OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

NEWS RELEASE

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OFHEO ANNOUNCES FIRST OFFICIAL CLASSIFICATION OF FANNIE MAE AND FREDDIE MAC UNDER BOTH MINIMUM AND RISK-BASED CAPITAL STANDARDS

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 September 30, 2002.

"This is the first quarter for which the Enterprises' capital classifications are based on both the minimum and risk-based capital requirements. I am pleased to report that Fannie Mae and Freddie Mac have met these stringent requirements. This is a critical milestone in ensuring the financial health of the nation's housing finance system," said Director Falcon.

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 capital standards to be classified as adequately capitalized. Under the terms of that statute, this is the first quarter that the risk-based standard is fully enforceable. OFHEO conducted and published results of two trial tests of the risk-based capital standard (in June and September) during the statutory one-year implementation period, which ended Sept. 13, 2002. The Enterprises passed both trial runs of the risk-based capital test.

RESULTS UNDER OFHEO’S RISK-BASED AND MINIMUM CAPITAL STANDARDS:

FANNIE MAE

As of September 30, 2002, Fannie Mae's risk-based capital requirement was $21.440 billion. Fannie Mae’s total capital of $27.278 billion on that date exceeded the risk-based capital requirement by $5.838 billion.

Fannie Mae’s minimum capital requirement was $25.756 billion. Fannie Mae’s core capital of $26.484 billion exceeded the minimum capital requirement by $729 million.

FREDDIE MAC

As of September 30, 2002, Freddie Mac's risk-based capital requirement was $4.919 billion. Freddie Mac's total capital of $23.101 billion on that date exceeded the requirement by $18.182 billion.

Freddie Mac’s minimum capital requirement was $20.538 billion. Freddie Mac’s core capital of $22.656 billion exceeded the minimum capital requirement by $2.118 billion.

The table below provides relevant capital data for each Enterprise as of September 30, 2002:*

Enterprise Risk-Based Capital Requirement
(Billions of Dollars)

	Fannie Mae				Freddie Mac			
	September 30, 2002		June 30, 2002		September 30, 2002		June 30, 2002	
Risk-Based Capital Requirement:								
High Interest Rate Scenario		18.887		16.936	4.919		10.764	
Low Interest Rate Scenario	21.440		22.103			0.732		1.533
Total Capital	27.278		27.178		23.101		22.220	
Surplus (Deficit)	5.838		5.075		18.182		11.456	

Enterprise Minimum Capital Requirement
(Billions of Dollars)

	Fannie Mae		Freddie Mac	
	September 30, 2002	June 30, 2002	September 30, 2002	June 30, 2002
Minimum Capital Requirement	25.756	25.227	20.538	19.520
Core Capital	26.484	26.382	22.656	21.445
Surplus (Deficit)	0.729	1.155	2.118	1.925

Enterprise Critical Capital Level
(Billions of Dollars)

	Fannie Mae		Freddie Mac	
	September 30, 2002	June 30, 2002	September 30, 2002	June 30, 2002
Critical Capital Level	13.145	12.867	10.463	9.950
Core Capital	26.484	26.382	22.656	21.445
Surplus (Deficit)	13.339	13.515	12.193	11.495

***Numbers have been rounded.**

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GENERAL ANALYSIS OF THE RISK-BASED CAPITAL RESULTS

At September 30, 2002, both Enterprises held substantially more capital than necessary to pass the risk-based capital (RBC) stress test. The Enterprises' successes in meeting their RBC requirements reflect the effectiveness of their interest rate risk management, the restrained magnitude of stress test interest rate changes in the current low-rate environment and, to a lesser extent, continuing house price appreciation.

As was the case for **Freddie Mac** in 1Q02 and 2Q02, in 3Q02 the up-interest-rate scenario was the more stressful of the two interest rate scenarios. During the third quarter the 10-year Constant Maturity Treasury (CMT) yield fell over 100 basis points, to below four percent, allowing Freddie Mac to replace a significant amount of callable long-term debt with new debt at lower cost. In accordance with the statutory formula, 10-year CMT rose more in the September 30 stress test than the June 30 test -- 4.55% for September 30 versus 3.79% for June 30 -- but the 10-year CMT did not rise to as high a level -- 8.42% for September 30 versus 8.72% for June 30. The lower rates in the September 30 test shortened the average lives of Freddie Mac's mortgage assets and reduced its need for the expensive (in the up-rate scenario) new funding with which the stress test replaces maturing debt. Freddie Mac's lowering of its debt costs during the third quarter, coupled with the somewhat reduced interest rates of the up-rate scenario also contributed to the $6.7 billion increase in its capital surplus between September 30 and June 30.

Fannie Mae fared better in the stress test at September 30 than at June 30, as reflected by the modest $0.7 billion increase in Fannie Mae's RBC capital surplus between June and September. In accordance with the statutory formula, the decline in the 10-year CMT for the September 30 stress test was substantially smaller -- 1.45% versus 2.44% for June 30 -- and the final rate was virtually unchanged -- 2.41% versus 2.49% for June 30. As did Freddie Mac, Fannie Mae reduced its long-term debt costs during the third quarter, but the benefits from that and from the greater use of derivative hedges against decreasing interest rates were largely offset by faster prepayments and their effects on interest income.

For the last three quarters, interest rate risk exposure has accounted for most of the Enterprises' RBC requirements. Recent house price growth has continued to support the credit quality of Enterprise mortgage portfolios, which, combined with effective risk sharing arrangements, has limited the significance of mortgage credit losses in the stress test.

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, final treatments for two new activities -- futures and swaptions -- have been incorporated into the stress test. This final treatment replaces the interim treatment that applied in previous quarters.

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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