



OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

# NEWS RELEASE

**FOR IMMEDIATE RELEASE**

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## **OFHEO ISSUES SECOND QUARTER 2002 RISK-BASED CAPITAL STRESS TEST RESULTS 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), announced today that both Enterprises passed the application of the risk-based capital stress test for the quarter ending June 30, 2002.

This is the second time OFHEO has calculated and published the results of the risk-based capital stress test. The first results of the risk-based capital test were published June 27, 2002 using first quarter 2002 data. OFHEO will use the risk-based capital standard to classify the Enterprises for regulatory purposes at the end of the third quarter 2002. These results will be released in December. Starting then, the Enterprises will need to meet both risk-based and minimum capital requirements to be classified as adequately capitalized. The risk-based capital stress test requires the Enterprises to hold capital commensurate with their risk exposures.

The results for the quarter ending June 30, 2002 are as follows:

### **FANNIE MAE**

As of June 30, 2002, Fannie Mae's risk-based capital requirement was \$22.103 billion. Fannie Mae's total capital of \$27.178 billion on that date exceeded the risk-based capital requirement by \$5.075 billion. However, Fannie Mae's **higher** minimum capital requirement of \$25.227 billion was binding.

### **FREDDIE MAC**

As of June 30, 2002, Freddie Mac's risk-based capital requirement was \$10.764 billion. Freddie Mac's total capital of \$22.220 billion on that date exceeded the requirement by \$11.456 billion. However, Freddie Mac's **higher** minimum capital requirement of \$19.520 billion was binding.

## ANALYSIS

Several factors contributed to the RBC requirements being lower than the minimum capital requirements, including recent rapid increases in house prices, low and moderately declining interest rates, and substantial Enterprise hedging programs. Over the past three years, house prices have risen 25 percent on average. This raises the value of the collateral on seasoned loans, which comprise most of the Enterprises' portfolios, and lowers the risk of default.

The 10-year Constant Maturity Treasury yield finished the quarter below 5 percent and averaged 4.98 percent over the preceding 9 months. In accordance with the statutory formula, the rates used in the stress test increased to 8.72 percent (or up 379 basis points from the preceding 9 month average) in the increasing (up-rate) interest rate scenario of the stress test and decreased to 2.49 percent (or down 244 basis points) in the decreasing (down-rate) interest rate scenario. These changes were less than the maximum 600 basis point changes possible in higher interest rate environments.

Both Enterprises' risk-based capital requirements were higher and their capital surpluses were smaller in the second quarter, when compared to the first quarter. Fannie Mae's risk-based capital requirements increased by \$1.875 billion over the previous quarter, \$987 million more than the increase in its total capital. In both quarters, the low interest rate scenario was more severe for Fannie Mae. The size and composition of its asset, liability, and derivative positions were much the same as they were 3 months earlier. Stress test interest rates during the last 9 years of the 10-year stress period were also much the same as they were for the stress test applied 3 months earlier. However, interest rates were lower during the first year of the stress period, increasing prepayments. Extra prepayments reduce interest income in the down interest rate scenario because mortgages paying relatively high rates are no longer on the books.

Freddie Mac's risk-based requirement reflected a greater change. While its asset and liability positions were similar in both quarters, its derivative positions at June 30 provided less complete protection against interest rate increases than they had at the end of the previous quarter. Because the up-rate interest rate scenario was more severe for Freddie Mac and the reorientation of its derivatives book caused greater net interest losses in the up-rate scenario, Freddie Mac's capital requirement increased.

## BACKGROUND

OFHEO's minimum capital standard requires each Enterprise to have **core capital** (the sum of the par value of common and preferred stock, additional paid-in capital, and retained earnings) that meets or exceeds its **minimum capital** requirement (2.5 percent of assets plus 0.45 percent of adjusted off-balance-sheet obligations). Minimum capital represents a capital floor mandated by Congress regardless of other measures of capital adequacy to protect an Enterprise against broad categories of business risk.

The **risk-based capital** standard requires each Enterprise to have total capital (core capital plus general loss reserves less specific loss reserves) that meets or exceeds its risk-based capital requirement. Stress test results are calculated for two 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 risk-based capital rule was proposed in April 1999 and finalized September 13, 2001. By statute, there was a one-year implementation period before the rule became enforceable September 13, 2002. A proposed technical and corrective amendment to the risk-based capital rule was published September 12, 2002, but is not yet final and was not incorporated in this calculation.

## RESULTS OF THE STRESS TEST

The tables below provide relevant capital data for each Enterprise as of June 30, 2002.

<b>ENTERPRISE RISK-BASED CAPITAL RESULTS</b>				
<b>(Billions of dollars)</b>				
	<b>FANNIE MAE JUNE 30, 2002</b>		<b>FANNIE MAE MARCH 31, 2002</b>	
Risk-Based Capital Requirement:				
High Interest Rate Scenario		16.936		18.475
Low Interest Rate Scenario	22.103		20.228	
Total Capital	27.178		26.290	
Surplus (Deficit)	5.075		6.062	
	<b>FREDDIE MAC JUNE 30, 2002</b>		<b>FREDDIE MAC MARCH 31, 2002</b>	
Risk-Based Capital Requirement:				
High Interest Rate Scenario	10.764		5.680	
Low Interest Rate Scenario		1.533		1.481
Total Capital	22.220		21.360	
Surplus (Deficit)	11.456		15.680	

<b>ENTERPRISE MINIMUM CAPITAL REQUIREMENT</b>				
<b>(Billions of dollars)</b>				
	<b>FANNIE MAE</b>		<b>FREDDIE MAC</b>	
	<b>June 30</b>	<b>March 31</b>	<b>June 30</b>	<b>March 31</b>
Minimum Capital Requirement	25.227	24.571	19.520	19.390
Core Capital	26.382	25.500	21.445	20.558
Surplus (Deficit)	1.155	.929	1.925	1.169

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