2. COUNTERPARTY RISK AND VALUATION ADJUSTMENTS

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In the last ten years, commonly used derivatives pricing methods have undergone several major changes aimed at the inclusion of several “valuation adjustments”. The main driver of this trend was probably the ever-increasing attention to counterparty credit risk and funding costs due to the financial crisis which begun in 2007-2008 (start of the US subprime mortgage crisis). After “CVA” (credit valuation adjustment) and “DVA” (debt valuation adjustment), several other adjustments were introduced – among these the “FVA” (funding valuation adjustment) – leading the generic name of “XVA”. We give an overview of the meaning and purpose of valuation adjustments, along with some practical examples of how they are applied.