



**OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT**  
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## **NEWS RELEASE**

**FOR IMMEDIATE RELEASE**  
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### **OFHEO ANNOUNCES FOURTH QUARTER 2005 MINIMUM AND RISK-BASED CAPITAL CLASSIFICATION FOR FANNIE MAE AND FREDDIE MAC**

**WASHINGTON, D.C.** — Stephen Blumenthal, Acting Director of the Office of Federal Housing Enterprise Oversight (OFHEO), safety and soundness regulator for Fannie Mae and Freddie Mac (the Enterprises), classified Fannie Mae and Freddie Mac as adequately capitalized as of December 31, 2005.

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.

Additionally, OFHEO is releasing qualifying subordinated debt positions of both Enterprises beginning with the fourth quarter 2005 in accordance with the September 1, 2005 Agreements between OFHEO and the Enterprises. ([See 9/2/05 release at OFHEO.gov](#))

#### **Fannie Mae**

Fannie Mae's capital classification is based on Fannie Mae's best estimates of its financial condition, as certified and represented as true and correct to the best of Fannie Mae management's belief and knowledge. The classification remains subject to revision during Fannie Mae's re-audit and accounting restatement process, as well as OFHEO's completion of its special examination of accounting policies and practices.

Fannie Mae remains subject to the requirements imposed by the Agreement dated September 27, 2004, supplement dated March 7, 2005, and the Capital Restoration Plan dated February 10, 2005. The Capital Restoration Plan required Fannie Mae to achieve a 30 percent capital surplus over the minimum capital requirement by September 30, 2005, a requirement Fannie Mae met and has continued to maintain through the fourth quarter 2005.

Fannie Mae's total capital and qualifying subordinated debt exceeded the requirements outlined in the Agreement dated September 1, 2005. Qualifying subordinated debt levels are disclosed in the accompanying chart.

### **Freddie Mac**

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 capital classification remains subject to revision based upon results from Freddie Mac's ongoing audit, management reviews, and control assessments.

OFHEO imposed a capital surcharge of 30 percent of the minimum capital surplus for Freddie Mac in January 2004 due to increased operational risk. Freddie Mac continued to maintain its minimum capital surplus in excess of the surcharge through the fourth quarter 2005.

Freddie Mac's total capital and qualifying subordinated debt exceeded the requirements outlined in the Agreement dated September 1, 2005. Qualifying subordinated debt levels are disclosed in the accompanying chart.

### **FOURTH QUARTER RESULTS:**

**As of December 31, 2005, Fannie Mae's risk-based capital requirement was \$12.636 billion. Fannie Mae's total capital of \$39.204 billion on that date exceeded the requirement by \$26.568 billion.**

**Fannie Mae's minimum capital requirement was \$28.463 billion. Fannie Mae's core capital of \$38.135 billion exceeded the minimum capital requirement by \$9.673 billion.**

**As of December 31, 2005, Freddie Mac's risk-based capital requirement was \$11.282 billion. Freddie Mac's total capital of \$36.781 billion on that date exceeded the requirement by \$25.499 billion.**

**Freddie Mac's minimum capital requirement was \$24.993 billion. Freddie Mac's core capital of \$36.328 billion exceeded the minimum capital requirement by \$11.335 billion.**

(more)

*Capital and Qualifying Subordinated Debt data for Fannie Mae and Freddie Mac as of September 30, 2005 and December 31, 2005:*

| Enterprise Risk-Based Capital Requirement<br>(Billions of Dollars) <sup>(1)</sup> |                          |       |                          |      |                          |        |                          |       |
|---|--------------------------|-------|--------------------------|------|--------------------------|--------|--------------------------|-------|
|   | Fannie Mae               |       |                          |      | Freddie Mac              |        |                          |       |
|   | 31-Dec-05 <sup>(2)</sup> |       | 30-Sep-05 <sup>(2)</sup> |      | 31-Dec-05 <sup>(4)</sup> |        | 30-Sep-05 <sup>(4)</sup> |       |
|   | Up                       | Down  | Up                       | Down | Up                       | Down   | Up                       | Down  |
| Risk Based Capital Requirement  | 12.636                   | 6.030 | 15.699                   | 0    | 7.594                    | 11.282 | 10.081                   | 6.832 |
| Total Capital   | 39.204                   |       | 37.860                   |      |                          | 36.781 | 36.721                   |       |
| Surplus (Deficit)   | 26.568                   |       | 22.161                   |      |                          | 25.499 | 26.639                   |       |

| Enterprise Minimum Capital Requirement<br>(Billions of Dollars) <sup>(1)</sup> |                            |                            |                          |                          |
|--|----------------------------|----------------------------|--------------------------|--------------------------|
|  | Fannie Mae                 |                            | Freddie Mac              |                          |
|  | 31-Dec-05 <sup>(2,3)</sup> | 30-Sep-05 <sup>(2,3)</sup> | 31-Dec-05 <sup>(4)</sup> | 30-Sep-05 <sup>(4)</sup> |
| Minimum Capital Requirement  | 28.463                     | 27.878                     | 24.993                   | 24.272                   |
| Core Capital   | 38.135                     | 36.993                     | 36.328                   | 36.258                   |
| Estimated Surplus (Deficit)  | 9.673                      | 9.115                      | 11.335                   | 11.986                   |

| Enterprise Critical Capital Requirement<br>(Billions of Dollars) <sup>(1)</sup> |                            |                            |                          |                          |
|---|----------------------------|----------------------------|--------------------------|--------------------------|
|   | Fannie Mae                 |                            | Freddie Mac              |                          |
|   | 31-Dec-05 <sup>(2,3)</sup> | 30-Sep-05 <sup>(2,3)</sup> | 31-Dec-05 <sup>(4)</sup> | 30-Sep-05 <sup>(4)</sup> |
| Critical Capital Level  | 14.643                     | 14.350                     | 12.774                   | 12.406                   |
| Core Capital  | 38.135                     | 36.993                     | 36.328                   | 36.258                   |
| Estimated Surplus (Deficit)   | 23.492                     | 22.643                     | 23.555                   | 23.852                   |

| Enterprise Qualifying Subordinated Debt Disclosure<br>(Billions of Dollars) <sup>(1,6)</sup> |                            |           |                          |           |
|--|----------------------------|-----------|--------------------------|-----------|
|  | Fannie Mae                 |           | Freddie Mac              |           |
|  | 31-Dec-05 <sup>(2,3)</sup> | 30-Sep-05 | 31-Dec-05 <sup>(5)</sup> | 30-Sep-05 |
| Total Capital & Qualifying Subordinated Debt   | 47.957                     | (7)       | 42.262                   | (7)       |
| Capital Requirement at 4% for On-Balance Sheet   | 41.051                     | (7)       | 36.610                   | (7)       |
| Surplus (Deficit)  | 6.906                      | (7)       | 5.652                    | (7)       |

- Numbers may not add due to rounding.
- Fannie Mae's capital calculation is based upon 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.
- Fannie Mae's minimum capital, critical capital, core capital and qualifying subordinated debt are adjusted for accounting errors identified to date.
- OFHEO will determine if risk-based capital resubmissions are required for 3Q05 and 4Q05 after Freddie Mac issues the financials for those periods, per its March 10, 2006 press release.
- OFHEO will determine if qualifying subordinated debt resubmissions are required for 4Q05 after Freddie Mac issues the financials for that period, per its March 10, 2006 press release.
- 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:
  - The corporation's core capital falls below 125% of critical capital, or
  - 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.
- Qualifying Subordinated Debt Disclosure not required for this period.

## **GENERAL ANALYSIS OF THE REGULATORY CAPITAL RESULTS**

### **Minimum Capital**

At the end of the fourth quarter of 2005, Fannie Mae's capital remained above the 30 percent minimum capital surplus required by OFHEO. Fannie Mae's minimum capital surplus increased by \$0.6 billion during the fourth quarter to \$9.7 billion, approximately 34.0 percent over the minimum capital requirement. The primary driver of the higher surplus was an increase in core capital. Core capital increased by \$1.1 billion to \$38.1 billion due to an increase in retained earnings.

At the end of the fourth quarter of 2005, Freddie Mac's minimum capital surplus was 45.4 percent over the minimum capital requirement, and it fell approximately \$0.7 billion to \$11.3 billion from the prior quarter's surplus amount of \$12.0 billion. Freddie Mac's assets grew slightly during the quarter, increasing the minimum capital requirement by \$0.7 billion. Core capital was virtually unchanged from the prior quarter's amount of \$36.3 billion.

### **Risk-based Capital**

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 fourth quarter of 2005, the nine-month average of the 10-year CMT rose to 4.29 percent, 7 basis points higher than the nine-month average at the end of the third quarter of 2005. As a result, 10-year CMT levels at the end of the first year in the risk-based capital stress test increased slightly from 7.39 percent to 7.50 percent in the up-rate stress test, and from 2.11 percent to 2.14 percent in the down-rate stress test.

The yield curve flattened for the quarter as short-term spot rates rose more quickly than long-term spot market interest rates. The 10-year CMT at the end of the quarter was only 5 basis points higher than at the end of the third quarter. As interest rates rose, expected prepayment speeds decreased, increasing the duration of fixed-rate mortgage assets. To match the duration of their assets and liabilities, the Enterprises issued debt and purchased derivatives.

Fannie Mae's capital surplus increased from \$22.2 billion to \$26.6 billion due primarily to a lower risk-based capital requirement. Similar to last quarter, the up-rate stress test produced a higher risk-based capital requirement than the down-rate stress test. Fannie Mae's risk-based capital requirement in the up-rate stress test decreased \$3.1 billion to \$12.6 billion from \$15.7 billion. The Enterprise's risk-based capital requirement was \$6.0 billion in the down-rate stress test.

Freddie Mac's risk-based capital surplus decreased from \$26.6 billion to \$25.5 billion due primarily to a higher risk-based capital requirement. The down-rate stress test produced a higher risk-based capital requirement than the up-rate stress test, which indicates that Freddie Mac is more exposed to falling rates. Freddie Mac's risk-based capital requirement increased by \$4.5 billion to \$11.3 billion in the down-rate stress test. Freddie Mac's risk-based capital requirement decreased by \$2.5 billion to \$7.6 billion in the up-rate stress test.

## 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.

## DEFINITION OF 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% 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.

*Technical questions regarding these results should be directed to: [rbcquestions@ofheo.gov](mailto:rbcquestions@ofheo.gov).*

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