

Acadameetrics Model Validation

- possible validation requirements arise
 - to match risk management processes with senior management decision making
 - to provide full documentation & description of models to facilitate “white room” replication or “judicial assessment”
 - to provide a rigorous validation of methodology, data & assumptions
 - within Basel II to fulfil FSA requirements for formal validation of internal models
- issues arise because of
 - no formal FSA specification of validation methodology
 - uncertainties of credit risk vs market risk – risk horizon, data availability, asymmetric distributions
 - the role of benchmarking & model replication
- our experience
 - is with major UK mortgage banks
 - has included provision of formal reports for model sign off in support of waiver applications
 - has covered “difficult” issues such as low default portfolios and use of expert judgment models

Acadameetrics Model Validation

The process involves

- a review of model documentation for completeness and level of detail that is sufficient to facilitate an independent review and to provide exact replication
- an examination of model theory to establish whether the appropriate statistical and economic theory has been used in the development of the models.
- a review and validation of data input and assumptions considering such as historic data aspects and whether the data used are representative of their application to the business
- a review of the model code and mathematics
- a review of the model results considering the clarity of the output and the degree of understanding by decision makers
- the production of a formal validation report