

Date: [Insert Date]

To: The Board of Directors and Senior Management of [Financial Institution Name]

Subject: Interagency Supervisory Guidance on Model Risk Management

1. Purpose

This letter provides guidance on effective model risk management (MRM) practices, consistent with the supervisory expectations set forth by federal regulatory agencies. As financial institutions increasingly rely on complex models for decision-making, the management of model risk becomes critical to safety and soundness.

2. Definition of Model

For the purposes of this guidance, a "model" refers to a quantitative method, system, or approach that applies statistical, economic, financial, or mathematical theories and techniques to process input data into quantitative estimates.

3. Model Risk Management Framework

The institution should maintain a comprehensive MRM framework that includes:

- **Model Development and Implementation:** Rigorous development processes, documentation of underlying assumptions, and testing of model limitations.
- **Model Validation:** Independent evaluation of models to verify that they are performing as intended and are fit for their specific purpose.
- **Governance and Controls:** Clear roles and responsibilities, internal audit oversight, and a central model inventory.

4. Supervisory Expectations

Examiners will assess the institution's MRM program based on the scale and complexity of model use. Institutions are expected to demonstrate:

- Effective challenge by independent parties during the validation process.
- Board-level oversight of model risk appetite and policy compliance.
- Ongoing monitoring of model performance to ensure continued validity under changing market conditions.

5. Conclusion

Failure to manage model risk effectively can lead to financial loss, poor strategic decision-making, and regulatory non-compliance. Institutions should review their current policies to ensure alignment with this guidance.

Authorized By:

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