



Office of Federal Housing Enterprise Oversight (OFHEO)
1700 G Street, NW 4th Floor
Washington, DC 20552
Phone: 202-414-3800
Fax: 202-414-3823
www.ofheo.gov

FOR IMMEDIATE RELEASE

December 28, 2006

CONTACTS:

Corinne Russell 202-414-6921
Stefanie Mullin 202-414-6376

**OFHEO ANNOUNCES THIRD QUARTER 2006
MINIMUM AND RISK-BASED CAPITAL CLASSIFICATION
FOR FREDDIE MAC**

WASHINGTON, D.C. — James B. Lockhart, Director of the Office of Federal Housing Enterprise Oversight (OFHEO), the safety and soundness regulator for Fannie Mae and Freddie Mac, classified Freddie Mac as adequately capitalized as of September 30, 2006. This classification is based on estimated numbers submitted by Freddie Mac and not on financial statements released to the public.

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.

While Freddie Mac continues to make progress in returning to timely financial filing, operational, accounting, and systems weaknesses remain. Significant work remains before Freddie Mac becomes a timely financial filer and corrects the evident operational weaknesses. It is therefore prudent for Freddie Mac to hold capital in excess of the OFHEO-directed requirement to compensate for these uncertainties.

Freddie Mac's surplus as a percent of the OFHEO-directed requirement decreased to 9.1 percent on September 30, 2006 from 9.7 percent over the prior quarter due to reduced retained earnings. Freddie Mac has agreed to growth restrictions on their retained portfolio as of July 1, 2006 and remains in compliance with these restrictions.

(more)

THIRD QUARTER CAPITAL RESULTS:

Minimum and Critical Capital

Freddie Mac's reported OFHEO-directed capital requirement on September 30, 2006 was \$33.8 billion and its reported statutory minimum capital requirement was \$26.0 billion. Freddie Mac's reported core capital of \$36.8 billion exceeded the OFHEO-directed minimum capital requirement by \$3.1 billion. Freddie Mac's core capital exceeded the statutory critical capital requirement by \$23.6 billion.

Freddie Mac Minimum Capital Requirement (Billions of Dollars) ^(a,b,c)		
	30-Sep-06	30-Jun-06
Minimum Capital - Statutory Requirement	25.973	26.460
Minimum Capital - OFHEO Directed Requirement	33.765	34.398
Core Capital	36.841	37.720 ^(d)
Surplus (Deficit) (based on OFHEO Directed Requirement)	3.076	3.322

Freddie Mac Critical Capital Requirement (Billions of Dollars) ^(a,b)		
	30-Sep-06	30-Jun-06
Critical Capital Level	13.290	13.522
Core Capital	36.841	37.720 ^(d)
Surplus (Deficit)	23.551	24.198

a. Numbers may not add due to rounding.

b. Subject to revision based upon results of ongoing financial restatement and audit processes.

c. OFHEO has directed Freddie Mac to maintain an additional 30% capital in excess of the statutory minimum capital requirement. This has been an additional requirement since January 24, 2004. The minimum capital requirement and minimum capital surplus numbers stated in these charts reflect the inclusion of the additional 30% OFHEO-directed capital requirement.

d. The June 30, 2006 core capital amount has been revised by Freddie Mac since OFHEO's published Second Quarter Capital Results based upon ongoing accounting adjustments.

During the third quarter of 2006, Freddie Mac's minimum capital surplus declined by \$0.2 billion to \$3.1 billion, approximately 9.1 percent over the OFHEO-directed capital requirement of \$33.8 billion. The surplus amount declined because the reduced minimum capital requirement, due to a decrease in assets, was more than offset by a decline in core capital. Core capital fell by approximately \$0.9 billion because of a reduction in retained earnings after a dividend payment of about \$0.4 billion.

Changes in critical capital mirrored changes in minimum capital.

(more)

Risk-Based Capital

As of September 30, 2006, Freddie Mac's risk-based capital requirement was \$14.9 billion. Freddie Mac's total capital of \$37.2 billion on that date exceeded the requirement by \$22.3 billion.

Freddie Mac Risk-Based Capital Requirement				
(Billions of Dollars) ^(a,b)				
Interest Rate Scenario	30-Sep-06		30-Jun-06	
	Up	Down	Up	Down
Risk Based Capital Requirement	14.879	13.785	10.843	17.024
Total Capital ^(c)	37.202		37.50	4
Surplus (Deficit)	22.323			20.480

- a. Numbers may not add due to rounding.
- b. Subject to revision based upon results of ongoing financial restatement and audit processes.
- c. The total capital number is understated and does not reconcile to the core capital submission because only the latter includes the effect of ongoing accounting adjustments.

By statute, stress test interest rate levels are a function of the average 10-year Constant Maturity Treasury (CMT) over the most recent nine months. At the end of the third quarter of 2006, the nine-month average of the 10-year CMT rose to 4.85%, 14 basis points higher than the nine-month average at the end of the second quarter of 2006. As a result, 10-year CMT levels at the end of the first year in the risk-based capital stress test increased from 8.24% to 8.48% in the up-rate stress test, and from 2.35% to 2.42% in the down-rate stress test.

In the third quarter of 2006, the yield curve shifted downward as compared to the previous quarter, and remained flat. As interest rates declined, expected prepayment speeds increased and the duration of fixed-rate mortgage assets decreased. To better match the duration of assets, the Enterprise adjusted its funding and derivative portfolios.

Freddie Mac's risk-based capital surplus increased from \$20.5 billion to \$22.3 billion due primarily to a lower risk-based capital requirement. Falling rates in the quarter caused rebalancing actions that increased exposure in the up-rate scenario and reduced exposure in the down-rate scenario. Freddie Mac's risk-based capital requirement in the up-rate stress test was \$14.9 billion for the third quarter versus \$10.8 billion in the second quarter. Freddie Mac's lower net pay-fixed swap positions caused the Enterprise to become more exposed to a rise in interest rates. In the down-rate stress test, the Enterprise's risk-based capital requirement decreased by \$3.2 billion to \$13.8 billion, also driven by its lower net pay-fixed swap positions.

(more)

QUALIFICATIONS AND COMPLIANCE

Freddie Mac's capital classification is based upon Freddie Mac's best estimates of its financial condition, as certified and represented as true and correct by Freddie Mac's management. The third quarter 2006 capital classification remains subject to revision pending Freddie Mac's submission of audited 2006 financial statements and corresponding regulatory capital reports.

OFHEO imposed a capital surcharge of 30 percent of the minimum capital requirement for Freddie Mac in January 2004 due to increased operational risk. Freddie Mac continued to maintain its minimum capital surplus in excess of the OFHEO-directed capital requirement through the third quarter 2006.

THIRD QUARTER QUALIFYING SUBORDINATED DEBT RESULTS

Additionally, OFHEO is releasing qualifying subordinated debt positions of Freddie Mac in accordance with the September 1, 2005 Agreements between OFHEO and the Enterprises. (See 9/2/05 release at <http://www.fhfa.gov/webfiles/2098/9205SubDebtDiscAgreements.pdf>)

Freddie Mac's total capital and qualifying subordinated debt for the third quarter 2006 exceeded the requirements outlined in the Agreement dated September 1, 2005.

Qualifying subordinated debt levels are disclosed below.

Freddie Mac Qualifying Subordinated Debt Disclosure (Billions of Dollars) ^(a,b,c)		
	30-Sep-06	30-Jun-06
Total Capital & Qualifying Subordinated Debt	42.525	43.821
Sub Debt Requirement ^(d)	37.956	38.849
Surplus (Deficit)	4.569	4.972

a. Numbers may not add due to rounding.

b. Qualifying Subordinated Debt is defined as subordinated debt that contains the interest deferral feature. The interest deferral requires the deferral of interest payments for up to 5 years if:

1) The corporation's core capital falls below 125% of critical capital, or

2) The corporation's core capital falls below minimum capital AND, pursuant to the corporation's request, the Secretary of the Treasury exercises discretionary authority to purchase the company's obligations under Section 306(c) of the Freddie Mac Charter Act and Section 304(c) of the Fannie Mae Charter Act.

c. Subject to revision based upon results of ongoing financial restatement and audit processes.

d. The sum of outstanding net MBS times 0.45 percent and on-balance sheet assets times 4 percent.

(more)

DEFINITION OF CAPITAL STANDARDS

Core Capital is the sum of outstanding common stock, perpetual, noncumulative preferred stock, paid-in capital, and retained earnings. Core capital does not include Accumulated Other Comprehensive Income (AOCI), which is captured as part of stockholder's equity.

Total Capital is the sum of Core Capital plus the allowance for loan losses.

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 by law 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, including guaranteed mortgage securities.

The **OFHEO-directed** capital requirement is the amount of capital the Enterprise needs to maintain to compensate for increased operational risks including systems, accounting, and internal control risks. The level is prescribed by the Director of OFHEO. At this time, both Enterprises are required to hold 30 percent over the statutory minimum capital requirement. This is calculated by multiplying the minimum capital requirement by 1.3 times.

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.

QUALIFYING SUBORDINATED DEBT

Qualifying subordinated debt is defined as subordinated debt that contains the interest deferral feature described below:

The interest deferral requires the deferral of interest payments for up to 5 years if:

- The corporation's core capital falls below 125 percent of critical capital, or
- The corporation's core capital falls below minimum AND, pursuant to the corporation's request, the Secretary of the Treasury exercises discretionary authority to purchase the company's obligations under Section 306(c) of the Freddie Mac Charter Act and Section 304(c) of the Fannie Mae Charter Act.

The September 1, 2005 agreement requires that:

Subordinated debt will be issued in a quantity such that the sum of total capital (core capital plus general allowance for losses) plus the outstanding balance of qualified subordinated debt will equal or exceed the sum of outstanding net MBS times 0.45 percent and total on-balance sheet assets times 4 percent.

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

###

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.