

An aerial photograph of a winding river flowing through a dense, lush green forest. The sun is low on the horizon, casting a warm, golden glow over the scene. The river reflects the light, and the surrounding forest is thick with trees. The overall mood is serene and natural.

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WHITE PAPER

What GPs Need to Know: Managing Open-Ended Funds

In Brief

- ❑ **Open-ended fund structures demand operational infrastructure that can keep pace. From continuous capital flows, to navigating FX exposures and liquidity; with perpetual capital comes perpetual complexity.**

Key Learnings

- Continuous subscription and redemption activity creates dynamic, unpredictable shifts in hedge exposure that require active, ongoing rebalancing
- FX risk divides into two distinct problems: funding risk pre-deployment and performance risk post-deployment, with the latter being more relevant for open-ended fund structures
- Bank credit appetite is structurally lower for open-ended funds. Expect a narrower counterparty pool and pressure toward shorter-dated hedge tenors
- Differing approaches to CSA terms and ATEs, often a function of the tenor considerations that drive most credit diligence by counterparties
- Liquidity reserves, historic rate rollovers, facility draws, and product selection must be carefully orchestrated – approaches differ from traditional closed-end structures

This primer provides a clear-eyed view of how General Partners (GPs) can take advantage of what open-ended structures offer while managing the unique complexities they introduce.





Introduction:

A Hedging Primer for Perpetual Capital

Against the backdrop of longer hold periods, higher competition for LPs and tighter credit, GPs are increasingly turning to open-ended and semi-liquid fund structures. This shift brings with it significant opportunities, but also continuous subscription and redemption cycles, compounding FX risk and liquidity management.

This is a primer for GPs considering the FX risks and liquidity dynamics of launching open-ended structures. We outline how currency fluctuations can impact fund performance and how hedge program design differs between open-ended and traditional closed-end fund structures.

Open-Ended Funds – A Primer

Open-ended funds are not a new phenomenon. Traditionally, open-ended funds have been the preferred structure for liquid, publicly available investment products (e.g., mutual funds, ETFs) and hedge funds.

Yet, as open-ended funds have grown dramatically - reportedly by 30% in the last year alone - private markets are coming to the realization that with perpetual capital comes perpetual complexity.

An open-ended fund does not have a fixed term and continues to operate until it is terminated. In contrast, a closed-end fund has a fixed term and has historically been the more common structure for private capital funds (e.g., private equity, credit, infrastructure). While closed-end funds have defined time periods to fundraise, deploy capital, and ultimately harvest investments, open-ended funds can continuously fundraise and invest without any pre-determined time constraints. In addition, while Limited Partners (LPs) are generally locked in for the duration of a closed-end fund, open-ended fund LPs are able to redeem their investment on a periodic basis, subject to certain restrictions.

- ① Given their long-term nature, open-ended fund offerings were originally focused on more illiquid, long-maturity, income-generating assets, such as core infrastructure and real estate. Open-ended funds are now increasingly being used to invest in a broader set of strategies, ideally with assets that have stable cash flows and are easier to value (e.g., private credit).



The Growth of Open-Ended Funds

The use of open-ended funds in private markets has expanded significantly in recent years, even as closed-end structures still dominate. The increasing adoption of open-ended structures can be attributed to the following factors:

Natural Evolution of Fund Technology / Market Sophistication

Closed-end fund structures have dominated the private markets. As markets continually evolve and mature, GPs can adjust their offerings and cater to specific LP needs.

Fundraising Goals

Open-ended funds can provide an attractive opportunity for GPs to raise incremental capital. As mature GP businesses look to diversify their LP base and deepen existing relationships, open-ended strategies have proven to be an efficient solution.

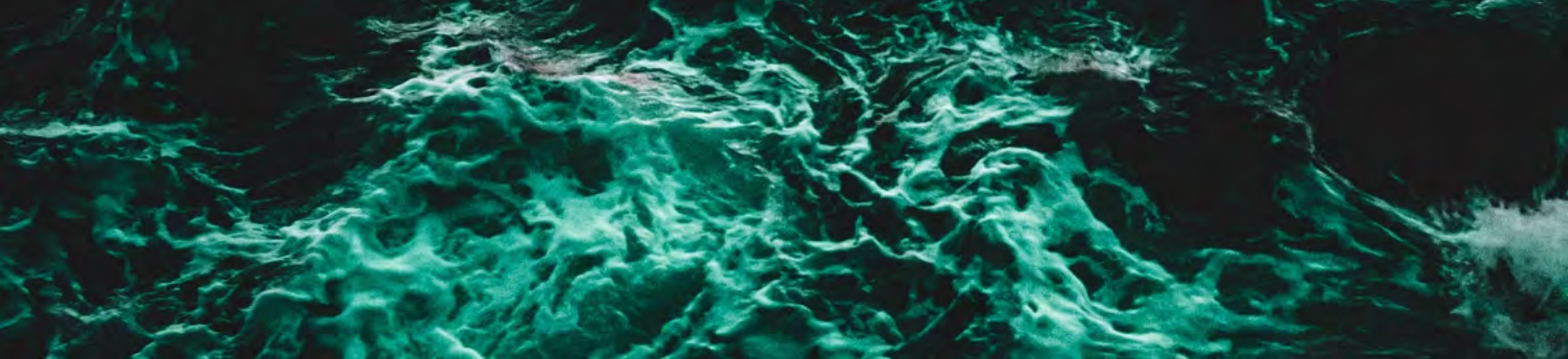
Retail Investor Channel

An increased interest in attracting retail investors to private market funds has accelerated the focus on open-ended vehicles which offer the convenience of liquidity via regular redemption periods.

Flexibility on Asset Hold Periods

As markets have recently dealt with extended periods of reduced deal activity and valuation gaps, open-ended fund structures have become more attractive as they are not bound by finite fund tenors.





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How Open-Ended Funds are Different

The structural differences between open-ended and closed-end funds go beyond fund mechanics – they reshape how capital is raised, deployed, and returned to investors at every stage of a fund's life. In an open-ended fund, LPs subscribe and redeem at the prevailing NAV, capital is called in the order commitments are received, and there is no fixed term constraining when investments must be made or exited.

For GPs, this means continuous fundraising flexibility and longer deployment horizons. For LPs, it means periodic liquidity, but also a different risk calculus; with redemption restrictions, lock-up periods, and NAV-based pricing replacing the fixed timelines and blind-pool dynamics of traditional closed-end structures.

Figure 1 below distills these differences across the four dimensions that matter most when evaluating fund structure: subscription mechanics, maturity, liquidity, and market price.

	OPEN-ENDED FUNDS	CLOSED-ENDED FUNDS
 SUBSCRIPTION >	Units continuously offered for sale at specified times (e.g., quarterly) with any specified duration. Different tranches of LPs given various subscription dates.	Commitments made during finite fundraising period (e.g., 12-24 months) with a specified duration per the fund documentation. LP base is fixed at the fund's final close.
 MATURITY >	No fixed fund life.	Fixed fund life set out in fund documentation.
 LIQUIDITY >	Shares can be redeemed at specified times (e.g., quarterly) subject to fund restrictions.	No liquid secondary market. Potential for negotiated transfers or secondary transaction subject to fund restrictions.
 MARKET PRICE >	Subscription/redemption value is based on the ongoing NAV.	Periodic NAV values are shared with LPs, but any transfer or secondary transaction would be highly negotiated.

Figure 1

Benefits of Open-Ended Funds

- **No Fixed Fund Life:** Closed-end funds are constrained by a fixed term, which may force GPs to liquidate under less than favorable market conditions. In contrast, open-ended funds can opportunistically monetize investments (providing liquidity to LPs) and deploy capital to acquire a more diverse asset portfolio over the indefinite lifespan of the fund.
- **More Efficient Fundraising:** Open-ended funds can continually fundraise, allowing some of the expenses associated with formation and fundraising to be spread over a longer timeframe (e.g., legal costs for entity formation and drafting of governance documents). While there could be additional costs for open-ended funds (e.g., feeder fund or share class formation, tax/accounting-related restructuring), a net positive benefit is still expected to accrue to the GP.
- **Long-Term Investment Horizons:** Open-ended funds are often attractive for large, institutional investors with similarly long-term investment horizons (e.g., pension funds, insurance). The ability to hold assets for longer can reduce churn and the associated transaction costs, as well as lock in longer-term returns via stable, income-generating assets.
- **Increased Liquidity:** Open-ended funds offer LPs greater liquidity compared to closed-end funds, as LPs can redeem their shares on a regular basis (subject to certain restrictions). Closed-end fund LPs can only exit their commitment early in certain circumstances (negotiated transfers/secondary transactions approved by the GP), or other specifically defined legal/regulatory reasons.
- **Blind Pool Risk:** There will always be blind pool risk inherent in subscribing to a closed-end vehicle (unless an LP comes into the fund via a secondary transaction). In a seasoned open-ended fund, the existing portfolio of assets can temper blind pool risk.
- **Managing the J-Curve:** Open-ended funds charge fees on invested capital (rather than commitments) and reduce blind pool risk for LPs (as noted above). This allows open-ended funds to manage the J-curve effect that is prevalent in closed-end funds.

Drawbacks of Open-Ended Funds

- **Operational complexity** – Perpetual capital introduces ongoing subscription/redemption cycles, tighter bank credit terms, and heightened liquidity management hurdles. GPs need to manage the periodic cash inflow/outflow as well as the unique economics for each LP (e.g., entry point, re-investment mechanics, fee calculations). Valuations may also need to be performed more frequently.
- **Less certain timeline for returns** – Given open-ended funds do not have fixed terms, there is less visibility around timing of capital deployment, harvesting and ultimately distributions. In a closed-end fund, LPs can take comfort in the restrictions that are put on the GP to exit all investments in a timelier fashion. While LPs in open-ended funds can redeem their shares, LPs are often subject to lock-up periods, and some may be hesitant to exit early if there is prospective value generation in the investment portfolio.
- **Impact on bank capacity for hedging programs** – Banks seek higher certainty and lower risk. With closed-end funds, lenders get clear visibility in the composition of LPs, clarity on the committed pool of capital and a fixed timeline for the fund management. There are also protections for early LP redemptions. Traditional fund structures give GPs more leeway to manage as they see fit, including tapping available liquidity (cash, uncalled capital) to service liabilities.



FUND-LEVEL FX RISK

Fund-Level FX Risk – An Overview

FX risk arises when a fund invests in assets which are denominated in a different currency from the fund currency or when assets are economically impacted by currency volatility. An incremental source of FX volatility arises when GPs offer multi-currency solutions for LPs. Whether this is structured as a master-feeder, parallel vehicles or hedged share classes, this feature introduces another source of FX exposure that needs to be managed by the GP (see figure 2).

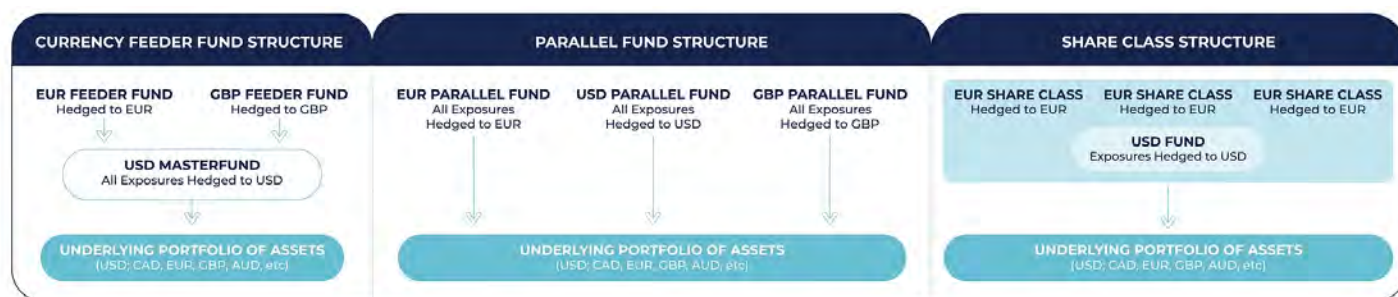


Figure 2

One simple investment-related example would be a USD-denominated fund making a private debt investment in a EUR loan. Since the loan's cash flows (interest + principal) will be denominated in EUR, the ultimate USD return for the fund's USD investors will be impacted by (1) local currency return, and (2) change in FX rate between the investment and receipt of interest + principal.

A more complicated example would be a USD-denominated fund making a private equity investment in a German company, which in turn has operations across the US, UK, and Germany. While the investment is denominated in EUR, there are certain second order impacts at the company driven by changes in EURUSD and EURGBP. Depending on how those risks are managed at the company, it would impact the net risk to which the USD-denominated fund is exposed.

Impact of FX Risk on Fund Operations & Performance

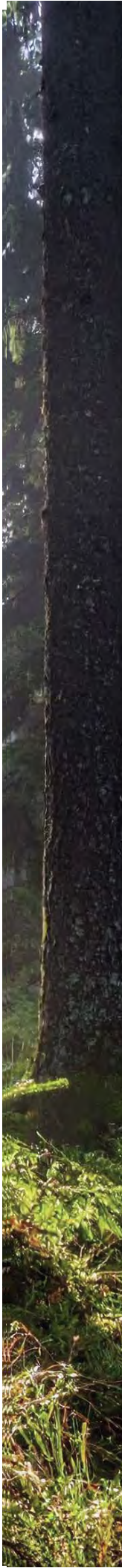
While there are endless sub-topics and complexity depending on the fund currency, exposure currency, fund structure, etc., we find it helpful to focus on two primary elements of fund-level FX risk:

Funding Risk

If a fund's LP commitments are in the same currency as the underlying investments, there would be certainty around investing capacity. For example, if LP commitments are \$1bn and target investments are all USD, there is no FX impact on the fund's investing capacity.

However, if the fund expects to invest outside its functional currency, FX volatility between fundraising and capital deployment will impact overall investing capacity. In our example, if USD weakens before it is invested in EUR assets, it will cost more USD to purchase the required EUR, therefore reducing the total amount of remaining dry powder and potentially impacting the fund's target returns. Some GPs consider hedging FX risks that may arise between the period of deal signing and closing or calling capital.

LP capital is funded upfront with open-ended structures and deployed more quickly than in closed-end funds. As a result, funding risk considerations are less pronounced for open-ended funds.



Performance Risk

Once capital is deployed outside the fund's functional currency, FX volatility will impact overall base currency returns.

GPs are paid to identify attractive investment opportunities. If there are exogenous market risks that can be efficiently hedged (e.g., FX, interest rates), many will take the view that it makes sense to mitigate these exposures so management can remain focused on maximizing value from the underlying portfolio.

❏ How to Hedge FX Exposure

The two primary approaches to hedging are:

Natural Hedging – uses debt denominated in the local currency of the investment

Financial Hedging – uses derivative contracts to offset the change in asset values that arise from moves in underlying FX rates.

❏ Hedge Metrics

Funds generally focus on Internal Rate of Return (IRR), Multiple on Invested Capital (MOIC) and Time Weighted of Return (TWR) as the relevant return metric(s) to optimize.

The appropriate approach to risk management will consider what return metric is prioritized by the GP (among other factors like cost and liquidity).

FX Risk Management Considerations

The goal of any fund-level FX hedging program is to mitigate the impact of FX volatility on base currency returns. Program design will differ based on the GP's priorities (e.g., IRR vs. MOIC), access to liquidity and bank credit capacity. The primary levers to be adjusted when constructing an FX hedging program are (1) product selection (e.g., forwards vs. option-based strategies), (2) hedge tenor (3) hedge ratio, and (4) liquidity support/capacity.

For closed-end funds, GPs have fewer unknowns to manage: There are no interim subscriptions or redemptions, capital commitments will be deployed in the investment period and investment hold periods will be somewhat constrained by the terms of the fund. In contrast, open-ended fund managers must take into account not only the long-term exposure to FX but also unknowns that arise when the constraints of a closed-end vehicle are lifted.

Impact of Ongoing Subscription/Redemption Activity

The primary differentiating factor of open-ended funds is the regular subscription/redemption activity. This dynamic creates uncertainty on several key aspects of the fund:

LP Composition

Unlike closed-end funds, the composition of the investor base will evolve over time.

Size

Unlike closed-end funds, fund size will fluctuate given LP subscription/redemption activity as well as investment performance.

Asset Hold Periods

Given the indefinite fund life period, there is less clarity around capital deployment and harvesting.

Liquidity

The variability of fund commitments lowers visibility on future liquidity positions, necessitating a more strategic approach.

- ❗ These key differences between open-ended and closed-end funds have a profound impact on how GPs manage fund-level FX exposure.

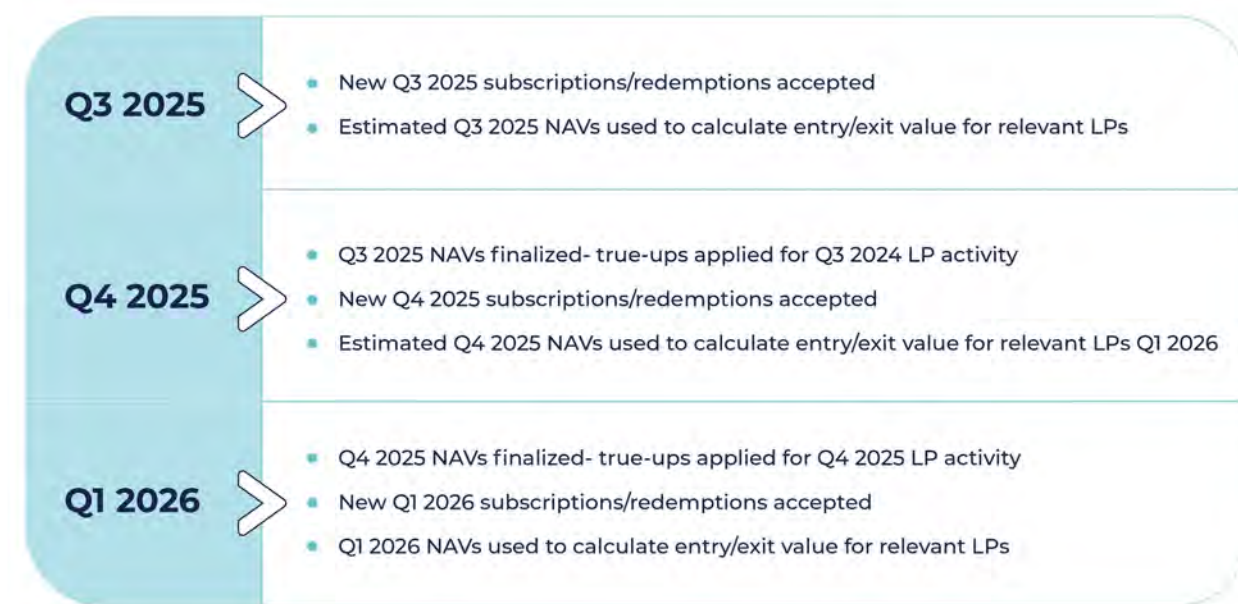
Timing / Valuation Lag

While closed-end funds have standard reporting requirements for LPs, open-ended fund GPs need to balance the timing of subscriptions, redemptions, and valuation changes to ensure fair treatment of all LPs and efficient management of the fund.

For a traditional open-ended fund, the key dates to manage are:

- **Subscriptions** – generally accepted in regular increments (e.g., quarterly), with capital called chronologically in line with when commitments are received.
- **Redemptions** – generally accepted in regular increments (e.g., quarterly), with certain limitations on the size of redemptions. GPs will typically limit the size of quarterly redemptions (e.g., 5% of the fund) or allow the GP to refuse redemptions if it is not in the best interest of the fund.
- **Valuations** – generally done in line with subscription/redemption calendar (e.g., quarterly). Since valuations may be completed on a lag, GPs may reserve a portion of redeemed capital to true-up for final valuations.

A sample timeline for a standard open-ended fund is included below for illustrative purposes.



Hedge Rebalancing

Fund-level hedges need to be rebalanced when underlying exposures change. While regular investing activity could trigger rebalancing the additional drivers are:

Subscriptions – if new subscriptions are accepted and immediately deployed in non-base currencies or if new non-base currency share class subscriptions are accepted.

Redemptions – if existing LPs are redeemed and assets are liquidated to facilitate the redemption.

□ GPs running open-ended structures can sometimes face a compounding problem: Redemption activity is often correlated across LPs, potentially creating heightened liquidity demand from investors as a function of sentiment and asset class trends. This is in addition to ongoing liquidity planning required for the FX hedging program and any other working capital needs

Bank Capacity / Tenor Considerations

Bank credit capacity (for hedging transactions or fund level financing) is often less robust for open-ended funds as compared to closed-end funds. The primary reasons for this are as follows:

- **Evolving LP Pool** – counterparty banks take comfort in understanding the fund's LPs as uncalled capital is source of liquidity in traditional closed-end fund structures. Since an open-ended fund's LPs are ever-changing and uncalled capital is less relevant, it impairs banks' ability to underwrite credit risk.
- **Redemption Activity** – while capital is locked up for the life of a closed-end fund, open-ended fund LPs may periodically redeem their interests (subject to fund restrictions). This potential draw on an open-ended fund's capital base is not viewed favorably and banks will review any restrictions on redemptions and GP's rights to refuse redemptions as part of their due diligence.

On the positive side, there is more visibility on the underlying asset portfolio for an open-ended fund since closed-end fund LPs are committing to a blind pool of assets. For open-ended funds, the existing portfolio removes some of those unknowns, but the net impact of the aforementioned factors generally leads to decreased risk appetite from banks.

The reduced credit appetite for open-ended funds results in a few practical impacts. First, some banks that may be comfortable with closed-end funds simply will not transact with open-ended funds (unless all trading is fully collateralized). Further, even those banks that will underwrite unsecured trading lines will often require shorter-dated hedge programs.



Hedge Structure Considerations

The combination of ongoing subscription/redemption activity and reduced bank credit appetite has profound impacts on the structuring of hedge programs for open-ended funds.

- **Hedge Tenor** – since GPs need to admit or redeem investors on a regular (e.g., quarterly) basis at the prevailing NAV, there is an appeal of rolling short-dated hedges to align hedge economics with these dates. While longer-dated hedges are often appealing for closed-end funds (to align with asset hold periods), many GPs prefer the simplicity of rolling short-dated hedges to crystallize and settle hedge gains/losses alongside subscription/redemption activity.
- **Credit Terms** – while hedge tenors are generally shorter, there will be reduced credit appetite for funds looking to use longer-dated strategies. As a result, banks will generally provide tighter ISDA/CSA credit terms. This may manifest itself in more restrictive Additional Termination Events (ATEs) or tighter CSA thresholds (e.g., smaller percentage of prevailing fund NAV). These points are intertwined - short-term hedge programs may not actually require tighter credit terms because the tenor considerations address the credit hesitancy. For longer-term hedging programs, the points around ATEs and CSAs remain relevant.
- **Available Counterparty Banks** – the pool of available hedge counterparties is narrower as numerous banks that are large players in closed-end fund-level hedging will not transact with open-ended funds or offer highly uncompetitive terms.

Bank credit appetite has improved in recent years and will continue to grow as open-ended funds continue to become more prevalent.



Liquidity Considerations

Given the shorter average hedge tenors and tighter credit terms, open-ended funds need to more actively manage liquidity requirements generated by the FX hedging program. To manage ongoing liquidity needs, funds will generally employ some of the following strategies:

Reserving Liquidity from Commitments / Harvest Proceeds

Underinvesting LP commitments or holding back distributable proceeds to reserve for hedge liquidity events.

Historic Rate Rollovers (HRR)

Deferring potential hedge losses by rolling settlement amounts into new hedge contracts.

Fund Leverage Facilities

Borrowing under fund-level facilities.

Product Selection

Embedding optionality in the hedge program can limit potential liquidity needs.

We are hearing from more GPs than ever who are looking to adopt open-ended structures to take advantage of the flexibility and broader LP access. Given dynamic subscription and redemption cycles, we advise managers on how to most effectively manage FX exposures, ongoing rebalancing and liquidity needs. The operational infrastructure needs to be in place for GPs to fully safeguard performance in open-ended funds.

– Bryan Cohen, Managing Director and Head of Americas Client Coverage, Validus Risk Management



Conclusion

As open-ended funds continue to grow in popularity for private capital funds and their investors, it is important for fund managers to adapt their approach to risk management. While the core principles of FX risk management still apply, structural differences between open-ended and closed-end funds may impact how hedging programs need to be implemented.

While this document aims to outline the high-level considerations, structural issues and risk management objectives of a given fund will drive the details of any hedging program.

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