



Credit Valuation Adjustment Target Operating Model

InteDelta’s Credit Valuation Adjustment (CVA) Target Operating Model offering is a structured and proven method for designing a process for active counterparty risk management and credit charging within financial institutions. Our consultants use their subject matter expertise of CVA to define best practice CVA infrastructure, fully considering organisation, business process and systems architecture.

The recent financial markets crisis and, in particular, the increase in counterparty defaults across all market segments, has led to a heightened focus on counterparty risks within financial institutions.

This, together with changes to accounting standards requiring proactive reserving for expected counterparty risk exposures, is driving banks to move from purely passive assessment of counterparty risks to active counterparty risk management from the point of pre-trade credit charging through to daily reserving and hedging of exposures.

InteDelta has significant experience in setting up active counterparty risk management within major banks. On the basis of this experience we have developed a structured approach to ensure market best practice is implemented across organisation, business process and systems infrastructure.

Our approach to the CVA Operating Model Review involves the following stages:

- Organisation and governance review
- Business process and methodology review
- Short term and strategic recommendations
- Target operating model and architecture definition
- Implementation plan



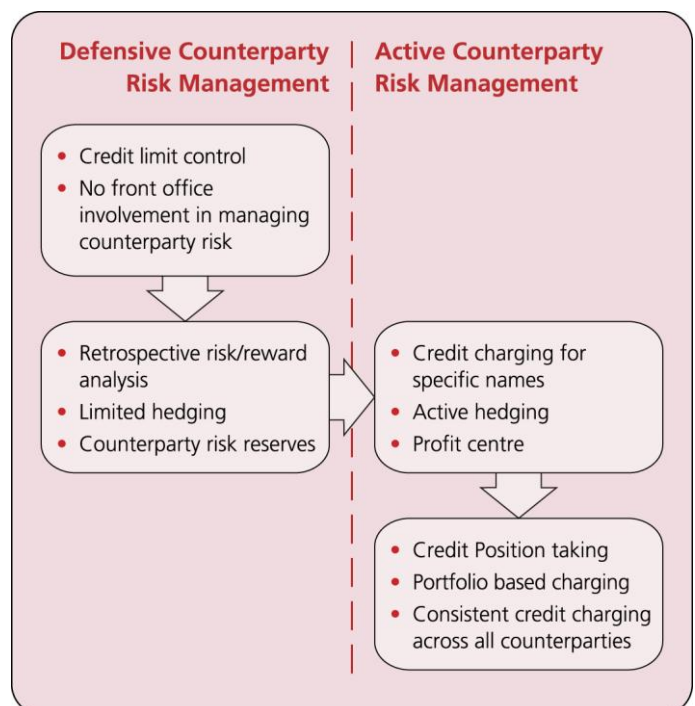
Organisation and governance

The most important initial step when setting up a CVA process is to clearly define its parameters and terms of reference in relation to organisation and governance.

In defining the approach to be undertaken, we will consider:

- **Organisational location;**
 - Where will the CVA desk sit (e.g. within the Front Office or CRM)?
 - Should this be centralised or in multiple locations?
- **Business Mandate;**
 - Is the CVA desk to be a pure service centre or profit centre?
 - Will its strategy be purely defensive, aimed at minimising loss, or also to take counterparty risk trading positions?

The diagram below illustrates how a bank might progress through the various levels of sophistication in designing this mandate.





Business process and methodology review

Once the organisational and governance issues have been agreed, the next step is to clearly define the scope and detail of the business processes which the CVA desk will perform.

The business process areas which will be addressed include:

- **Pre-trade Pricing**
 - Should credit charges be passed on to counterparties wherever possible?
 - Should pre-trade pricing take into account portfolio offsets?
 - How will credit charge premiums be transfer priced from the originating desk to the CVA desk?
 - What are the implications for counterparties trading through electronic trading platforms?
 - Where there is no publicly traded debt or CDS for the counterparty, how will default probabilities be assigned?
 - What is the methodology for the calculation of CVA?
- **P&L Reporting/Reserving**
 - How frequently will P&L be calculated for the CVA desk?
 - How to treat hedges?
 - Reserving approach?
- **Risk Mitigation**
 - What hedging methods are available?
 - What should be the approach for collateralised counterparties?
- **Risk Reward Analysis**
 - What risk/reward metrics should be measured?
 - Over what period should counterparty profitability be assessed?
- **Watch lists and Workouts**
 - What will be the role of the CVA desk in managing the watch list process and workout situations?
- **Reporting**
 - What reporting will the CVA desk be required to generate?
- **Touch Points with other areas**
 - How will the CVA desk work with other areas (e.g. Sales, CRM, etc)?

Target operating model & architecture definition

Building upon the analysis and recommendations from the organisation and process review, we work with the organisation to define the target operating model and functional architecture for the CVA solution.

This architecture and operating model definition covers the end to end CVA process, including all impacted user communities within the organisation.

In many cases, but depending upon the organisation, this architecture definition will involve making a build/buy decision for the organisation's strategic CVA solution.

System selection

InteDelta has extensive experience managing system selections for CVA. In carrying out a selection exercise, we use our own wide-ranging experience of CVA systems to manage the process as quickly as possible, whilst ensuring the bank chooses the most appropriate vendor for its specific needs.

We have a tried and tested assessment methodology for this process, specifically tailored to the risk management market.

Project roadmap and implementation plan

We recognise that achieving excellence with CVA is a long term exercise. At the same time there are many critical short term and medium term priorities and goals to be achieved. As a foundation for achieving all of these goals in a structured way, we will create a project roadmap and project implementation plan. These will be based both on your organisation's priorities but also, importantly, on our market experience and understanding of the dependencies between different aspects of the functional architecture.

We can provide you with the full Operating Model Review from initial review through to project implementation plan or, alternatively, we can provide you with individual parts of this process, if this is more appropriate to your particular needs.

For more information please e-mail contact@intedelta.com or call us on **+44 (0) 20 7153 1037**. Further information about InteDelta can also be found at www.intedelta.com

Short term and strategic recommendations

The first deliverable of the Operating Model Review is a report providing recommendations for the short term to provide clear initial business benefits in implementing a CVA process, which can be made without fundamental and structural change to the existing systems environment, as well as strategic improvements.