A Supervisory Perspective on Applying Model Risk Management (MRM) in CCAR

David Palmer
Federal Reserve Board

CCAR Modelling Symposium
June 2014

Expectations for MRM in CCAR

- BHCs are expected to have satisfactory validation for CCAR models
  - CAP Principle 6 (underlining added): "The BHC has robust internal controls governing capital adequacy process components, including policies and procedures; change control; <u>model validation and independent review</u>; comprehensive documentation; and review by internal audit."
  - ROPE (p. 7): "BHCs should conduct independent review and validation of all models used in internal capital planning, consistent with existing supervisory guidance on model risk management (SR 11-7)"
- SR 11-7 lays out expectations not just for validation, but for all aspects of MRM
- MRM for stress testing & assessing capital adequacy under stress conditions presents specific challenges

A Few Points of Emphasis on MRM

- The "first line of defense" in MRM is very important (development, implementation & use)
  - MRM not just the responsibility of validation staff
- Still see more opportunity for sensitivity analysis and challenge of model assumptions, including during the development stage
- Recognize that, in some cases, not all MRM activities can be conducted before a model is used in CCAR
  - If so, need transparency, exception process, remediation plans, and compensating controls
  - Should at least attempt some type of conceptual soundness review
  - Use greater caution for models with higher uncertainty
- Model materiality a fundamentally important consideration in MRM
  - More material models need more attention
- MRM for CCAR should be consistent with overall MRM framework expected under SR 11-7

A Few Common Questions

- What are expectations for use of overlays/overrides?
  - ✓ Should they be subject to validation/effective challenge?

- Do models for normal business needs have to be re-evaluated for their use in CCAR?

- Do supervisors require a model risk buffer?