MODEL RISK FRAMEWORK FOR MEDIUM-SIZE AND SMALL BANKS

Supervisory Guidance on Model Risk Management, known as SR 11-7, was published by the Federal Reserve in 2011, along with companion guidance from the OCC. Since then, the largest banks have dramatically improved their model risk management (MRM) programs by increasing the number and skill sets of those involved in model risk management, enhancing policy and procedure, and improving technology to make model risk management more efficient.

Progress has been slower and more challenging at smaller institutions and community banks, even though the use of models at these institutions continues to grow rapidly. In 2017, the FDIC adopted the Fed's Supervisory Guidance on Model Risk Management for all banks with assets greater than $1 billion, definitively requiring these institutions bolster their MRM practices.

This paper describes the key components of a sound model risk management program, with a focus on smaller institutions. It provides an in-depth guide for banks to develop a model risk management program, including: a governance framework, a model identification process, model risk rating, a model inventory, a model development process, model validation, an ongoing model monitoring program, and finally a risk appetite statement.

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