Funding Valuation Adjustment

Funding Valuation Adjustment is introduced to capture the incremental costs of funding uncollateralized derivatives. It can be referred to as the difference between the rate paid for the collateral to the bank’s treasury and rate paid by the clearinghouse.

FUNDING VALUATION ADJUSTMENT can be thought of as a hedging cost or benefit arising from the mismatch between an uncollateralized client trade and a collateralized hedge in the interdealer market. FUNDING VALUATION ADJUSTMENT should be also calculated at portfolio level.

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FUNDING VALUATION ADJUSTMENT is the cost of funding that is considered in the valuation of uncollateralized derivatives. It is introduced to quantify the adjustment to the value of derivatives in order to ensure that a trader recovers funding costs that are consistent with the market’s view of the funding costs associated with the same trade.

Credit value adjustment is the market price of counterparty credit risk that has become a central part of counterparty credit risk management. By definition, CREDIT VALUE ADJUSTMENT is the difference between the risk-free portfolio value and the true/risky portfolio value.

CREDIT VALUE ADJUSTMENT not only allows institutions to quantify counterparty risk as a single measurable P&L number, but also offers an opportunity for banks to dynamically manage, price, and hedge counterparty risk. The benefits of CREDIT VALUE ADJUSTMENT are widely acknowledged. Many banks have set up internal credit risk trading desks to manage counterparty risk on derivatives.

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Reference:

https://finpricing.com/lib/EqWarrant.html