



Office of Federal Housing Enterprise Oversight (OFHEO)

CONTACT: Corinne Russell (202) 414-6921
Stefanie Mullin (202) 414-6376
www.ofheo.gov

NEWS RELEASE

FOR IMMEDIATE RELEASE

March 30, 2007

**OFHEO ANNOUNCES FOURTH QUARTER 2006
MINIMUM AND RISK-BASED CAPITAL CLASSIFICATION
FOR FANNIE MAE and FREDDIE MAC**

**Reclassifies Fannie Mae Q1-3 2002, 2003 and 2004 as Significantly Undercapitalized and
Reaffirms Freddie Mac Q1-3 2006 as Adequately Capitalized**

WASHINGTON, DC — James B. Lockhart III, Director of the Office of Federal Housing Enterprise Oversight (OFHEO), the safety and soundness regulator for Fannie Mae and Freddie Mac, classified Fannie Mae and Freddie Mac as adequately capitalized as of December 31, 2006. Fannie Mae's classification is based on estimated numbers submitted by Fannie Mae and not financial statements released to shareholders. Freddie Mac's classification is based upon numbers consistent with the information statement and annual report it released on March 23, 2007.

Fannie Mae had a 10.9 percent surplus above the OFHEO-directed requirement, which is 30 percent above required minimum capital. Freddie Mac's surplus above that requirement was 7.7 percent.

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires the OFHEO Director to determine the capital level and classification of the Enterprises not less than quarterly, and to report the results to Congress. OFHEO classifies the Enterprises as adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized. The Enterprises are required by federal statute to meet both minimum and risk-based capital standards to be classified as adequately capitalized.

Fannie Mae

Fannie Mae's fourth quarter 2006 classification of adequately capitalized remains subject to change as the company continues its ongoing accounting review and issuance of public statements. Fannie Mae's quarterly numbers carry forward its 2004 accounting adjustments, as well as ongoing estimates of additional accounting changes for 2005 and 2006. The ongoing disclosures provide OFHEO additional assurance that the company is maintaining a capital surplus in excess of the OFHEO-directed requirement.

Fannie Mae's surplus as a percent of the OFHEO-directed requirement decreased slightly to 10.9 percent from 11.4 percent the prior quarter. The slight change is due mainly to an increased capital

requirement due to on- and off-balance sheet growth. Fannie Mae continues to operate under growth restrictions for its retained portfolio and has maintained compliance with this agreement throughout the quarter. There are no restrictions on its issuance of guaranteed MBS.

On December 28, 2006, OFHEO released 2002, 2003, and 2004 year-end classifications of significantly undercapitalized following Fannie Mae's release of its 2004 10-K, which was filed with the Securities and Exchange Commission (SEC) on December 6, 2006. Consistent with the year-end classifications and following resubmissions of the interim quarter information by Fannie Mae, OFHEO is now providing public notification of its reclassification of Fannie Mae from adequately capitalized to significantly undercapitalized for the interim 2002, 2003, and 2004 quarters. Because Fannie Mae was not required to restate quarterly results for Q1-3 2002 and 2003 per an SEC waiver, OFHEO agreed to accept estimates of the minimum and critical capital positions for these periods. The additional effort to produce the quarter-end positions for OFHEO outweighed the precision necessary to appropriately classify the capital position for these periods as significantly undercapitalized. Although Fannie Mae is now classified as having been significantly undercapitalized, the estimates do provide assurance that Fannie Mae did not fall below critical capital levels for these periods. For Q1-3 2004 Fannie Mae provided actual restated capital results, which were used in OFHEO's reclassification. All capital data for these historical quarters can be found on OFHEO's website in the historical charts at </CapitalRequirements.aspx?Nav=273>.

While progress is evident and OFHEO is classifying Fannie Mae as adequately capitalized for the fourth quarter 2006, significant work remains before Fannie Mae becomes a timely financial filer and corrects its internal control and operational weaknesses. It continues to remain prudent for Fannie Mae to hold capital in excess of the OFHEO-directed requirement to compensate for these uncertainties.

Freddie Mac

Freddie Mac's fourth quarter 2006 classification of adequately capitalized is based upon results consistent with its recently filed information statement and annual report. Freddie Mac resubmitted Q1-3 2006 capital results to OFHEO on March 22, 2007 that showed higher core capital numbers than originally submitted. This resubmission coincided with the 2006 information statement and annual report filing on March 23, 2007. OFHEO reaffirms the adequately capitalized classification for these quarters. The restated quarterly results for these periods can be found on OFHEO's website at </CapitalRequirements.aspx?Nav=138>. OFHEO determined that risk-based capital results did not require resubmission.

Freddie Mac's surplus as a percent of the OFHEO-directed requirement decreased to 7.7 percent from 9.1 percent the prior quarter due to a core capital reduction of \$0.9 billion, mostly from mark-to-market losses resulting in lower retained earnings. Freddie Mac has agreed to growth restrictions on their retained portfolio as of July 1, 2006 and remains in compliance with these restrictions. There are no restrictions on its issuance of guaranteed MBS.

While the filing of the 2006 information statement and annual report is a significant move forward for Freddie Mac, internal control and operational weaknesses remain evident. Significant work remains before Freddie Mac becomes a timely filer and SEC registrant. It continues to remain prudent for Freddie Mac to hold capital in excess of the OFHEO-directed requirement to compensate for these uncertainties.

FOURTH QUARTER CAPITAL RESULTS

Minimum and Critical Capital

Fannie Mae's adjusted¹ OFHEO-directed capital requirement on December 31, 2006 was \$38.1 billion and its adjusted statutory minimum capital requirement was \$29.3 billion. Fannie Mae's adjusted core capital of \$42.3 billion exceeded the adjusted OFHEO-directed capital requirement by \$4.2 billion. Fannie Mae's adjusted core capital exceeded the adjusted statutory critical capital requirement by \$27.1 billion.

Freddie Mac's reported OFHEO-directed capital requirement on December 31, 2006 was \$33.6 billion and its reported statutory minimum capital requirement was \$25.8 billion. Freddie Mac's reported core capital of \$36.2 billion exceeded the OFHEO-directed minimum capital requirement by \$2.6 billion. Freddie Mac's core capital exceeded the statutory critical capital requirement by \$22.9 billion.

Enterprise Minimum Capital Requirement (Billions of Dollars) ^(a)				
	Fannie Mae		Freddie Mac	
	31-Dec-06 ^(b,c,d)	30-Sept-06 ^(b,c,d)	31-Dec-06 ^(c)	30-Sept-06 ^(c, e)
Minimum Capital - Statutory Requirement	29.332	29.010	25.844	25.979
Minimum Capital - OFHEO Directed Requirement	38.131	37.714	33.597	33.773
Core Capital	42.295	42.008	36.170	37.035
Surplus (Deficit) (based on OFHEO Directed Requirement)	4.163	4.294	2.573	3.262

Enterprise Critical Capital Requirement (Billions of Dollars) ^(a)				
	Fannie Mae		Freddie Mac	
	31-Dec-06 ^(b,d)	30-Sept-06 ^(b,d)	31-Dec-06	30-Sept-06 ^(e)
Critical Capital Level	15.134	14.959	13.237	13.293
Core Capital	42.295	42.008	36.170	37.035
Surplus (Deficit)	27.161	27.049	22.933	23.743

- a. Numbers may not add due to rounding.
- b. Subject to revision based upon results of ongoing financial restatement and audit processes.
- c. OFHEO has directed both Fannie Mae and Freddie Mac to maintain an additional 30% capital in excess of the statutory minimum capital requirement. These requirements have been an additional requirement since January 28, 2004, for Freddie Mac and since September 30, 2005, for Fannie Mae. The OFHEO-directed minimum capital requirement and capital surplus numbers stated in these charts reflect the inclusion of the additional 30% OFHEO-directed capital requirement.
- d. Fannie Mae's minimum capital, critical capital, and core capital are adjusted for accounting errors identified to date.
- e. Restated by Freddie Mac on March 23, 2007.

¹ The term "adjusted" reflects that Fannie Mae's minimum capital submissions adjust book capital based upon estimated accounting change impacts, including the roll-forward of 2004 adjustments.

During the fourth quarter of 2006, Fannie Mae's minimum capital surplus decreased by \$0.1 billion to \$4.2 billion, 10.9 percent over the OFHEO-directed capital requirement of \$38.1 billion. The reported capital surplus fell because the OFHEO-directed requirement rose by \$0.4 billion due to growth in on-balance sheet assets, primarily short-term liquid investments, and in off-balance sheet obligations, primarily MBS outstanding. Core capital increased by \$0.3 billion in the fourth quarter to \$42.3 billion due to a growth in retained earnings that more than offset dividends of \$521 million.

Freddie Mac's surplus was 7.7 percent over the OFHEO-directed capital requirement. Its surplus fell by \$0.7 billion to \$2.6 billion from the prior quarter's surplus of \$3.3 billion due to a reduction in core capital, partially offset by a decline in the OFHEO-directed requirement. Core capital fell by approximately \$0.9 billion due to an equal decrease in retained earnings. The reduction in retained earnings was the result of reported losses of \$480 million including mark-to-market losses of approximately \$1.0 billion, which are a result of a decline in the level and volatility of interest rates, and dividends of \$415 million.

Changes in critical capital mirrored changes in minimum capital.

Risk-Based Capital

As of December 31, 2006, Fannie Mae's risk-based capital requirement was \$26.9 billion. Fannie Mae's total capital of \$43.0 billion on that date exceeded the requirement by \$16.1 billion.

As of December 31, 2006, Freddie Mac's risk-based capital requirement was \$15.3 billion. Freddie Mac's total capital of \$36.7 billion on that date exceeded the requirement by \$21.4 billion.

Enterprise Risk-Based Capital Requirement (Billions of Dollars) ^(a)								
Interest Rate Scenario	Fannie Mae ^(b)				Freddie Mac			
	31-Dec-06		30-Sep-06		31-Dec-06		30-Sep-06	
	Up	Down	Up	Down	Up	Down	Up	Down
Risk Based Capital Requirement	26.870	9.134	22.524	16.447	15.320	12.934	14.879	13.785
Total Capital	43.046		41.820		36.742		37.202	
Surplus (Deficit)	16.176		19.296		21.422		22.323	

a. Numbers may not add due to rounding.

b. Subject to revision based upon results of ongoing financial restatement and audit processes.

By statute, stress test interest rate levels are a function of the average 10-year Constant Maturity Treasury (CMT) over the most recent nine months. At the end of the third quarter of 2006, the nine-month average of the 10-year CMT rose to 4.87 percent, 14 basis points higher than the nine-month average at the end of the second quarter of 2006. As a result, 10-year CMT levels at the end of the first year in the risk-based capital stress test increased from 8.24 percent to 8.48 percent in the up-rate stress test, and from 2.35 percent to 2.42 percent in the down-rate stress test.

While year-end stress test rate levels rose slightly, market interest rates actually fell in the fourth quarter as the yield curve flattened further. As a consequence, expected prepayment speeds increased and the duration of fixed-rate mortgage assets decreased. In response, Fannie Mae correspondingly shortened the duration of its debt and derivative portfolio to maintain an asset/liability match. Freddie Mac also adjusted its funding and derivative portfolio to match changes in asset duration.

Fannie Mae's rebalancing actions increased its exposure in the up-rate scenario and reduced exposure in the down-rate scenario. As a result, the up-rate stress test remained binding in the fourth quarter. Fannie Mae's risk-based capital requirement in the up-rate stress test rose \$4.4 billion to \$26.9 billion. By

contrast, the risk-based capital requirement in the down-rate stress test fell \$7.3 billion to \$9.1 billion. Overall, Fannie Mae's risk-based capital surplus decreased from \$19.3 billion to \$16.2 billion.

Freddie Mac's risk-based capital surplus decreased from \$22.3 billion to \$21.4 billion due to a higher risk-based capital requirement and a decline in total capital. Falling rates in the quarter caused rebalancing actions that increased exposure moderately in the binding up-rate scenario. Freddie Mac's risk-based capital requirement in the up-rate stress test was \$15.3 billion for the fourth quarter versus \$14.9 billion in the third quarter. Freddie Mac's risk-based capital requirement in the down-rate stress test decreased by \$0.9 billion to \$12.9 billion driven in part by an increase in its receive-fixed swaption positions.

QUALIFICATIONS AND COMPLIANCE

Fannie Mae's capital classification is based upon Fannie Mae's best estimates of its financial condition, as certified and represented as true and correct to the best of Fannie Mae management's belief and knowledge. The fourth quarter 2006 capital classification remains subject to revision pending Fannie Mae's submission of audited 2006 financial statements and corresponding regulatory capital reports.

Fannie Mae remains subject to the requirements imposed by the Consent Order dated May 23, 2006 and the Capital Restoration Plan approved February 17, 2005. The Capital Restoration Plan required Fannie Mae to achieve a 30 percent capital surplus over the minimum capital requirement by September 30, 2005 (OFHEO-directed capital requirement). Fannie Mae is required to maintain a capital surplus above the OFHEO-directed requirement on an ongoing basis. Fannie Mae met the initial September 30, 2005 achievement of 30 percent surplus and it has continued to maintain the surplus through the fourth quarter 2006.

Freddie Mac's capital classification is based upon its financial condition, as certified and represented as true and correct by Freddie Mac's management, and consistent with the publicly disclosed information statement and annual report. The annual report and financial statements were given an unqualified opinion by PricewaterhouseCoopers. OFHEO imposed a capital surcharge of 30 percent of the minimum capital requirement for Freddie Mac in January 2004 due to increased operational risk. Freddie Mac continued to maintain its minimum capital surplus in excess of the OFHEO-directed capital requirement through the fourth quarter 2006.

FOURTH QUARTER QUALIFYING SUBORDINATED DEBT RESULTS

Additionally, OFHEO is releasing qualifying subordinated debt positions of Fannie Mae in accordance with the September 1, 2005 Agreements between OFHEO and the Enterprises. (See 9/2/05 release at <http://www.ofheo.gov/newsroom.aspx?ID=237&q1=0&q2=9>)

Fannie Mae's total capital and qualifying subordinated debt for the fourth quarter 2006 exceeded the requirements outlined in the Agreement dated September 1, 2005.

Freddie Mac's total capital and qualifying subordinated debt for the fourth quarter 2006 exceeded the requirements outlined in the Agreement dated September 1, 2005.

Qualifying subordinated debt levels are disclosed below.

Enterprise Qualifying Subordinated Debt Disclosure				
(Billions of Dollars) ^(a)				
	Fannie Mae		Freddie Mac	
	31-Dec-06	30-Sep-06	31-Dec-06	9/30/2006 ^(b)
Total Capital & Qualifying Subordinated Debt	50.705	50.453	42.602	42.743
Capital Requirement at 4% for On-Balance Sheet Assets and at 0.45% for Net MBS / PCs Outstanding	41.798	41.488	37.576	37.966
Surplus (Deficit)	8.908	8.965	5.026	4.777

Footnote:

- a. Qualifying Subordinated Debt is defined as subordinated debt that contains the interest deferral feature. The interest deferral requires the deferral of interest payments for up to 5 years if:
- 1) The corporation's core capital falls below 125% of critical capital, or
 - 2) The corporation's core capital falls below minimum capital AND, pursuant to the corporation's request, the Secretary of the Treasury exercises discretionary authority to purchase the company's obligations under Section 306(c) of the Freddie Mac Charter Act and Section 304(c) of the Fannie Mae Charter Act.
- b. Restated by Freddie Mac on March 23, 2007.

DEFINITION OF CAPITAL STANDARDS

Core Capital is the sum of outstanding common stock, perpetual, noncumulative preferred stock, paid-in capital, and retained earnings. Core capital does not include Accumulated Other Comprehensive Income (AOCI), which is captured as part of stockholder's equity.

Total Capital is the sum of Core Capital plus the allowance for loan losses.

Minimum capital represents an essential amount of capital needed to protect an Enterprise against broad categories of business risk. For purposes of minimum capital, an Enterprise is considered by law adequately capitalized if core capital — common stock; perpetual noncumulative preferred stock; paid in capital; and retained earnings — equals or exceeds minimum capital. The minimum capital standard is 2.5 percent of assets plus 0.45 percent of adjusted off-balance-sheet obligations, including guaranteed mortgage securities.

The OFHEO-directed capital requirement is the amount of capital the Enterprise needs to maintain to compensate for increased operational risks including systems, accounting, and internal control risks. The level is prescribed by the Director of OFHEO. At this time, both Enterprises are required to hold 30 percent over the statutory minimum capital requirement. This is calculated by multiplying the minimum capital requirement by 1.3 times.

OFHEO's risk-based capital requirement is the amount of total capital — core capital plus a general allowance for loan losses less specific reserves — that an Enterprise must hold to absorb projected losses flowing from future adverse interest-rate and credit-risk conditions specified by statute, plus 30 percent mandated by statute to cover management and operations risk. The risk-based capital standard is based on stress test results calculated for the two statutorily prescribed interest rate scenarios, one in which 10-year Treasury yields rise 75 percent (up-rate scenario) and another in which they fall 50 percent (down-rate scenario). Changes in both scenarios are generally capped at 600 basis points. The risk-based capital level for an Enterprise is the amount of total capital that would enable it to survive the stress test in whichever scenario is more adverse for that Enterprise, plus 30 percent of that amount to cover management and operations risk.

The **critical capital** level is the amount of core capital below which an Enterprise must be classified as critically undercapitalized and generally must be placed in conservatorship. Critical capital levels are computed consistent with the Federal Housing Enterprises Safety and Soundness Act of 1992 as follows: One-half of the portion of minimum capital requirement associated with on-balance-sheet assets plus five-ninths of the portion of the minimum capital requirement associated with off-balance-sheet obligations.

QUALIFYING SUBORDINATED DEBT

Qualifying subordinated debt is defined as subordinated debt that contains the interest deferral feature described below:

The interest deferral requires the deferral of interest payments for up to 5 years if:

- The corporation's core capital falls below 125 percent of critical capital, or
- The corporation's core capital falls below minimum AND, pursuant to the corporation's request, the Secretary of the Treasury exercises discretionary authority to purchase the company's obligations under Section 306(c) of the Freddie Mac Charter Act and Section 304(c) of the Fannie Mae Charter Act.

The September 1, 2005 agreement requires that:

Subordinated debt will be issued in a quantity such that the sum of total capital (core capital plus general allowance for losses) plus the outstanding balance of qualified subordinated debt will equal or exceed the sum of outstanding net MBS times 0.45 percent and total on-balance sheet assets times 4 percent.

Technical questions regarding these results should be directed to: rbcquestions@ofneo.gov.

###

OFHEO's mission is to promote housing and a strong national finance system by ensuring the safety and soundness of Fannie Mae and Freddie Mac.