Worried hedge funds move cash

NEWS ANALYSIS

Concern about creditworthiness of prime brokers is behind trend, finds **Sophia Grene**

Nervous hedge funds are moving cash away from their prime brokers and into AAA-rated institutional money market funds as they try to limit the risk of being unable to access their money.

"We're talking to hedge funds at the moment who are all very concerned about the creditworthiness of their prime brokers," said Chris Oulton, chief executive of Prime Rate Capital. "They need to know that the money is available when they need it."

Barclays Global Investors, which manages more than £130bn (€164bn, $260bn) in cash assets for clients, is seeing a similar trend. "We've definitely seen an increased interest from hedge funds, both current clients and new," said James Finch, BGI's head of liquidity sales in Europe.

"They are either increasing their activity in cash or redeploying cash from elsewhere."

Hedge funds are likely to hold quite large proportions of their assets as cash, explained Mr Finch. "If you think about hedge fund strategies, whether they are performing well or not, there's always a demand for cash.

"It could just be to manage subscriptions and redemptions, but the other side is that they need the cash to play the market. Then there is also their need to hold margin or collateral."

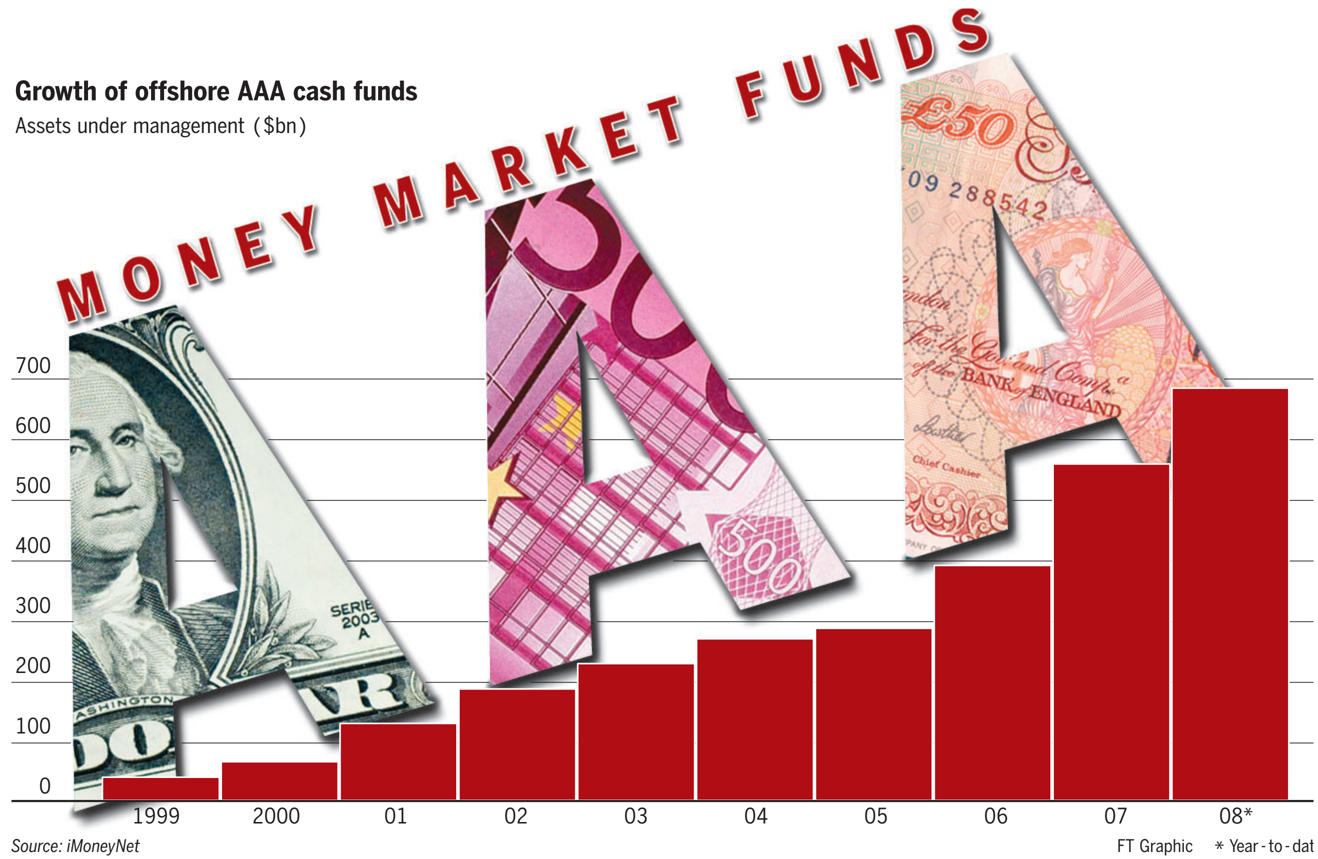
Prime brokers have historically provided cash management services to hedge funds along with a package of services including clearing and financing. If all the cash is with a single prime broker, this presents a counter-party risk to the hedge fund. Recently hedge funds have been looking to diversify this risk, initially by spreading their assets across multiple prime brokers and now by putting some into AAA-rated money market funds. "That's definitely a trend we've been seeing," agreed Mr Finch, "and it's accelerated in current market conditions".

AAA-rated money market funds invest in a variety of short-term debt instruments, according to certain credit and duration parameters. With an emphasis on capital preservation and liquidity, they generally offer a higher return than bank deposits with relatively low risk.

Difficult market conditions are driving huge inflows to money market funds from all sorts of investors, not just hedge funds, Mr Finch pointed out. Already this year, the assets in offshore money market funds based in Dublin and Luxembourg have grown by more than 20 per cent to $685bn, according to figures from iMoneynet.

"Hedge funds are a fairly interesting part of that flow," according to Mr Finch. "As you would see in any kind of portfolio, in times of stress, there's increased allocation to cash."

"We're talking to a number of the largest hedge funds, who have all got cash management and credit risk concerns," said Mr Oulton. Prime Rate Capital launched its first fund today, having been established last year.



Not all money market fund managers are seeing increased interest from hedge funds. Ownership of a prime broking franchise may be the differentiator: Morgan Stanley Investment Managers has not heard from hedge funds looking to move away from prime brokers, while JPMorgan Asset Management is similarly unexcited.

"We've actually had hedge funds as clients for a while now," said Kathleen Hughes, global head of liquidity sales at JPMorgan Asset Management, which manages $118bn in money market funds. "We haven't seen any change in behaviour." JPMorgan Chase has not yet completed the acquisition of Bear Sterns, which has a substantial prime brokerage.

Donald Aiken, head of liquidity funds at Morgan Stanley, is also chairman of the Institutional Money Market Funds Association.

"From the Morgan Stanley perspective, prime broking and money market funds are actually very similar credit risks.

"We're seeing no unusual movement in money market funds," he commented.