



Office of Thrift Supervision

Department of the Treasury *Managing Director, Examinations, Supervision, and Consumer Protection*

1700 G Street, N.W., Washington, DC 20552 • (202) 906-7984

November 7, 2006

MEMORANDUM FOR: Chief Executive Officers

FROM:

Scott M. Albinson

A handwritten signature in black ink that reads 'Scott M. Albinson'.

SUBJECT:

The *Enhanced* NPV Model

Beginning with the September 2006 reporting cycle, OTS will produce interest rate risk reports with an updated version of its *Net Portfolio Value Model* (the *Enhanced NPV Model*). Dr. Thomas Ho and his team at THC, Ltd., a New York-based financial engineering company, developed the new interest rate risk model exclusively for OTS. Individual interest rate risk reports produced each quarter initially will look like the current reports. The *Enhanced NPV Model* will use quarterly information reported by thrift institutions on the existing Consolidated Maturity Rate (CMR) Schedule.

The *Enhanced NPV Model* is based on many of the same valuation algorithms and model assumptions documented in the current [NPV Model Handbook](#). The *Enhanced NPV Model*, however, is both technically and analytically superior to the current *NPV Model* and will produce more precise results. More importantly, it will enable OTS to provide a series of new reports and features in future quarters that will give you a more in-depth understanding of your institution's interest rate risk profile. OTS will provide additional guidance as it introduces improvements and changes. Please refer to [The Quarterly Review of Interest Rate Risk \(Issue 11, Volume 1\)](#) for an in-depth discussion of the *Enhanced NPV Model's* capabilities and OTS's future model development plans.

For the past two quarters, OTS has been testing and validating the *Enhanced NPV Model*. As part of this process, the current model has run in parallel with the *Enhanced NPV Model* to make sure that the new model's valuation routines are accurate and to determine the extent to which the overall results from the two models differ. Based on this analysis, OTS anticipates a smooth transition and does not expect a significant change in the overall interest rate risk profile of the industry.

For a small number of institutions, however, migrating to the *Enhanced NPV Model* will result in a pre-shock capital ratio change of more than ten percent or a sensitivity measure change that exceeds 150 basis points. In some cases, these differences may result in a change of an institution's TB-13a supervisory risk classification. If this happens, OTS personnel will contact those institutions affected and will explain why the results from the two models are different.

OTS will work closely with institutions during the transition period, and all affected institutions will receive appropriate time to address and correct any significant new interest rate risk management deficiencies detected by the new model.

If you have any questions, please contact your regional OTS capital markets representative (listed at the bottom of your institution's *IRR - Executive Summary Report*) or Scott Ciardi, Director, Risk Modeling & Analysis Division, at (202) 906-6960.