1. **Overriding Objective**

1.1. This Directive establishes the rules and processes to ensure the Bank's model risk management is undertaken in accordance with the Financial and Risk Management Policy (Sec2019-017).

1.2. The exercise and interpretation of this Directive shall seek to give effect to this overriding objective.

2. **General Principles**

2.1. This Directive sets out the governance structure to manage the Bank's models proportionate to model risk.

2.2. A model is any tool that applies assumptions to transform input data to generate quantitative estimates for decision-making or reporting purposes. It has three components:
   i. Information input: Delivers assumptions and data into the model.
   ii. Processor: Transforms inputs into estimates.
   iii. Reporting: Translates estimates into useful business information.

2.3. Models used for specific investment origination and workout purposes fall outside the scope of this Directive and are controlled separately through the project approval process and related Directive and Administrative Guidance.

2.4. Model risk is the potential loss that the Bank may incur due to decisions principally based on model outputs, including losses due to errors in the development, implementation or use of such models.

3. **Definitions**

3.1. **Model developer** is the party who designs, implements and creates the initial model documentation. Such party may be internal or external to the Bank.

3.2. **Model inventory** is a catalogue of all the models used by the Bank, containing details on their materiality, level of model risk, approval details and subsequent review dates.

3.3. **Model output** comprise the end results generated by the model.

3.4. **Model owner** is the department responsible for operating the model, liaising with model input providers and communicating issues relating to its use to the Risk Management Department (RMD) and model users.
3.5. **Model status** is the overall assessment of a model, taking into consideration the model's materiality and risk score and characterized as red, amber or green.

3.6. **Model user** is the Bank department that makes business decisions based, in whole or in part, on the model output.

3.7. **Model validation** is the process of assessing the appropriateness of the assumptions of a model, including the extent to which the model output is consistent with its methodological documentation.

4. **Determination of model status**

4.1. Each model owner shall determine the model status of the models for which it is responsible. RMD shall be responsible for verifying such determination.

5. **Model approval**

5.1. Where a model has a model status of amber or red, a model validation shall be performed prior to model approval. Such validation shall be performed by RMD unless RMD is the model developer, in which case, the Chief Risk Officer (CRO) will choose another party to perform the validation.

5.2. Where a model is developed by an external provider, RMD shall review its model validation results, where available, prior to approval.

5.3. Each model approved for use shall be reported by its model owner to RMD, which shall log the relevant details of such model into the model inventory.

5.4. Where a model has been in use from a date preceding the Effective Date of this Directive, RMD and the model owner shall agree a plan to re-approve such model in accordance with this Directive. Until such approval, such model shall be recorded as in-use but not approved within the model inventory.

6. **Model change management**

6.1. Any changes to an approved model can only be made by the model owner, and such change shall be verified in advance by RMD. The model status of the model shall be re-evaluated following any such change.

6.2. The approval body of such change shall be based on the model's status and magnitude of the change.

6.3. Any change in model owner shall be agreed in advance between the current model owner and the proposed model owner.
6.4. All model changes in either processes, methodology, ownership or users shall be recorded in the model inventory.

6.5. The model owner shall inform the model users of any changes to the model.

7. **Model use**

7.1. The model owner shall operate the model as specified in the model documentation, except where the model owner concludes that the circumstances of the model run are incompatible with the underlying assumptions, in which case the model owner may override the model output results as required.

7.2. The model owner shall inform RMD of the details surrounding such override, including the size of deviation, if any, from the model output, which RMD shall, in turn, log in the model inventory to facilitate subsequent model development.

8. **Model monitoring and reporting**

8.1. Each model shall undergo a periodic assessment, to be performed at least annually by its model owner. Such assessment shall describe the frequency with which the model has been used, including any operational issues experienced in connection therewith, and any changes to the materiality of the model since the last assessment.

8.2. RMD shall report to Risk Committee at least annually on the model status of the models used by the Bank.

9. **Information Disclosure by the Bank**

9.1. AIIB’s Public Information Policy and its related Directive and Administrative Guidance govern the disclosure of all information in the Bank’s possession, including with respect to this Directive.

10. **Implementation**

10.1. The CRO shall oversee this Directive and introduce any related Administrative Guidance and ensure their efficient and accurate implementation.

11. **Authority**

11.1. The CRO shall make all final decisions regarding the application of this Directive.