



OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
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NEWS RELEASE

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OFHEO CLASSIFIES FANNIE MAE AS SIGNIFICANTLY UNDERCAPITALIZED FOR FOURTH QUARTER 2004 AND ADEQUATELY CAPITALIZED FOR FIRST QUARTER 2005

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 classified Fannie Mae as significantly undercapitalized as of December 31, 2004 and adequately capitalized as of March 31, 2005.¹

Fannie Mae's capital classification is based on estimated financial information provided by the Enterprise and the application of accounting policies currently under review by OFHEO. The capital classification also utilizes current best estimates as certified and represented by Fannie Mae management of its financial condition, including adjustments for additional accounting errors. This capital classification is subject to change as additional information becomes available; such as Fannie Mae's certification of its financial statements; and, OFHEO's completion of its review of Fannie Mae's accounting policies and practices.

Both the release of the December 31, 2004 classification, and the early release for the March 31, 2005 capital classification are a result of the circumstances surrounding the review of Fannie Mae's accounting policies and practices. Estimates provided by Fannie Mae of the accounting errors' impact on capital required OFHEO's review and analysis to assess the year-end capital impact. Further, as a result of ongoing monitoring and the filing of the March 31, 2005 capital position by Fannie Mae, a more accurate assessment of the capital adequacy can now be made.

¹ 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.

December 31, 2004 Classification

As of December 31, 2004, based upon the information provided by Fannie Mae and adjustments for the estimated accounting errors' impact on capital, Fannie Mae's estimated core capital exceeded the minimum capital requirement by a small margin. However, given the significant control weaknesses and the remaining uncertainties associated with the ongoing review of Fannie Mae's financial controls and accounting policies, a significant risk remains that accounting adjustments could deplete Fannie Mae's core capital to an amount below the required minimum for this time period. The small surplus at year-end 2004 leaves little room for discrepancies in the estimated capital position. Accordingly, OFHEO has retained the significantly undercapitalized position as of December 31, 2004.

March 31, 2005 Classification

As of March 31, 2005, based upon the information provided by Fannie Mae and adjustments for the estimated accounting errors' impact on capital, Fannie Mae has achieved an estimated \$4 billion surplus through earnings retention and asset sales. This projected surplus over the minimum capital requirement is sufficient to absorb uncertainties in the estimated impact to capital of the accounting errors, based on current information. Accordingly, OFHEO has determined that Fannie Mae is adequately capitalized as of March 31, 2005.

Continuing Capital Conditions

While Fannie Mae's capital classification at March 31, 2005 is adequately capitalized, Fannie Mae remains subject to the requirements imposed by the Agreement dated September 27, 2004, including the supplement dated March 7, 2005, and the Capital Restoration Plan dated February 10, 2005, which require Fannie Mae to achieve a 30% capital surplus over the minimum capital requirement by September 30, 2005. OFHEO is actively monitoring Fannie Mae's compliance with the Capital Restoration Plan on a weekly basis. At this time, incorporating estimated accounting impacts, Fannie Mae remains on target and has adequate contingencies in place to achieve the required 30% surplus over minimum capital by September 30, 2005.

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

Media questions regarding these results should be directed to Corinne Russell at: crussell@ofheo.gov or 202.414.6921, or Stefanie Mullin at: stefanie.mullin@ofheo.gov or 202.414.6376.

CAPITAL RESULTS:²

As of December 31, 2004, Fannie Mae's estimated risk-based capital requirement was \$10.039 billion. Fannie Mae's estimated total capital of \$35.878 billion on that date exceeded the estimated risk-based capital requirement by \$25.839 billion. As of March 31, 2005, Fannie Mae's estimated total capital of \$35.495 billion on that date exceeded the estimated risk-based capital requirement by \$29.140 billion.

As of December 31, 2004, Fannie Mae's adjusted minimum capital requirement was \$32.166 billion. Fannie Mae's adjusted core capital of \$32.641 billion exceeded the estimated minimum capital requirement by \$475 million. As of March 31, 2005, Fannie Mae's adjusted minimum capital requirement was \$30.959 billion. Fannie Mae's adjusted core capital of \$34.998 billion exceeded the estimated minimum capital requirement by \$4.039 billion.

Capital data for Fannie Mae as of September 30, 2004, December 31, 2004 and March 31, 2005: ³

Risk Based Capital	Fannie Mae					
	31-Mar-05		31-Dec-04		30-Sep-04	
	Up	Down	Up	Down	Up	Down
Interest Rate Scenario						
Risk Based Capital Requirement	6.355	1.214	10.039	6.582	13.026	18.342
Total Capital	35.495		35.878			38.762
Surplus (Deficit)	29.140		25.839			20.420

Minimum Capital	Fannie Mae		
	31-Mar-05	31-Dec-04	30-Sep-04
	Adjusted Minimum Capital Requirement	30.959	32.166
Adjusted Core Capital	34.998	32.641	28.856
Estimated Surplus (Deficit)	4.039	0.475	(2.981)

Critical Capital	Fannie Mae		
	31-Mar-05	31-Dec-04	30-Sep-04
	Adjusted Critical Capital Level	15.861	16.455
Adjusted Core Capital	34.998	32.641	28.856
Estimated Surplus (Deficit)	19.137	16.186	12.569

² Fannie Mae's capital calculation is based on financial information and the application of accounting policies currently under review by OFHEO. The outcome of the review may result in a restatement of prior period results and a revision of the respective capital calculations. The results have been adjusted for the estimated capital impact of accounting errors identified to date.

³ Numbers may not add due to rounding.

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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