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FX Liquidity Strategies for Australian Superannuation Funds

Executive Summary

Offshore allocations by Australian superannuation funds now exceed 47% of total assets under management (AUM) and are expected to rise further. The Reserve Bank of Australia (RBA) estimates that foreign exchange (FX) hedging books could more than double in size over the next decade, from their current level of approximately \$500 billion, making liquidity risk a central challenge for the industry¹. This paper explores key liquidity management strategies, including extending the tenor of FX forwards, optimising collateral usage, holding excess cash, reducing FX hedge ratios, and introducing cross-currency basis swaps. It also examines differentiated hedging approaches for public versus private assets, given their distinct liquidity profiles.

Over the past 18 months, the IFM Investors Treasury team has actively engaged with superannuation funds, asset consultants, and regulatory bodies to address emerging liquidity risks and discuss practical strategies tailored to the evolving needs of the sector.

¹ Andrew Hauser, "A Hedge Between Keeps Friendship Green: Could Global Fragmentation Change the Way Australian Investors Think About Currency Risk?", speech at a function hosted by CLS Bank International and NAB, Sydney, 16 September 2025, Reserve Bank of Australia, <https://www.rba.gov.au/speeches/2025/sp-dg-2025-09-16.html>.

Introduction

Hedging FX exposure from global listed and unlisted assets presents a range of challenges, including cost efficiency, regulatory compliance, operational complexity, and risk management. Among these, liquidity risk has emerged as the most critical concern, driven by settlement obligations during periods of AUD depreciation, replacement costs when rolling hedges in volatile markets, and regulatory expectations from the Australian Prudential Regulation Authority (APRA) and the RBA for prudent liquidity management. This paper focuses on the liquidity pressures Australian superannuation funds face when hedging FX exposure—particularly for global unlisted assets—and outlines practical strategies to mitigate these risks while maintaining portfolio resilience.

Why Liquidity Risk is the Main Concern

Australian superannuation funds are steadily increasing their offshore allocations, driven by diversification objectives and deployment demands. As exposure to private and unlisted assets grows, FX hedging requirements—and the associated liquidity pressures—are rising even more rapidly, particularly given that funds typically hedge 100% of this exposure. This has heightened the industry's

sensitivity to movements in the Australian dollar. The liquidity crunch of 2020 served as a stark reminder of the importance of maintaining robust liquidity buffers to navigate market dislocations. Looking ahead, even modest market disruptions could trigger significant stress, given the scale of offshore exposure now embedded across the sector.

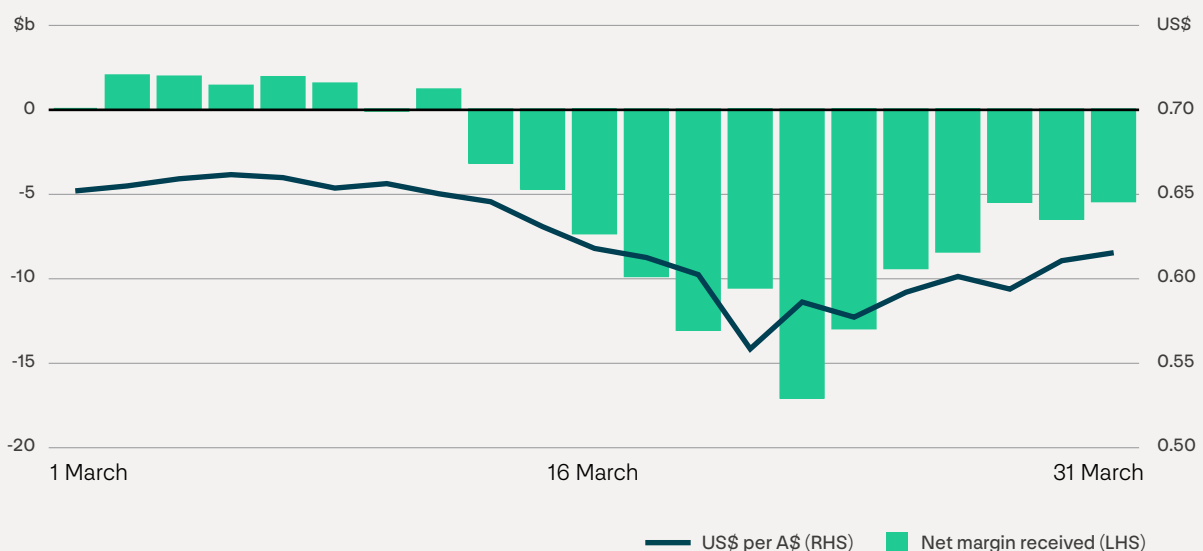
Shorter-dated FX hedging significantly amplifies liquidity risk across trustee portfolios. Frequent settlements—often monthly or quarterly—create regular liquidity demands, requiring funds to maintain elevated cash reserves or liquidate assets to meet settlement obligations. This leads to performance drag and in stressed markets, such as during the GFC or COVID-19, these liquidity pressures can force asset sales at depressed valuations. To mitigate these risks, some funds reduce hedge ratios, however this introduces additional exposure to rapid AUD rebounds, increasing volatility and downside risk at the total portfolio level.

The Australian dollar has historically been procyclical, experiencing significant depreciations during periods of market turmoil. This means that hedging investment currencies back to AUD may result in substantial liquidity drawdowns when

FIGURE 1

SUPERANNUATION FUNDS' HEDGING OBLIGATIONS

Cumulative change, March 2020



Source: RBA Financial Stability Review, April 2021

² Reserve Bank of Australia, *Financial Stability Review – October 2025* (Sydney: Reserve Bank of Australia, 2025), <https://www.rba.gov.au/publications/fsr/2025/oct/pdf/financial-stability-review-2025-10.pdf>.



market conditions are unfavourable, particularly when risk asset valuations are declining. It's not uncommon for these liquidity drawdowns to exceed 20% of the notional hedge exposure. This drawdown pressure is often exacerbated when FX hedging programs utilise short-tenor (one to six-month) FX forwards. A notable example occurred during the COVID-19 market shock in March 2020, when the AUD fell approximately 15% against the USD, triggering up to \$17 billion in daily margin calls across superannuation funds to meet FX settlement obligations.

The RBA's October 2025 Financial Stability Report ([Financial Stability Review](#)) reinforced the importance of liquidity risk management, noting that as the sector expands its foreign asset exposure and FX hedging activities, rollover risk and margin call pressures will likely increase. The report also highlighted that simultaneous stress events could force funds to *"secure liquidity in ways that could amplify financial market stress."*²

Listed vs Unlisted Assets considerations

Superannuation funds are increasingly allocating capital across both listed and unlisted assets, each with distinct liquidity profiles and investment horizons. Listed assets—such as listed equities and bonds—are highly liquid and typically suited to shorter-tenor FX hedging strategies, with more frequent settlement requirements. Conversely, unlisted assets—including infrastructure, real estate, and private equity—are less liquid and often held over extended periods, frequently exceeding 10 years. Hedging these assets requires careful consideration of liquidity constraints and the cumulative cost of rolling short-dated forwards over long time horizons.

For listed assets, funds can dynamically adjust hedge ratios and employ shorter-tenor FX forwards in response to market conditions. For unlisted assets, a more strategic approach is warranted, potentially involving longer-tenor instruments or a combination of FX forwards and cross-currency basis swaps to reduce rollover risk and manage liquidity more effectively.

While it is common practice to hedge currency exposure at the total portfolio level, this approach may overlook the differing liquidity risk profiles of listed versus unlisted assets. As allocations to global unlisted assets grow, superannuation funds should consider separating their hedging strategies to better reflect the characteristics of each asset class. Tailoring FX hedging frameworks to distinguish between listed and unlisted exposures allows for more precise liquidity risk management and can help avoid unintended consequences during periods of market stress.

The IFM Treasury team has been managing currency and liquidity risks associated with private assets for over 15 years through its Strategic Hedge Framework. This hybrid approach combines extended-duration FX forwards, cross-currency basis swaps, and FX options to manage downside AUD spot risk and reduce rollover pressure. This paper outlines the benefits and considerations of alternative liquidity and currency risk management strategies for Australian superannuation funds, including extending FX forward tenors, using cross-currency basis swaps, FX options, collateral optimisation, holding excess cash, and adjusting hedge ratios.

Alternative Liquidity Risk Management Strategies

As FX hedging programs grow in size and complexity, Australian superannuation funds must adopt a broader set of tools to manage liquidity risk effectively. To build resilience, funds are increasingly exploring alternative strategies that offer greater

flexibility, reduce rollover risk, and align more closely with the liquidity profiles of their underlying assets.

The following table outlines a range of liquidity risk management strategies, summarising their key benefits and considerations to help funds tailor their approach based on portfolio needs and governance frameworks.

TABLE 1

Hedging Strategies	Benefits	Considerations
Extending Tenor of FX Forwards	Reduces rollover risk; improves cash flow certainty and aligns with private assets	Counterparty exposure management and credit costs
FX Options	Asymmetric protection in extreme currency moves; complements existing hedges	Premium costs vary with implied volatility; governance approval required
Cross-Currency Basis Swaps	Extend tenor without interest rate duration risk; aligns with private assets	Collateral requirements apply only to the interest rate component; notional exchanges are exempt
Collateral Solutions	Reduces cash buffer need; improves credit terms	Operational complexity; opportunity cost of encumbered assets
Holding Excess Cash	Immediate liquidity; operational simplicity	Performance drag; inflation risk; potential forced asset sales during stress
Reducing Hedge Ratios	Lowers liquidity demands; introduces currency diversification	Increased FX risk and volatility; benchmark tracking error; APRA test implications

Extending Tenor of FX Forwards

Extending FX forward tenors beyond short-dated contracts—such as the commonly used 3- or 6-month tenors—to 2–3 years can significantly reduce rollover frequency and help mitigate liquidity shocks. This approach also better aligns hedge maturities with the cash flow profiles of underlying assets, particularly for long-term private investments. A laddered structure of longer-dated forwards provides predictability and smooths liquidity impacts during periods of AUD depreciation, lowering drawdowns compared to short-tenor hedges.

This approach also reduces operational intensity and stress during market turmoil, creating a more stable liquidity profile for superannuation funds. Hedges

can be structured to maintain a uniform distribution out to two or three years, with rolls occurring three to six months before expiry to ensure certainty of near-term liquidity requirements.

As shown over the last 20 years, the annual liquidity drawdowns of the hedging strategies using 3-month FX Forwards are significantly higher compared to the hedging strategies with longer tenors using 12-month and 3-year FX Forwards for comparison strategies. The liquidity drawdowns exceeding 20% of the notional hedge have coincided with material equity market weakness ('01,'09,'16, '20 & '25), adding material liquidity requirements to investor hedging programs. This is often at the time when liquidity is scarce for investors, due to risk-asset volatility impacting redemptions and asset allocation rebalancing requirements.

FIGURE 2

AUDUSD HEDGING QUARTERLY DRAWDOWN

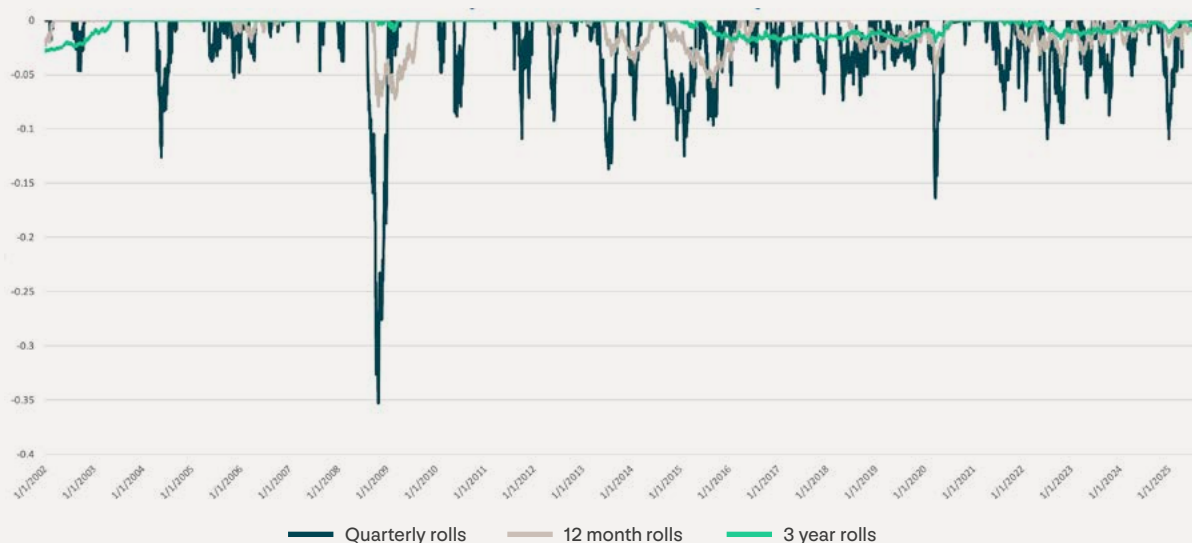


Chart 2 shows the realised annual liquidity needs from an AUD based hedging perspective rolling 12-month hedges quarterly and annually, and three-year hedges rolled annually.³

Source: Bloomberg

³ As at 10th October 2025. The above chart shows the realised quarterly liquidity needs of an investor trading hedge rolls quarterly, (Quarterly rolls, each hedge roll is 100% of hedged notional), rolling 12-month hedges quarterly (each hedge roll is 25% of hedged notional), and rolling three-year hedges quarterly (each hedge roll is 8.3% of hedged notional). This material is provided for educational purposes only and should not be construed as investment advice or a recommendation to buy or sell securities.

However, longer-dated forwards introduce important considerations. They generally attract higher credit charges for non-collateralised positions, though these costs are often minimal compared to the expense of holding excess cash for margin requirements. Strong counterparty relationships and sufficient credit lines are essential to support extended maturities.

Another consideration is that FX forwards do carry some interest rate duration risk, this exposure remains relatively modest when tenors are kept within the 2–3 year range. Duration risk nonetheless requires an effective risk management framework. IFM has developed a Strategic Hedge Framework to help manage duration risk, alongside counterparty exposure and liquidity risk.

Importantly, forward points in FX forwards tend to be negatively correlated with AUD/USD spot movements. This means that when the AUD depreciates, the interest rate differential embedded in the forward contract often generates a positive return, helping to offset mark-to-market (MTM) losses from the spot movement. This dynamic provides a natural cushion during periods of AUD weakness. The longer the tenor of the FX forward, the greater the potential offset from forward point movements—helping to smooth liquidity impacts and reduce the need for immediate

cash settlements. From a Total Portfolio Approach, incorporating longer-tenor FX forwards can also reduce overall portfolio volatility.

Combining long-dated forwards with alternative strategies such as FX options can further manage liquidity risk, ensuring any adverse impact from significant FX movements is experienced gradually, allowing time for portfolios to respond and for underlying assets to maintain cash flows.

Cross-Currency Basis Swaps

Cross-currency basis swaps (CCS) provide an effective alternative or complement to FX forwards, particularly for extending hedge tenors beyond two years without introducing interest rate duration risk. Unlike long-dated forwards, which embed interest rate differentials and duration exposure, CCS exchanges principal and interest payments in two currencies, neutralising duration risk while delivering long-term currency hedging. This approach is especially useful when interest rate differentials create negative hedging returns, as CCS can extend tenor without locking in those costs.

CCS align well with long-term private asset profiles and can improve collateral efficiency when structured

under CSA agreements, often working best in combination with forwards for an optimal hedge structure. However, CCS involve more complex documentation and operational setup and require collateral and ongoing margining, making strong governance and operational capability essential.

FX Options

FX options provide superannuation funds with a mechanism to manage downside liquidity risk in extreme currency moves. Specifically, options can be structured to protect against significant AUD depreciation (e.g., >10%), which historically has triggered large margin calls on FX forwards and collateral requirements. Unlike forwards, options provide asymmetric protection with a defined cost—limited to the premium—without daily margining. This makes them a valuable complement to existing hedging programs, particularly in mitigating tail-risk liquidity events.

Options act as insurance against sharp AUD declines, helping reduce the risk of sudden liquidity drains. Their cost is upfront and transparent, with flexibility to tailor strike levels and time horizons to match specific stress scenarios. However, premium costs can be high in volatile markets due to implied volatility pricing. Governance approval is typically required, and liquidity for very long-dated AUD options (beyond two years) remains limited. Monetisation strategies and clear derivative use policies are also important considerations when integrating options into a broader liquidity management framework.

Collateral Solutions

Using collateral—such as cash, bonds, or equities—to meet mark-to-market (MTM) exposure can enhance credit terms and reduce hedging costs, while avoiding the need for large cash buffers. However, this approach introduces operational complexity in managing collateral, potential opportunity costs from encumbered assets, and the risk of procyclical margin calls during periods of AUD weakness.

Holding Excess Cash

Maintaining excess cash reserves provides immediate liquidity and operational simplicity, offering resilience during stress events. However, holding large cash buffers can significantly drag on performance, introduce benchmark tracking error, and expose portfolios to inflation risk. In adverse liquidity conditions, funds may be forced to sell liquid assets like equities at cyclical lows to meet FX settlements – precisely the scenario that a robust FX liquidity management framework is designed to avoid.

Reducing Hedge Ratios

Reducing FX hedge ratios is another strategy to alleviate future liquidity risk, though it increases portfolio exposure to currency movements. This approach lowers liquidity demands and introduces currency as a potential diversifier. However, it comes with key considerations: higher portfolio volatility, tracking error, and the risk of underperformance relative to benchmarks and APRA performance tests—particularly when AUD offers a yield advantage over the hedged currency.

Conclusion

Effective liquidity management is critical for Australian superannuation funds as they continue to expand their global investment portfolios. Managing FX-related liquidity risk requires a multi-faceted approach that balances cost, flexibility, and resilience. Extending the tenor of FX forwards can help reduce rollover risk and improve cash flow certainty, although it may involve considerations around pricing and counterparty exposure. Cross-currency basis swaps offer a way to extend hedge maturity without introducing duration risk, and can be well-suited to match long-term private asset profiles. While they may require additional structuring and operational coordination, they present a valuable tool in the liquidity management toolkit.

FX options provide asymmetric protection against extreme currency moves, helping to mitigate tail-risk liquidity events without daily margining. Although premium costs can be elevated in volatile markets, options offer flexibility in strike and tenor design, making them a useful complement to traditional hedging programs. When used alongside other strategies—such as collateral optimisation, maintaining adequate cash buffers, and adjusting hedge ratios—these tools can significantly enhance a fund's ability to withstand liquidity stress.

Ultimately, a well-structured liquidity risk framework should incorporate robust governance, regular stress testing, and proactive engagement with counterparties and regulators. By diversifying liquidity management strategies and tailoring them to portfolio needs, superannuation funds can build greater resilience and ensure continuity through periods of market dislocation.

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