FVA and electricity bill valuation adjustment – much of a difference?

Abstract:

Pricing counterparty credit risk, although being in the focus for almost a decade by now, is far from being resolved. It is highly controversial if any valuation adjustment besides the basic CVA should be taken into account, and if so, for what purpose. Even today, the handling of CVA, DVA, FVA, ... differs between the regulatory, the accounting, and the economic point of view. Eventually, if an agreement is reached that CVA has to be taken into account, it remains unclear if CVA can be modelled linearly, or if nonlinear models need to be resorted to. Finally, industry practice and implementation differ in several aspects. Hence, a unified theory and treatment of FVA and alike is not yet tangible. The conference Challenges in Derivatives Markets, held at Technische Universität München in March/April 2015, featured a panel discussion with panelists representing different points of view: John Hull, who argues that FVA might not exist at all; in contrast to Christian Fries, who sees the need of all relevant costs to be covered within valuation but not within adjustments. Damiano Brigo emphasises the nonlinearity of (most) valuation adjustments and is concerned about overlapping adjustments and double-counting. Finally, Daniel Sommer puts the exit price in the focus. The following (mildly edited) record of the panel discussion repeats the main arguments of the discussants—ultimately culminating in the awareness that if everybody
charges an electricity bill valuation adjustment, it has to become part of any quoted price.

Stichworte: Counterparty credit risk, Credit valuation adjustment, Debit valuation adjustment, Wrong way risk

Zeitschriftentitel: Springer Verlag

Jahr: 2016

Seiten: 147-168

Reviewed: ja

Sprache: en

Volltext / DOI: doi:10.1007/978-3-319-33446-2_8

WWW: http://link.springer.com/chapter/10.1007/978-3-319-33446-2_8

Print-ISSN: 978-3-319-33445-5

Status: Verlagsversion / published

TUM Einrichtung: Lehrstuhl für Finanzmathematik

Occurences:
- Einrichtungen > Fakultäten > Fakultät für Mathematik > Zentrum Mathematik > M13 Lehrstuhl für Finanzmathematik (Prof. Zagst) > Book Sections and Proceedings > Scherer, M.
- Hochschulbibliographie > 2016 > Fakultäten > Mathematik > M13 Lehrstuhl für Finanzmathematik (Prof. Zagst)

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