



OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

NEWS RELEASE

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OFHEO ANNOUNCES FOURTH QUARTER MINIMUM AND RISK-BASED CAPITAL CLASSIFICATIONS FOR FANNIE MAE AND FREDDIE MAC

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 determined that the Enterprises were adequately capitalized under OFHEO's capital standards as of December 31, 2002.

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. Each Enterprise was also adequately capitalized under minimum and risk-based capital standards at September 30, the first enforceable quarter for risk-based capital.

FOURTH QUARTER RESULTS:

FANNIE MAE

As of December 31, 2002, Fannie Mae's risk-based capital requirement was \$17.434 billion. Fannie Mae's total capital of \$28.871 billion on that date exceeded the risk-based capital requirement by \$11.437 billion.

Fannie Mae's minimum capital requirement was \$27.203 billion. Fannie Mae's core capital of \$28.079 billion exceeded the minimum capital requirement by \$877 million.

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FREDDIE MAC

As of December 31, 2002, Freddie Mac's **risk-based capital** requirement was \$4.743 billion. Freddie Mac's total capital of \$24.222 billion on that date exceeded the requirement by \$19.479 billion.

Freddie Mac's **minimum capital** requirement was \$21.620 billion. Freddie Mac's core capital of \$23.792 billion exceeded the minimum capital requirement by \$2.172 billion.

Freddie Mac's minimum and risk-based capital requirements for December 31, 2002 are based upon unaudited financial results. At the end of the audit process OFHEO will re-examine the classifications to determine what, if any adjustments need to be made.

Capital data for each Enterprise as of September 30, and December 31, 2002:

Enterprise Risk-Based Capital Requirement (Billions of Dollars) (2)								
	Fannie Mae				Freddie Mac			
	31-Dec-02		30-Sep-02		31-Dec-02 (1)		30-Sep-02	
	High	Low	High	Low	High	Low	High	Low
Interest Rate Scenario	17.434	14.637	18.887	21.440	4.743	3.753	4.919	0.732
Total Capital	28.871		27.278		24.222		23.101	
Surplus (Deficit)	11.437		5.838		19.479		18.182	

Enterprise Minimum Capital Requirement (Billions of Dollars) (2)				
	Fannie Mae		Freddie Mac	
	31-Dec-02	30-Sep-02	31-Dec-02 (1)	30-Sep-02
	Minimum Capital Requirement	27.203	25.756	21.620
Core Capital	28.079	26.484	23.792	22.656
Surplus (Deficit)	0.877	0.729	2.172	2.118

Enterprise Critical Capital Requirement (Billions of Dollars) (2)				
	Fannie Mae		Freddie Mac	
	31-Dec-02	30-Sep-02	31-Dec-02 (1)	30-Sep-02
	Critical Capital Level	13.880	13.145	11.009
Core Capital	28.079	26.484	23.792	22.656
Surplus (Deficit)	14.199	13.339	12.783	12.193

- (1) Freddie Mac's 12/31/2002 capital numbers are based on unaudited financial statements, which are currently undergoing an audit. These numbers are subject to change.
 (2) Numbers may not add due to rounding.

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GENERAL ANALYSIS OF THE RISK-BASED CAPITAL RESULTS

At December 31, 2002 capital surpluses for both Enterprises grew. The continuing favorable interest rate environment, the dampening effect of a sustained period of low interest rates on the size of the stress test interest rate shocks, effective interest rate risk management, and, to a lesser extent, recent years' house price appreciation, largely accounted for these results.

For the first time, at December 31 the up-interest rate scenario became the more stressful scenario for Fannie Mae. A \$6.8 billion decline in Fannie Mae's RBC requirement in the down-rate scenario reflected its successful efforts to reduce a duration gap that was relatively large during the summer. In the fourth quarter Fannie Mae shortened the duration of its liabilities to better match that of its mortgage asset durations in a falling interest rate environment, and also increased its hedges against falling interest rates. At the same time, Fannie Mae increased hedges against rising interest rates, to help produce a \$1.5 billion decline from September 30 in the now-binding up-rate scenario. Fannie Mae's capital surplus increased by \$5.6 billion between September 30 and December 31, including a \$1.6 billion increase in its capital position.

As was the case throughout 2002, at year-end the up-rate interest scenario posed more stress to Freddie Mac than the down-rate scenario, but less than in prior quarters. From September 30 to December 31 Freddie Mac's December 31 RBC requirement declined by about \$.2 billion. Freddie Mac's capital surplus increased by \$1.3 billion from September 30 to December 31, reflecting a \$1.1 billion increase in its capital position over that period. Other factors that interacted to generate the surplus change included lower costs for new long-term Enterprise debt issued during the stress test, and increased hedging against rising rates during the fourth quarter. With respect to the former, the 10-year Constant Maturity Treasury (CMT) yield largely determines the cost of new long-term Enterprise borrowing during the stress test. Consistent with statutory requirements, the ten-year CMT rose by 3.77% in the December 31 test vs. 4.55% in the September 30 test, reflecting the interest rate declines of recent years.

Interest rate risk exposure continues to account for most of the Enterprises' RBC requirements. Although moderated in the fourth quarter, past house price growth continued to support the overall credit quality of Enterprise mortgage portfolios, which, combined with effective risk sharing arrangements, has limited the significance of mortgage credit losses in the 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.

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