reserves exist for a variety of reasons: to cover operational expenses, to meet redemptions and to serve as trading capital. To ensure ready liquidity, managers should have an outside cash manager that provides separately managed accounts, rather than commingled funds – and those monies need to be custodially protected. It's simply unacceptable not to have ready liquidity. Today, more than ever, it's increasingly clear that liquidity is of the utmost importance.

With regard to control, fund managers should know – and are being paid to know – exactly what cash balances are being invested in, and exactly how much control they have over those investments. In the case of a separately managed account, fund managers can dictate their specific – and often unique – investment parameters to the advisor who is managing the cash. This advisor will, in turn, execute the investments that they see fit best within those parameters. Obviously, in a passive cash management vehicle, such as a money market fund, that individual control isn't possible.

HFM: Can cash reserves still generate returns in a near-zero interest rate environment?

PM: Absolutely. What is important to remember is that whether you are in a very low interest rate environment or a high interest rate environment, any additional basis point that you earn will be added to the fund's bottom line; for example, 25 basis points on \$100m is an extra \$250,000. Consequently, while it is very easy in this low interest rate environment to say that cash reserves are not going to make a difference, any basis points earned on balances which are essentially just sitting there are going to be beneficial to the fund. In many instances,

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this could make the difference between a losing and winning year for the fund manager.

HFM: What resources exist for finding the right cash management specialist?

PM: Today, a large number of fund managers perform due diligence on cash managers and cash holdings. Over the years, we at Horizon have also observed increased attention coming from institutional investors, who, upon deciding to make an allocation to a fund, want to talk not only to the fund manager and to the administrator, but also to the cash manager. We've observed, however, that many of the questions being asked by the investor during the due diligence process aren't particularly applicable to a cash manager. We'd often get a due diligence guide that was perhaps better suited to a prime broker, custodian or an administrator. In response to this, we created a due diligence guide to cash management which includes over 50 questions that fund managers and investors ought to ask of whomever is charged with the management of a fund's cash reserves. Examples of these questions include: 'Does the client control the investment parameters?', 'Are assets managed in separate portfolios or in a pooled investment vehicle?' and 'Does the firm provide 100% transparency on all client investments? Is this transparency provided daily?' It's hard to find the best resource for cash management if you're not asking the right questions.

HFM: Do you think hedge fund managers, generally speaking, are aware of the importance of choosing the right cash management specialist?

PM: Definitely. In the past, many fund managers relied on passive investment vehicles – leaving money with prime brokers, putting it in a money market fund, and so forth. In the wake of Bear Stearns and Lehman Brothers, there is certainly now a greater importance being placed on how cash balances are managed, what they are being invested in and the level of managers' access to liquidity. Looking ahead, I believe that investors will continue to demand that cash be managed actively and to best effect. Investors have a tremendous amount of influence over how the funds they invest in are managed. This is especially true with cash. Fund managers are always going to be guided by their investors.

HFM: What makes Horizon Cash Management stand out from the competition?

PM: First off, we have nearly 20 years' experience in managing cash reserves for funds and institutional investors. There aren't many who have focused solely on cash management and have worked dedicatedly with hedge funds and managed futures funds over that time frame. We're also unique in that, from the beginning, we've offered separately managed accounts (rather than commingled funds), custody protection for all assets, custom-designed portfolios for each client (rather than some off-the-shelf offering) and 100% daily transparency. It's gratifying to see that many of the best practices that institutional investors and industry groups are now beginning to embrace, Horizon has been offering since we opened our doors. ■