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**OFHEO ISSUES
SECOND QUARTER 2003 CAPITAL CLASSIFICATIONS
FOR FANNIE MAE AND FREDDIE MAC**

WASHINGTON, D.C. — Armando Falcon, Jr., Director of the Office of Federal Housing Enterprise Oversight (OFHEO), safety and soundness regulator for Fannie Mae and Freddie Mac (the Enterprises), has determined that the Enterprises were adequately capitalized under OFHEO's capital standards as of June 30, 2003.

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires OFHEO 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.

Freddie Mac's capital classification is based on financial information and the application of accounting policies currently undergoing re-audit and restatement. The accounting changes reflected in the 2003 restatements will impact both minimum capital surpluses and, to a lesser degree, risk-based capital surpluses. The stress test for risk-based capital utilizes cash flows and the economics of the individual transactions; which have not changed.

Freddie Mac will publish restated financial results for 2003. The Director will then determine whether there is a need to recalculate regulatory capital.

SECOND QUARTER RESULTS:

FANNIE MAE

As of June 30, 2003, Fannie Mae's **risk-based capital** requirement was \$18.114 billion. Fannie Mae's total capital of \$31.469 billion on that date exceeded the risk-based capital requirement by \$13.355 billion.

Fannie Mae's minimum capital requirement was \$29.147 billion. Fannie Mae's core capital of \$30.675 billion exceeded the minimum capital requirement by \$1.527 billion.

FREDDIE MAC

As of June 30, 2003, Freddie Mac's risk-based capital requirement was \$4.720 billion. Freddie Mac's total capital of \$29.340 billion on that date exceeded the requirement by \$24.620 billion.

Freddie Mac's minimum capital requirement was \$22.687 billion. Freddie Mac's core capital of \$28.958 billion exceeded the minimum capital requirement by \$6.270 billion.

Capital data for each Enterprise as of March 31, 2003 and June 30, 2003:

Enterprise Risk-Based Capital Requirement (Billions of Dollars) (2)								
Interest Rate Scenario	Fannie Mae				Freddie Mac(1)			
	30-Jun-03		31-Mar-03		30-Jun-03		31-Mar-03	
	High	Low	High	Low	High	Low	High	Low
Risk-Based Capital Requirement	18.114	10.558	16.555	11.466	4.720	4.720	5.198	5.198
Total Capital	31.469		30.309		29.340	29.340	26.512	26.512
Surplus (Deficit)	13.355		13.753		24.620	24.620	21.314	21.314

Enterprise Minimum Capital Requirement (Billions of Dollars) (2)				
	Fannie Mae		Freddie Mac(1)	
	30-Jun-03	31-Mar-03	30-Jun-03	31-Mar-03
Minimum Capital Requirement	29.147	28.226	22.688	21.773
Core Capital	30.675	29.516	28.958	26.107
Surplus (Deficit)	1.527	1.291	6.270	4.334

Enterprise Critical Capital Requirement (Billions of Dollars) (2)				
	Fannie Mae		Freddie Mac(1)	
	30-Jun-03	31-Mar-03	30-Jun-03	31-Mar-03
Critical Capital Level	14.912	14.413	11.540	11.088
Core Capital	30.675	29.517	28.958	26.107
Surplus (Deficit)	15.762	15.103	17.418	15.020

(1) Freddie Mac's 3/31/2003 and 6/30/2003 capital numbers are based on financial information and application of accounting policies currently undergoing re-audit and restatement. These numbers are subject to change.

(2) Numbers may not add due to rounding.

GENERAL ANALYSIS OF THE RISK-BASED CAPITAL RESULTS

At June 30, 2003, Freddie Mac's capital surplus increased by \$3.3 billion, continuing a trend observed since the third quarter of 2002, and Fannie Mae's capital surplus decreased by \$0.4 billion.

Interest rates during the stress test are, by statute, a function of recent rates. At June 30, 2003, interest rates at the start of the stress test declined from their March 31, 2003 levels in spite of an upward trend in rates that started during the second half of June.

As with the prior quarter, the up-rate stress test is the more stressful scenario for Fannie Mae. In the up-rate scenario, Fannie Mae's risk-based capital surplus decreased from the prior quarter because an increase in starting capital was offset by a larger increase in the capital requirement. Debt costs in the up-rate scenario decreased as a result of lower interest rates and increased protection in the form of caps and pay-fixed swaptions. Lower debt costs were offset by lower interest income driven by a slight decrease in the size of the retained portfolio and lower yields on mortgages. Strong growth in MBS guarantees and a slight increase in loss severity consistent with the addition of newly originated mortgages also resulted in higher credit losses

As with the prior quarter, Freddie Mac's risk-based capital requirement is the same for both the up- and down-rate scenarios, indicating that its financial position improved throughout the stress test. This result primarily reflects Freddie Mac's continued conservative hedging of its interest rate risk. The risk-based capital surplus increased by \$3.3 billion as a result of an increase in starting capital. Freddie Mac has maintained a surplus of both minimum and risk-based capital, which creates a buffer against potential volatility that may result following the restatement.

TREATMENTS FOR NEW ACTIVITIES

Each quarter OFHEO must incorporate into the stress test all new activities and instruments before determining whether an Enterprise is adequately capitalized (new activities are defined in section 3.11.1 of the risk-based capital regulation). When OFHEO requires more time for analysis to determine the appropriate capital treatment for a new activity, the activity will receive an interim treatment in the stress test. Final treatment for these instruments are determined after additional analysis, based upon consideration of the risks associated with the item. As a part of this quarter's capital classification, a final treatment for reverse mortgages has been incorporated into the stress test. The final treatment reflects acceptance of the interim treatment for these products applied in previous quarters. The specific treatment can be found on OFHEO's web site.

DEFINITION OF CAPITAL STANDARDS

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 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.

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.

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