



Counterparty Credit Risk and Credit Value Adjustment: A Continuing Challenge for Global Financial Markets

By Jon Gregory

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A practical guide to counterparty risk management and credit value adjustment from a leading credit practitioner

*Please note that this second edition of Counterparty Credit Risk and Credit Value Adjustment has now been superseded by an updated version entitled **The XVA Challenge: Counterparty Credit Risk, Funding, Collateral and Capital**.*

Since the collapse of Lehman Brothers and the resultant realization of extensive counterparty risk across the global financial markets, the subject of counterparty risk has become an unavoidable issue for every financial institution. This book explains the emergence of counterparty risk and how financial institutions are developing capabilities for valuing it. It also covers portfolio management and hedging of credit value adjustment, debit value adjustment, and wrong-way counterparty risks. In addition, the book addresses the design and benefits of central clearing, a recent development in attempts to control the rapid growth of counterparty risk. This uniquely practical resource serves as an invaluable guide for market practitioners, policy makers, academics, and students.

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Editorial Review

From the Inside Flap

Counterparty credit risk and credit value adjustment

“Jon Gregory is the acknowledged global expert on counterparty credit risk. This new edition of his definitive treatment of the subject, fully updated and expanded, will remain the go-to source on counterparty risk management and valuation. The concepts and examples are perfectly pitched to masters students, financial market participants, and regulators.”—**Darrell Duffie, Dean Witter Distinguished Professor of Finance, Graduate School of Business, Stanford University**

“Jon Gregory is an all too rare individual, a state-of-the-art quant who knows the limits of mathematical analysis and who also can express himself effectively with words. As in his previous volume, he provides a solid exposition of the conceptual and institutional aspects of this complex form of risk. Relying mainly on graphics and examples to illustrate his points allows him to banish most mathematical formulas to online appendices that will be needed only by those with strong mathematical interest. The second edition provides a timely update with revised or expanded discussion of topics that have received particular attention in finance and public policy circles over the past two years. I highly recommend this book to any intelligent layperson who seeks a better understanding of counterparty credit risk and its implications for public policy.”—**David M. Rowe, President, David M. Rowe Risk Advisory and Long-time Risk Analysis Columnist, Risk Magazine**

“It is great to see a timely and extensive update to what has quickly become a classic text in a rapidly evolving field of counterparty credit risk.”—**Vladimir V. Piterbarg, Global Head of Quantitative Analytics, Barclays**

“Much has happened in financial markets since the first edition of Counterparty Credit Risk was published. With the second edition Jon Gregory brings the reader right up to date. Most of the material has been rewritten or expanded. The book will continue to be essential reading for anyone who works in derivatives.”—**Professor John Hull, Maple Financial Professor of Derivatives and Risk Management, Joseph L. Rotman School of Management, University of Toronto**

“Utmost important topic covered by one of the best experts in the field. A must read for everybody in the financial industry dealing with counterparty risk.”—**Wim Schoutens, Research Professor, University of Leuven**

“Jon Gregory provides a comprehensive treatment of counterparty risk, including centralized clearing. His exposition is clear and accessible, which is remarkable given the complexity of the topic. There are many practical examples, including experiences from the recent credit crisis. His book should be required reading for risk managers, senior banking executives, regulators, policy makers and scholars concerned about counterparty risk.”—**Stuart M. Turnbull, Bauer Chaired Professor, Bauer College of Business**

From the Back Cover

Failures of large financial institutions and sovereigns, leading to bankruptcies and dramatic bailouts have

thrust counterparty credit risk heavily into the spotlight as the key element of financial risk management. The sudden realisation of extensive counterparty risks has severely compromised the balance sheets of banks globally, the health of global financial markets and state of the general economy. Understanding and managing counterparty risk and CVA (credit value adjustment) has become a key problem for all financial institutions.

Counterparty Credit Risk and Credit Value Adjustment: A Continuing Challenge for Global Financial Markets, Second Edition explains the history of the subject and its emergence as the key financial risk during the global financial crisis. The basics of counterparty risk management, including aspects such as potential future exposure, netting and collateral, are defined. Banks and other financial institutions have been developing their capabilities for pricing counterparty risk and these elements are considered in detail via a characterisation of credit value adjustment. Wrong-way counterparty risks are addressed in detail in relation to interest rate, foreign exchange, commodity and credit derivative products and regulatory capital for counterparty risk, including the recent Basel III requirements for CVA VAR is discussed. The implications of an institution valuing their own default via debt value adjustment (DVA) and funding costs (FVA) are also considered at length. The management of counterparty risk within an institution by a CVA desk is also discussed with the associated portfolio management and hedging of CVA described in full. Finally, the design and benefits of central clearing, a recent development to attempt to control the rapid growth of counterparty risk, is considered.

The first edition of this book has become a standard reference on the subject of counterparty credit risk. The second edition has been completely re-written to cover the recent extensive changes in theory, market practice and regulation and the new topics of risk-free valuation, funding considerations and Basel III capital requirements. The book is unique in being practically focused but also covers the more technical aspects. It is an invaluable complete reference guide for any market practitioner, policy maker, academic or student with any responsibility or interest within the area of counterparty credit risk and CVA.

The book has a supporting website, www.cvacentral.com, which contains spreadsheets, mathematical appendices and other supporting documentation, all of which are freely downloadable.

About the Author

Jon Gregory is an experienced practitioner in the area of financial risk management. From 1995 to 1997 he worked in the Fixed Income division of Salomon Brothers. From 1997 to 2005 he was with BNP Paribas and from 2005 until 2008 he was global head of credit analytics at Barclays Capital. Jon has published a number of papers and articles on risk management, credit derivatives and quantitative finance and is a regular speaker at international conferences. He was a co-author of the book *Credit: A Complete Guide to Pricing, Hedging and Risk Management*, nominated in 2001 for the Kulp-Wright award for the most significant text in risk management and insurance. He is currently a partner at Solum Financial based in London and advises a number of banks on their counterparty risk and CVA practices. He holds a PhD from Cambridge University.

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Phyllis Baudoin:

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