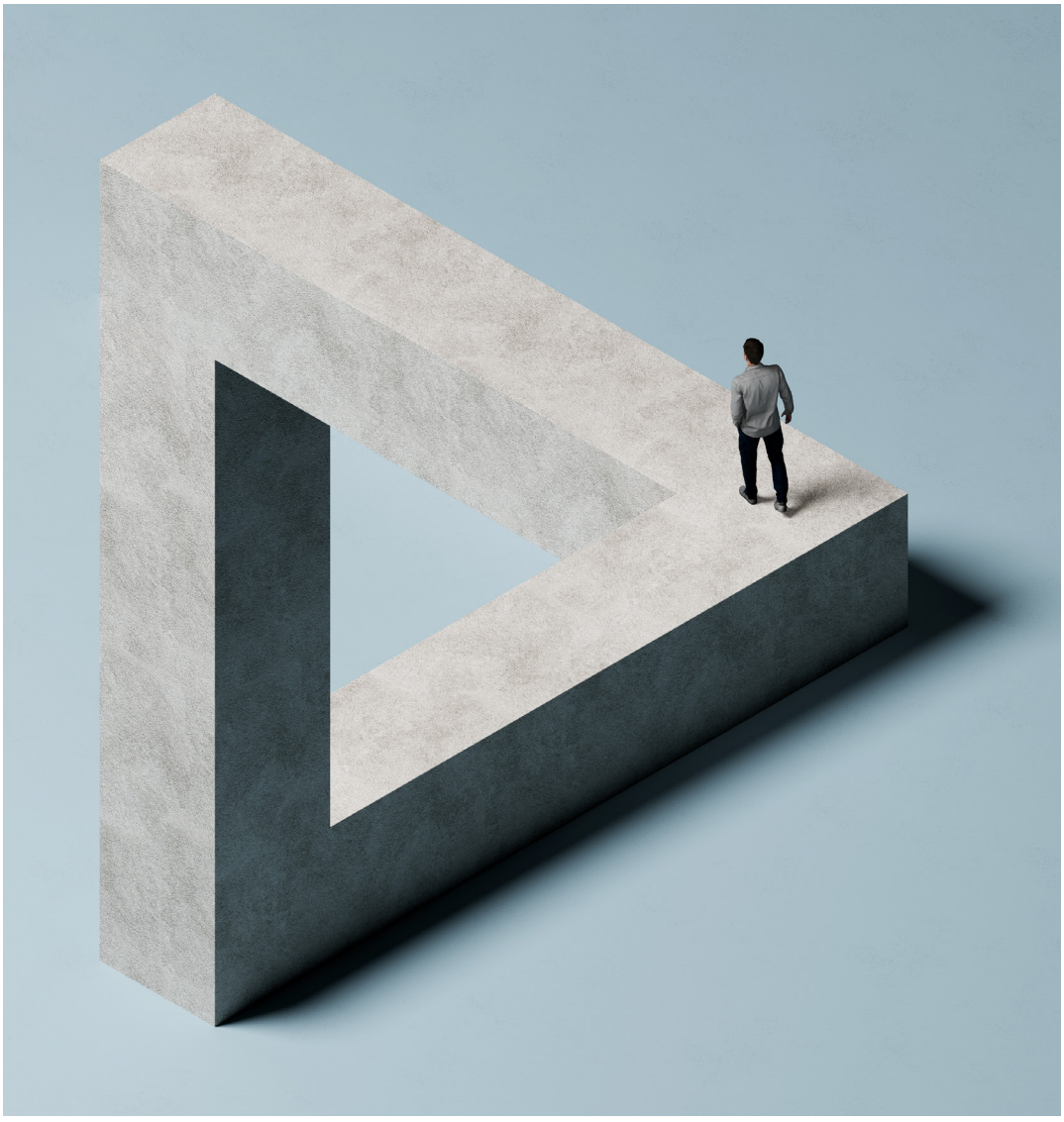
VALIDUS



THE LIQUIDITY PARADOX

Hedging in open-ended fund structures

PRIVATE EQUITY WIRE®

KEY TAKEAWAYS

PE hedges differently:
PE firms leave space for upside in their hedging instruments.

The paradox:
Hedging tenors for PE funds tend to be longer dated while more credit funds use shorter tenors compared to other asset classes.

Evergreen liquidity:
Most PE funds with shorter-dated hedging tenors are open-ended.

Hedging is a critical tool for funds that raise and deploy capital globally to protect themselves from currency risk. Against a volatile macroeconomic backdrop and an increasingly challenging fundraising and exit environment, that imperative is only growing.

Open-ended structures have emerged as the vehicle of choice for GPs seeking wider investor access, periodic liquidity provisions and more stable long-term capital. Without a fixed term, they allow continuous fundraising and longer deployment horizons, meeting demand that closed-ended funds weren't built to serve.

But with perpetual capital comes perpetual complexity: Redemption cycles, tighter bank credit appetite and the need for active liquidity management create a materially different operating environment. As Validus data shows, how funds hedge in response isn't just a function of strategy, but also of structure.

INSIDE THE INSTRUMENT

85%
Of short-dated PE hedges are for open-ended funds

36%
Of PE funds using options/ structured products to hedge

For the majority of private asset classes, across secondaries, infrastructure, real estate and private credit, all or just short of all funds employ forwards as hedging instruments (see Figure 1). The steady yield and, in some cases, narrower return margins in these asset classes make forwards a cost-effective way to minimise FX risk.

Private equity firms, on the other hand, seem willing to incur a higher cost to leave room for upside potential – 36% of these funds using option-based or structured products to hedge their FX risk.

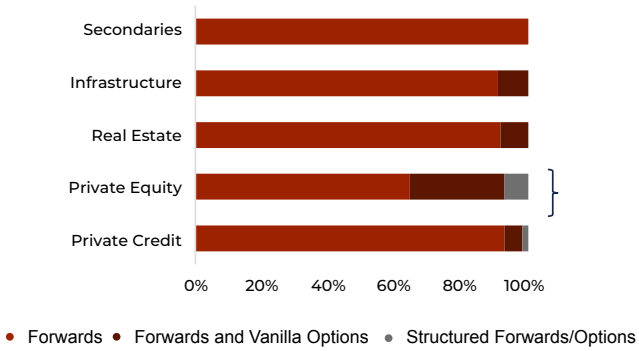
"While options can incur an explicit premium compared with the implicit cost embedded into forwards, they can be a valuable tool for maintaining upside participation and importantly, for mitigating liquidity risk, particularly when hedging illiquid asset classes such as private equity," says Nirvani Sookdeo, Global Head of Risk Advisory at Validus.

TENOR TRACKING

The duration, yield and upside potential of asset classes have a similar bearing on the hedging tenor – with more credit funds favouring shorter-dated tenors to cover ongoing liquidity risk, while other asset classes opt for longer dated programmes (see Figure 2).

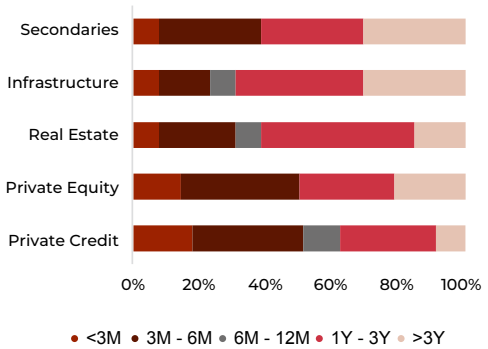
In theory, private equity funds should align with the latter category, but the additional considerations that come with open-ended fund structures – now accounting for a significant share of new launches – are pushing over 50% of private equity funds towards shorter-dated hedging programmes.

FIGURE 1 - Preferred hedging instrument by asset class



Source: Validus Data

FIGURE 2 - Hedging tenor by asset class



Source: Validus Data

*Structured products/options largely used as a liquidity risk management tool for PE funds

Indeed, of all the funds that use short-dated forwards, more than 85% are open-ended funds (see Figure 3.1). And splitting a different way, Private Equity Wire® data confirms that 50% of all open-ended funds places their hedging tenor for liquidity risk as shorter than 12 months (see Figure 3.2).

The conundrum for firms is that a shorter-dated hedging tenor, while a good safeguard against redemptions in open-ended funds, in itself poses liquidity risks due to ongoing settlements. This is in addition to being highly complex and operationally intensive – adding onto the already significant operational demands such as liquidity gating and valuation mechanisms that are unique to open-ended fund structures.

Firms have a number of options at their disposal to ensure the liquidity risk on both sides is managed in an operationally feasible manner.

Sookdeo says: "The starting point is the hedging strategy itself, as this directly drives potential liquidity requirements arising from the hedge. Managers should assess the underlying asset profile alongside the investor subscription/redemption cycle and any gating mechanisms to design an appropriate hedging approach - particularly with respect to hedge tenor - that aligns with the vehicle's expected cash flow dynamics.

Right-sizing liquidity buffers is a further critical component of programme design. This may involve holding dedicated cash reserves and/or allocating a portion of the portfolio to liquid assets to mitigate potential liquidity mismatches.

Determining the appropriate size of these liquidity pools requires modelling potential worst-case cash outflows that could arise from the selected hedging strategy – often using a Value at Risk analysis."

Once implemented, the hedging programme should be supported by a robust liquidity risk monitoring framework. Managers need to continuously quantify potential adverse settlements on their live hedging programme and incorporate these into forward-looking liquidity planning. This enables a clearly defined liquidity waterfall, identifying sources of cash available to meet potential hedge related outflows. These typical sources of liquidity can include the cash buffers, asset income, credit facilities and net subscriptions – which would be reliant on timing.

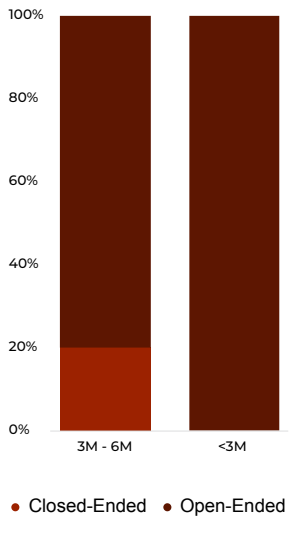
Sookdeo concludes: "Ultimately, effective hedging for open-ended funds is complex – requiring a keen focus on liquidity management. Success depends on proactively aligning hedge design, buffer sizing and monitoring frameworks from inception, rather than responding reactively when settlement stress occurs."

In a challenging fundraising and exit environment, GPs should continue to adopt innovative structures to improve liquidity yet maintain a clear-eyed view of the potential for operational drag.

FIGURE 3.1 - PE Hedging tenor:

Open-ended vs. Closed-ended funds.

Most funds with shorter-dated hedging tenors are open-ended

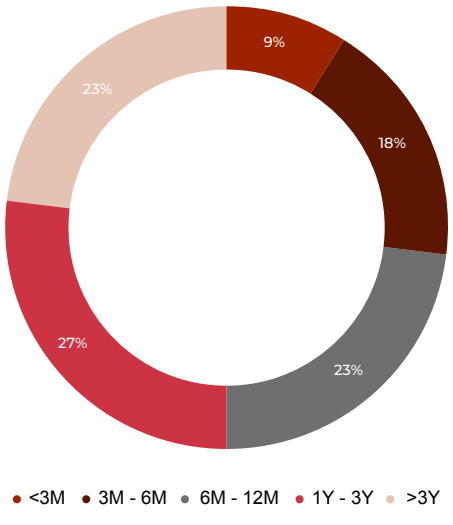


Source: Validus Data

FIGURE 3.2 - PE Hedging tenor:

Open-ended funds.

Half of all open-ended funds have shorter-dated hedging programmes



Source: Private Equity Wire® Q1 2026 Reader Survey

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