



OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT  
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## NEWS RELEASE

**FOR IMMEDIATE RELEASE**  
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### **OFHEO ANNOUNCES FIRST QUARTER 2006 MINIMUM AND RISK-BASED CAPITAL CLASSIFICATION FOR FANNIE MAE AND FREDDIE MAC**

**WASHINGTON, D.C.** — James B. Lockhart, 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 March 31, 2006.

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.

Given the ongoing operational weaknesses at both Enterprises, Director Lockhart is reemphasizing the importance for the Enterprises to maintain capital at least 30% above the statutory minimum capital requirement. As a result, OFHEO is now disclosing the Enterprises' minimum capital surplus over the OFHEO-directed requirement versus the statutory requirement previously disclosed.

“Operational weaknesses involving accounting systems, internal controls, and risk management continue at both Enterprises,” said Lockhart. “These problems were recently documented in OFHEO’s 2005 Annual Report to Congress, the Report of the Special Examination of Fannie Mae, and Freddie Mac’s 2005 Annual Report. Therefore, it is very important to have a strong capital cushion at both Enterprises,” Lockhart said.

For comparison purposes, the historical capital charts will reflect the OFHEO-directed requirement from the time it was imposed at each Enterprise. (Minimum Capital History <http://www.fhfa.gov/Default.aspx?Page=147> and Risk-Based Capital History <http://www.fhfa.gov/Default.aspx?Page=150>.)

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

### **Fannie Mae**

Fannie Mae's capital classification is based upon 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.

Fannie Mae remains subject to the requirements imposed by the Consent Order dated May 23, 2006 and the Capital Restoration Plan approved February 17, 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 first quarter 2006.

Fannie Mae's total capital and qualifying subordinated debt for the first quarter 2006 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 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 surcharge through the first quarter 2006.

On May 30, 2006, Freddie Mac submitted amended Minimum Capital Reports for all quarters of 2005 in conjunction with the issuance of financial statements for 2005. OFHEO has determined that Freddie Mac remained adequately capitalized during all periods in 2005. OFHEO has also determined, based upon analysis of information submitted by Freddie Mac, that Freddie Mac is not required to resubmit risk-based capital for the four quarters in 2005. Amended minimum capital results are available. (See [Minimum Capital History \(link\)](#) and [Risk-Based Capital History \(link\)](#)).

Freddie Mac's total capital and qualifying subordinated debt for the first quarter 2006 exceeded the requirements outlined in the Agreement dated September 1, 2005. Qualifying subordinated debt levels are disclosed in the accompanying chart.

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**FIRST QUARTER RESULTS:**

As of March 31, 2006, Fannie Mae's risk-based capital requirement was \$17.533 billion. Fannie Mae's total capital of \$41.174 billion on that date exceeded the requirement by \$23.641 billion.

Fannie Mae's adjusted<sup>1</sup> OFHEO-directed minimum capital requirement was \$37.320 billion and its adjusted statutory minimum capital requirement was \$28.708 billion. Fannie Mae's core capital of \$40.333 billion exceeded the OFHEO-directed minimum capital requirement by \$3.013 billion.

As of March 31, 2006, Freddie Mac's risk-based capital requirement was \$11.935 billion. Freddie Mac's total capital of \$37.624 billion on that date exceeded the requirement by \$25.689 billion.

Freddie Mac's OFHEO-directed minimum capital requirement was \$33.150 billion and its statutory minimum capital requirement was \$25.500 billion. Freddie Mac's core capital of \$37.165 billion exceeded the OFHEO-directed minimum capital requirement by \$4.015 billion.

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<sup>1</sup> The term "adjusted" reflects that Fannie Mae's minimum capital submissions adjust book capital based upon estimated accounting change impacts.

*Capital and Qualifying Subordinated Debt data for Fannie Mae and Freddie Mac as of December 31, 2005 and March 31, 2006:*

Enterprise Risk-Based Capital Requirement (Billions of Dollars) <sup>(1)</sup>								
	Fannie Mae				Freddie Mac			
	31-Mar-06 <sup>(2)</sup>		31-Dec-05 <sup>(2)</sup>		31-Mar-06 <sup>(2)</sup>		31-Dec-05 <sup>(3)</sup>	
	Up	Down	Up	Down	Up	Down	Up	Down
Interest Rate Scenario								
Risk Based Capital Requirement	17.533	10.529	12.636	6.030	8.801	11.935	7.594	11.282
Total Capital	41.174		39.204		37.	624	36.	781
Surplus (Deficit)	23.641		26.568			25.689		25.499

Enterprise Minimum Capital Requirement (Billions of Dollars) <sup>(1,4)</sup>				
	Fannie Mae		Freddie Mac	
	31-Mar-06 <sup>(2,5)</sup>	31-Dec-05 <sup>(2,5)</sup>	31-Mar-06 <sup>(2)</sup>	31-Dec-05 <sup>(6)</sup>
Minimum Capital - Statutory Requirement	28.708	28.463	25.500	25.010
Minimum Capital - OFHEO Directed Requirement	37.320	37.002	33.150	32.513
Core Capital	40.333	38.135	37.165	35.963
Surplus (Deficit) (based on OFHEO Directed Requirement)	3.013	1.134	4.015	3.451

Enterprise Critical Capital Requirement (Billions of Dollars) <sup>(1)</sup>				
	Fannie Mae		Freddie Mac	
	31-Mar-06 <sup>(2,5)</sup>	31-Dec-05 <sup>(2,5)</sup>	31-Mar-06 <sup>(2)</sup>	31-Dec-05 <sup>(6)</sup>
Critical Capital Level	14.779	14.643	13.037	12.782
Core Capital	40.333	38.135	37.165	35.963
Surplus (Deficit)	25.553	23.492	24.128	23.181

Enterprise Qualifying Subordinated Debt Disclosure (Billions of Dollars) <sup>(1,7)</sup>				
	Fannie Mae		Freddie Mac	
	31-Mar-06 <sup>(2,5)</sup>	31-Dec-05 <sup>(2,5)</sup>	31-Mar-06 <sup>(2)</sup>	31-Dec-05 <sup>(6)</sup>
Total Capital & Qualifying Subordinated Debt	49.029	47.957	42.710	41.831
Capital Requirement at 4% for On-Balance Sheet Assets	41.288	41.051	37.344	36.633
Surplus (Deficit)	7.741	6.906	5.366	5.198

- Numbers may not add due to rounding.
- Subject to revision based upon results of ongoing financial restatement and audit processes.
- OFHEO determined risk-based capital resubmissions are not required.
- OFHEO has directed both Fannie Mae and Freddie Mac to maintain an additional 30% capital in excess of the statutory minimum capital requirement. These requirements have been an additional requirement since January 28, 2004, for Freddie Mac and since September 30, 2005, for Fannie Mae. The minimum capital requirement and minimum capital surplus numbers stated in these charts reflect the inclusion of the additional 30% capital requirement.
- Fannie Mae's minimum capital, critical capital, core capital and qualifying subordinated debt are adjusted for accounting errors identified to date.
- Resubmitted
- 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.

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

### **Minimum Capital**

At the end of the first quarter of 2006, Freddie Mac's core capital was 12.1 percent or \$4.0 billion higher than the OFHEO-directed capital requirement.

For the same date, Fannie Mae's core capital was 8.1 percent or \$3.0 billion higher than the OFHEO-directed capital requirement. As the Enterprises now have retained portfolios of about equal size, the larger OFHEO-directed capital requirement for Fannie Mae is due primarily to its much larger volume of guaranteed mortgage securities and other off-balance sheet items.

### **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 first quarter of 2006, the nine-month average of the 10-year CMT rose to 4.42%, 13 basis points higher than the nine-month average at the end of the fourth 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 from 7.50% to 7.74% in the up-rate stress test, and from 2.14% to 2.21% in the down-rate stress test.

Similar to last quarter, the yield curve flattened during the quarter as short-term spot rates rose more quickly than long-term spot market interest rates. Rising interest rates increased the duration of the Enterprises' assets. To match the duration of their assets, the Enterprises extended the duration of their liabilities.

Freddie Mac's risk-based capital surplus increased from \$25.5 billion to \$25.7 billion due primarily to higher total capital. The down-rate stress test produced a higher risk-based capital requirement than the up-rate stress test. Freddie Mac's risk-based capital requirement increased by \$0.7 billion to \$11.9 billion in the down-rate stress test, and by \$1.2 billion to \$8.8 billion in the up-rate stress test.

Fannie Mae's risk-based capital surplus decreased from \$26.6 billion to \$23.6 billion. 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 increased \$4.9 billion to \$17.5 billion from \$12.6 billion. The Enterprise's risk-based capital requirement in the down-rate stress test increased by \$4.5 billion to \$10.5 billion.

## **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, including guaranteed mortgage securities.

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The **OFHEO-directed** capital requirement is the amount of capital the Enterprise currently needs to maintain to compensate for increased operational, accounting, and control risks. The level is prescribed by the Director of OFHEO. At this time, both Enterprises are required to hold 30% 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% 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](mailto:rbcquestions@ofheo.gov).*

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