Office of Federal Housing Enterprise Oversight
(OFHEO)

NEWS RELEASE

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For Immediate Release
May 06, 2004

OFHEO Directs Fannie Mae to Recognize Asset Impairment
OFHEO Examination Finds Current Accounting Fails to Reflect Earnings Volatility

WASHINGTON, D.C. — Armando Falcon Jr., Director of the Office of Federal Housing Enterprise Oversight (OFHEO) has directed Fannie Mae to account for manufactured housing and aircraft lease securities impairments in the periods in which they occur. The OFHEO examination of Fannie Mae has determined that the Enterprise is not applying the appropriate accounting with respect to determining asset impairments and revenue recognition for these securities.

"Fannie Mae improperly accounted for these assets in a way that fails to reflect losses," said Falcon. "As safety and soundness regulator, we will take the necessary steps to correct this."

Falcon directed Fannie Mae to complete the accounting to recalculate the proper asset impairment on the securities by close of business Friday, May 14, 2004.

The OFHEO examination of Fannie Mae's accounting policies and practices continues.

The letter and attachment follow.

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

OFHEO

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

May 6, 2004

Franklin D. Raines
Chairman and CEO
Fannie Mae
3900 Wisconsin Avenue, NW
Washington, DC 20016-2892

Dear Mr. Raines:

The OFHEO examination of Fannie Mae has determined that Fannie Mae is not applying the proper accounting standard with respect to determining asset impairments and revenue recognition for manufactured housing and aircraft lease securities. The current accounting of Fannie Mae does not reflect the earnings volatility associated with these assets, does not best reflect actual economic performance and does not recognize on a timely basis impairments of the portfolio. These are inconsistent with the objectives of providing high-quality earnings information and achieving a "best in class" level of accounting expected of the Enterprise.

Accordingly, I am directing Fannie Mae to recognize asset impairments in the periods in which they occur using the steps outlined in the attached document to calculate impairment and revenue recognition, including for prior fiscal quarters. Please complete this procedure by the close of business May 14, 2004.

As you are aware, the related matters of fair value estimation, cash flow forecasting and internal controls remain under review and OFHEO may have findings to communicate to you in these matters in the future. Please note that OFHEO's examination is continuing in other areas and we may have findings in other areas to convey to you, findings that may require further financial analysis on your part.

Questions or additional guidance on the directive and attached document may be directed to Christopher Dickerson, Chief Compliance Examiner at 202-414-3819.

Sincerely,

Armando Falcon, Jr.
Director

Attachment

OFHEO

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

Attachment

OFHEO Examination of FNMA
Manufactured Housing Securities and Aircraft Lease Securities
Steps to Calculate Impairment and Determine Revenue Recognition

The following steps should be performed to measure the amount of any impairment for Fannie Mae's portfolio.	
1	Identify all manufactured housing securities and aircraft lease securities with an S&P (or equivalent) rating lower than AA-.
2	For the securities identified in 1 above, determine which securities had a fair value less than its amortized cost.
3	For securities identified in 2 above, determine whether there was an adverse change in estimated cash flows since the prior quarter. Note: For purposes of this step, OFHEO believes that a downgrade of one full grade or more (e.g. a downgrade from "AA - High grade, high credit quality" to "A- Upper-medium grade") is implicitly considered to represent an adverse change in expected cash flows. Thus, any such downgrade should be considered an adverse change in cash flows, irrespective of the results of other cash flow modeling performed by the company.
4	Determine the amount of write-down to reflect an other-than temporary impairment based on the excess of amortized cost over fair value for each security that experienced both a decline in fair value below cost (per step 2) and an adverse change in cash flows (per step 3).
5	For each security for which a write-down is determined per step 4, adjust the yield prospectively based on the revised (written down) amortized cost and estimated future cash flows for the security. Ensure that each security's amortized cost used in subsequent quarters' analyses is adjusted to reflect the write-downs and the adjusted yield.
6	Determine the effect on net pre-tax net income for each quarter as a result of the adjustments in steps 4 and 5 above.
7	Prepare an analysis summarizing the results of the above steps and the impact for each quarter-end beginning with December 31, 2002.