



OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT  
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## NEWS RELEASE

**FOR IMMEDIATE RELEASE**  
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### **OFHEO ANNOUNCES THIRD 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 September 30, 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.

#### **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, which requires Fannie Mae to achieve a 30 percent capital surplus over the minimum capital requirement by September 30, 2005. As OFHEO announced on November 1, 2005, Fannie Mae achieved the 30 percent surplus as of September 30, 2005.

#### **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 third quarter 2005.

(more)

### THIRD QUARTER RESULTS:

As of September 30, 2005, Freddie Mac's risk-based capital requirement was \$10.081 billion. Freddie Mac's total capital of \$36.721 billion on that date exceeded the requirement by \$26.639 billion.

Freddie Mac's minimum capital requirement was \$24.272 billion. Freddie Mac's core capital of \$36.258 billion exceeded the minimum capital requirement by \$11.986 billion.

As of September 30, 2005, Fannie Mae's risk-based capital requirement was \$15.699 billion. Fannie Mae's total capital of \$37.860 billion on that date exceeded the requirement by \$22.161 billion.

Fannie Mae's minimum capital requirement was \$27.878 billion. Fannie Mae's core capital of \$36.993 billion exceeded the minimum capital requirement by \$9.115 billion.

*Capital data for Fannie Mae and Freddie Mac as of June 30, 2005 and September 30, 2005:*

Enterprise Risk-Based Capital Requirement (Billions of Dollars) (1)								
	Fannie Mae				Freddie Mac			
	30-Sept-05 (2)		30-June-05 (2)		30-Sep-05		30-June-05 (4)	
	Up	Down	Up	Down	Up	Down	Up	Down
Interest Rate Scenario								
Risk Based Capital Requirement	15.699	0	23.061	0	10.081	6.832	11.144	2.873
Total Capital	37.860		36.144		36.721		36.099	
Surplus (Deficit)	22.161		13.083		26.639		24.955	

Enterprise Minimum Capital Requirement (Billions of Dollars) (1)				
	Fannie Mae		Freddie Mac	
	30-Sept-05 (2,3)	30-June-05 (2,3)	30-Sep-05	30-Jun-05 (5)
Minimum Capital Requirement	27.878	29.727	24.272	24.073
Core Capital	36.993	35.641	36.258	36.140
Estimated Surplus (Deficit)	9.115	5.914	11.986	12.067

Enterprise Critical Capital Requirement (Billions of Dollars) (1)				
	Fannie Mae		Freddie Mac	
	30-Sept-05 (2,3)	30-June-05 (2,3)	30-Sep-05	6/30/2005 (5)
Critical Capital Level	14.350	15.255	12.406	12.297
Core Capital	36.993	35.641	36.258	36.140
Estimated Surplus (Deficit)	22.643	20.385	23.852	23.843

1. Numbers may not add due to rounding.
2. 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.
3. Fannie Mae's minimum capital, critical capital and core capital are adjusted for accounting errors identified to date.
4. OFHEO determined that the risk-based capital resubmissions are not required for 1Q05 and 2Q05 as minimum capital remains the binding capital requirement and the impact on the surplus from resubmitted financials is minimal.
5. Resubmitted by Freddie Mac.

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

### **Minimum Capital**

At the end of the third quarter of 2005, Fannie Mae achieved the 30 percent minimum capital surplus required by OFHEO. Fannie Mae's minimum capital surplus increased by \$3.2 billion during the third quarter to \$9.1 billion, approximately 32.7 percent over the minimum capital requirement. The primary drivers of the higher surplus were a reduction in asset balances, which resulted from management actions to lower the minimum capital requirement, and an increase in retained earnings, which increased core capital. Lower asset balances reduced the minimum capital requirement by \$1.8 billion, and an increase in retained earnings increased core capital by \$1.4 billion.

At the end of the third quarter of 2005, Freddie Mac's minimum capital surplus of \$12.0 billion, 49.4 percent over the minimum capital requirement, was virtually unchanged from the prior quarter's surplus of \$12.1 billion. Freddie Mac's assets grew slightly during the quarter, increasing the minimum capital requirement by \$0.2 billion. The slight increase in the minimum capital requirement was partially offset by an increase in core capital of \$0.1 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 third quarter of 2005, the nine-month average of the 10-year CMT rose to 4.22 percent, only 1 basis point higher than the nine-month average at the end of the second 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 7.37 percent to 7.39 percent in the up-rate stress test, and from 2.10 percent to 2.11 percent in the down-rate stress test.

Spot market interest rates increased during the third quarter. The 10-year CMT at the end of the quarter was 40 basis points higher than at the end of the second quarter. As interest rates rose, expected prepayment speeds decreased, increasing the duration of fixed-rate mortgage assets. To manage interest rate exposure, the Enterprises responded to longer duration assets by extending the duration of debt and derivatives.

Fannie Mae's capital surplus increased from \$13.1 billion to \$22.2 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; however Fannie Mae's risk-based capital requirement in the up-rate stress test decreased significantly to \$15.7 billion from \$23.1 billion. The Enterprise's risk-based capital requirement was \$0 in the down-rate stress test.

Freddie Mac's risk-based capital surplus increased from \$25.0 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; Freddie Mac's risk-based capital requirement decreased by \$1.1 billion to \$10.1 billion in the up-rate stress test. Freddie Mac's risk-based capital requirement increased by \$3.9 billion to \$6.8 billion in the down-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.

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

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