

FVA – decisions and implementation

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KPMG INTERNATIONAL

Funding Valuation Adjustment (FVA) is a pricing and valuation component of uncollateralized derivatives.

FVA has been the subject of much discussion in recent months as some of the world's biggest derivative banks have adapted their valuation models to include it. A number of regulators have raised its inclusion in valuations. Many more banks are seriously questioning whether they want to adopt or as the market moves, whether they in fact may be forced to adopt.

This presents all institutions with a series of questions:

- **Is FVA something our front office should be managing?**
- **Do we need to adopt FVA in our valuations?**
- **What might the impact be of doing so?**
- **What would the impact be on other systems and processes within my organization?**

Management of FVA

Our ongoing discussions with leading market practitioners show that FVA clearly impacts the pricing of certain trades and that most market participants already consider FVA in their traders' price negotiations. In some trades, e.g. long dated derivatives with supranational counterparties, the FVA component can be observed most clearly.

Consequently banks are increasingly interpreting FVA as an important component of fair value. As noted, at year end 2013 FVA was included in the financial statements of more than half-dozen international banks, sometimes with an impact in the magnitude of hundreds of millions of USD.

To learn more about FVA, please ask your KPMG contact about meeting with our experts or download our [comprehensive booklet](#)*.

While there is currently diversity in practice regarding the inclusion of FVA in fair value, KPMG is expecting market standards to evolve in the near future.

All this results in the need to tackle the management of FVA now – trade evidence shows that one cannot sensibly participate in long dated unsecured transactions without knowing the FVA impact.

A framework for FVA management should comprise at least the following elements:

- A definition of FVA which avoids double counting with CVA/DVA and eliminates arbitrage opportunities
- Evaluation of current practices in pricing of new business, portfolio transactions, and CSA negotiations
- Design of an operating model which sets clear roles for trading and treasury departments and enables management of FVA as well as FVA volatility
- Establishment of an IT architecture for FVA analytics, comprising the required simulation of market risk factor scenarios and their implication for cash and collateral flows on a portfolio level
- Implementation of downstream processes, e.g. P&L calculation and accounting as well as internal and external reporting and treatment of FVA in regulatory capital

*<https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/funding-valuation-adjustment.pdf>

How we can help

KPMG has established itself as a thought leader and expert on FVA. Our member firms offer support through:

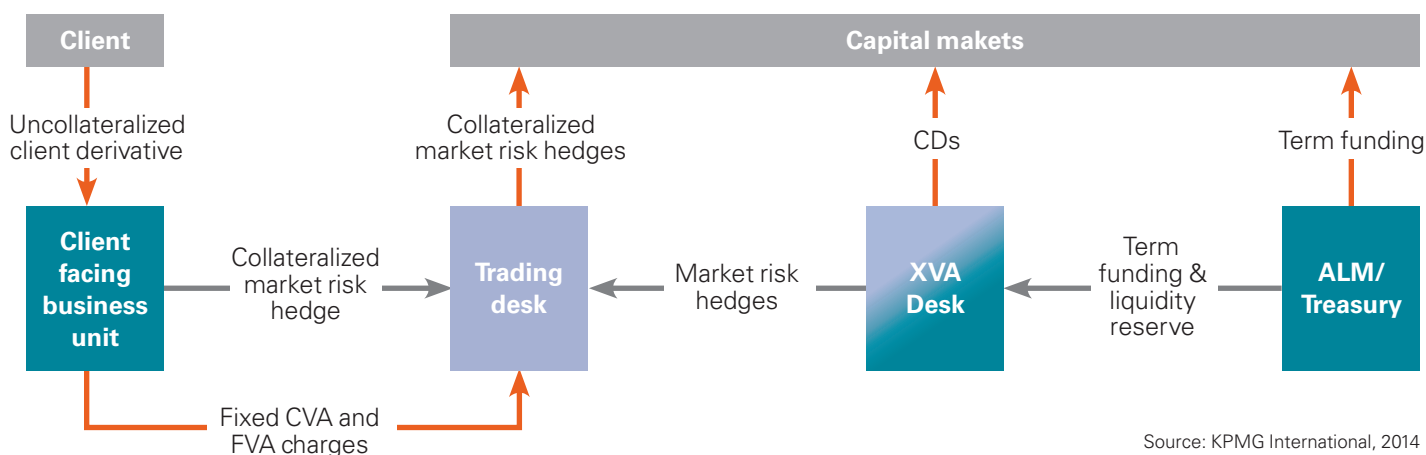
- Assisting institutions with challenge, market insights and advice in their thinking through **whether to amend their valuation approach**
- Performing **quantitative impact analyses** on the basis of an FVA calculation tool which offers insights into a given FVA position, its risks, and the potential for trading and portfolio management actions
- **Benchmarking** your definitions and concepts against market practice. Discussion of alternate concepts for delineation of CVA, DVA and FVA
- Establishment of a **framework** for FVA management, consistent with internal funds transfer pricing, liquidity risk management and ICAAP approaches
- Development of **target operating models** for FVA management including the explicit risk transfer between involved business units and the pricing of this transfer

- **Design of methods** for calculating and pricing FVA, both in books and records under IFRS 13 and for prudent valuation
- Supporting the integration of FVA into **IT systems** for pricing, valuation, and risk controlling

The implementation of a best practice FVA management approach will help improve your pricing of new derivatives business. Last but not least, FVA is increasingly an indispensable element of good liquidity risk management.

KPMG's network offers a team of experts in the areas of treasury management, ALM, risk management, valuation and accounting. The team combines deep academic knowledge and hands-on experience and possesses excellent industry contacts. In addition, KPMG has addressed the importance and the complexity of the design and implementation of IT architectures in trading functions and risk control units. KPMG's FVA projects are supported by a team of experienced project managers with specific expertise in relevant vendor solutions. Your local KPMG contact would be delighted to assist you as you move forward in your consideration of FVA.

Potential target operating model for FVA management



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