Credit Valuation Adjustment

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

In practice, CREDIT VALUATION ADJUSTMENT should be computed at portfolio level. That means calculation should take Master agreement and CSA agreement into account.

CREDIT VALUATION 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 VALUATION ADJUSTMENT are widely acknowledged. Many banks have set up internal credit risk trading desks to manage counterparty risk on derivatives.

CREDIT VALUATION ADJUSTMENT is defined as the difference between the risk-free portfolio value and the true/risky portfolio value;

CVA not only allows institutions to move beyond the traditional control mindset of credit risk limits and 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 CVA are widely acknowledged. Many banks have set up internal credit risk trading desks to manage counterparty risk on derivatives.

Reference:

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