



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

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February 27, 2003

The Honorable Richard Shelby  
Chairman  
Committee on Banking, Housing,  
and Urban Affairs  
United States Senate  
534 Dirksen Senate Office Building  
Washington, DC 20510-6075

Dear Chairman Shelby:

In accordance with the Government Performance and Results Act, enclosed for your information is OFHEO's Fiscal Year 2002 Performance Report. Please do not hesitate to contact me should you have any questions about this report.

Sincerely,

A handwritten signature in black ink, appearing to read "Armando Falcon, Jr." with a stylized flourish at the end.

Armando Falcon, Jr.  
Director

Enclosure



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

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February 27, 2003

The Honorable Jack Reed  
Ranking Minority Member  
Subcommittee on Housing and Transportation  
Committee on Banking, Housing,  
and Urban Affairs  
United States Senate  
S-534 Dirksen Senate Office Building  
Washington, DC 20510-6075

Dear Senator Reed:

In accordance with the Government Performance and Results Act, enclosed for your information is OFHEO's Fiscal Year 2002 Performance Report. Please do not hesitate to contact me should you have any questions about this report.

Sincerely,

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Director

Enclosure



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
*1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800*

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February 27, 2003

The Honorable Paul E. Kanjorski  
Ranking Minority Member  
Capital Markets, Insurance and Government  
Sponsored Enterprises Subcommittee  
U.S. House of Representatives  
2129 Rayburn House Office Building  
Washington, DC 20515

Dear Congressman Kanjorski:

In accordance with the Government Performance and Results Act, enclosed for your information is OFHEO's Fiscal Year 2002 Performance Report. Please do not hesitate to contact me should you have any questions about this report.

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Director

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February 27, 2003

The Honorable Barney Frank  
Ranking Minority Member  
Committee on Financial Services  
U.S. House of Representatives  
B301C Rayburn House Office Building  
Washington, DC 20515-6050

Dear Congressman Frank:

In accordance with the Government Performance and Results Act, enclosed for your information is OFHEO's Fiscal Year 2002 Performance Report. Please do not hesitate to contact me should you have any questions about this report.

Sincerely,

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February 27, 2003

The Honorable Christopher Bond  
Chairman  
Veterans Affairs, HUD and Independent  
Agencies Subcommittee  
United States Senate  
137 Dirksen Senate Office Building  
Washington, DC 20510-6032

Dear Chairman Bond:

In accordance with the Government Performance and Results Act, enclosed for your information is OFHEO's Fiscal Year 2002 Performance Report. Please do not hesitate to contact me should you have any questions about this report.

Sincerely,

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Director

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FHEO

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

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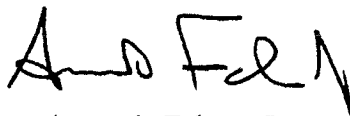
March 28, 2003

The Honorable Richard Shelby  
Chairman  
Committee on Banking, Housing and Urban Affairs  
U.S. Senate  
534 Dirksen Senate Office Building  
Washington, DC 20510

Dear Chairman Shelby:

Enclosed is a copy of the FY 2004 Annual Performance Plan for the Office of Federal Housing Enterprise Oversight. Please do not hesitate to call me at 202-414-3801 if you have any questions.

Sincerely,



Armando Falcon, Jr.  
Director

Enclosures

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*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
*1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800*

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March 28, 2003

The Honorable Christopher Bond  
Chairman  
Subcommittee on Veteran Affairs, HUD  
and Independent Agencies  
U.S. Senate  
137 Dirksen Senate Office Building  
Washington, DC 20510-6032

Dear Chairman Bond:

Enclosed is a copy of the FY 2004 Annual Performance Plan for the Office of Federal Housing Enterprise Oversight. Please do not hesitate to call me at 202-414-3801 if you have any questions.

Sincerely,

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Armando Falcon, Jr.  
Director

Enclosures



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*1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800*

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March 28, 2003

The Honorable Paul E. Kanjorski  
Ranking Minority Member  
Subcommittee on Capital Markets, Insurance  
and Government Sponsored Enterprises  
U.S. House of Representatives  
2353 Rayburn House Office Building  
Washington, DC 20515

Dear Congressman Kanjorski:

Enclosed is a copy of the FY 2004 Annual Performance Plan for the Office of Federal Housing Enterprise Oversight. Please do not hesitate to call me at 202-414-3801 if you have any questions.

Sincerely,

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Armando Falcon, Jr.  
Director

Enclosures





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March 28, 2003

The Honorable Barney Frank  
Ranking Minority Member  
Committee on Financial Services  
U.S. House of Representatives  
B-301C Rayburn House Office Building  
Washington, DC 20515

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Director

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**OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT**  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800  
*Office of the Director*

---

June 30, 2003

Honorable Barney Frank  
Ranking Minority Member  
Committee on Financial Services  
House of Representatives  
Washington, DC 20515

**Re: Capital Classification at March 31, 2003**

Dear Congressman Frank:

In accordance with §§ 1362 and 1364 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and 12 CFR § 1750, the Office of Federal Housing Enterprise Oversight (OFHEO) is required to determine the capital level and classification of the Federal National Mortgage Association (Fannie Mae) not less than quarterly, and to report the results to Congress. OFHEO hereby reports that Fannie Mae is classified as adequately capitalized at March 31, 2003.

On June 13, 2003, OFHEO issued a notice of proposed action indicating its intention to classify Fannie Mae as adequately capitalized at March 31, 2003. Fannie Mae had until June 26, 2003, to submit for OFHEO's consideration any information relevant to the notice of proposed action. Fannie Mae did not submit additional information and agreed with the minimum and risk-based capital requirements as calculated by OFHEO.

As indicated in the enclosures, Fannie Mae's minimum capital requirement was \$28.226 billion, its critical capital level was \$14.414 billion, and its risk-based capital level was \$16.555 billion at March 31, 2003. Thus, Fannie Mae's core capital of \$29.517 billion on that date exceeded the minimum requirement by \$1.291 billion and the critical level by \$15.103 billion. Fannie Mae's total capital of \$30.309 billion on that date exceeded the risk-based capital requirement by \$13.754 billion.

Please contact me if you should have any questions or concerns regarding this matter.

Sincerely,

Armando Falcon, Jr.  
Director

Enclosures

FEDERAL NATIONAL MORTGAGE ASSOCIATION  
Minimum Capital Level  
March 31, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE MINIMUM CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	22,813
OFF-BALANCE SHEET OBLIGATIONS	
MBS and Equivalents	4,984
Commitments	284
OTHER OFF-BALANCE SHEET OBLIGATIONS	
Interest Rate and Foreign Exchange Rate Contracts	91
Other Off-Balance Sheet Obligations	53
MINIMUM CAPITAL LEVEL	28,226
CORE CAPITAL	29,517
SURPLUS/(DEFICIENCY)	1,291

Note: Totals may not add due to rounding.

FEDERAL NATIONAL MORTGAGE ASSOCIATION  
Critical Capital Level  
March 31, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE CRITICAL CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	11,407
OFF-BALANCE SHEET OBLIGATIONS	3,007
CRITICAL CAPITAL LEVEL	14,414
CORE CAPITAL	29,517
SURPLUS/(DEFICIENCY)	15,103

Note: Totals may not add due to rounding.

FEDERAL NATIONAL MORTGAGE ASSOCIATION  
Risk-Based Capital Level  
March 31, 2003

SUMMARY

(Dollars in millions)

STRESS TEST SCENARIO RESULTS	
UP-RATE SCENARIO	16,555
DOWN-RATE SCENARIO	11,466
RISK-BASED CAPITAL LEVEL	16,555
TOTAL CAPITAL	30,309
SURPLUS/(DEFICIENCY)	13,754

Note: Totals may not add due to rounding.



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*Office of the Director*

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June 30, 2003

Honorable Richard C. Shelby, Chairman  
Committee on Banking, Housing and Urban Affairs  
United States Senate  
Washington, DC 20510

**Re: Capital Classification at March 31, 2003**

Dear Mr. Chairman:

In accordance with §§ 1362 and 1364 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and 12 CFR § 1750, the Office of Federal Housing Enterprise Oversight (OFHEO) is required to determine the capital level and classification of the Federal National Mortgage Association (Fannie Mae) not less than quarterly, and to report the results to Congress. OFHEO hereby reports that Fannie Mae is classified as adequately capitalized at March 31, 2003.

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As indicated in the enclosures, Fannie Mae's minimum capital requirement was \$28.226 billion, its critical capital level was \$14.414 billion, and its risk-based capital level was \$16.555 billion at March 31, 2003. Thus, Fannie Mae's core capital of \$29.517 billion on that date exceeded the minimum requirement by \$1.291 billion and the critical level by \$15.103 billion. Fannie Mae's total capital of \$30.309 billion on that date exceeded the risk-based capital requirement by \$13.754 billion.

Please contact me if you should have any questions or concerns regarding this matter.

Sincerely,

Armando Falcon, Jr.  
Director

Enclosures

FEDERAL NATIONAL MORTGAGE ASSOCIATION  
Critical Capital Level  
March 31, 2003

SUMMARY

(Dollars in millions)

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FEDERAL NATIONAL MORTGAGE ASSOCIATION  
Risk-Based Capital Level  
March 31, 2003

SUMMARY

(Dollars in millions)

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UP-RATE SCENARIO	16,555
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RISK-BASED CAPITAL LEVEL	16,555
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June 30, 2003

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Ranking Minority Member  
Committee on Financial Services  
House of Representatives  
Washington, DC 20515

**Re: Capital Classification at March 31, 2003**

Dear Congressman Frank:

In accordance with §§ 1362 and 1364 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and 12 CFR § 1750, the Office of Federal Housing Enterprise Oversight (OFHEO) is required to determine the capital level and classification of the Federal Home Loan Mortgage Corporation (Freddie Mac) not less than quarterly, and to report the results to Congress. OFHEO hereby reports that Freddie Mac is classified as adequately capitalized at March 31, 2003.

On June 17, 2003, OFHEO issued a notice of proposed action indicating its intention to classify Freddie Mac as adequately capitalized at March 31, 2003. Freddie Mac had until June 26, 2003, to submit for OFHEO's consideration any information relevant to the notice of proposed action. Freddie Mac did not submit additional information and agreed with the minimum and risk-based capital requirements as calculated by OFHEO.

As indicated in the enclosures, Freddie Mac's minimum capital requirement was \$21.773 billion, its critical capital level was \$11.088 billion, and its risk-based capital level was \$5.198 billion at March 31, 2003. Thus, Freddie Mac's core capital of \$26.107 billion on that date exceeded the minimum requirement by \$4.334 billion and the critical level by \$15.019 billion. Freddie Mac's total capital of \$26.512 billion on that date exceeded the risk-based capital requirement by \$21.314 billion.

Freddie Mac's capital classification is based on financial information and application of accounting policies currently undergoing re-audit and restatement. The accounting changes will impact minimum capital surpluses but have limited impact on risk-based capital surpluses as the cash flows modeled and the economics of the various transactions have not changed. When the restatement of Freddie Mac's financial results is concluded, Freddie Mac will resubmit appropriate financial data and I will determine whether to recalculate prior periods' risk-based and minimum capital requirements, and whether to re-classify Freddie Mac.

Please contact me if you should have any questions or concerns regarding this matter.

Sincerely,

Armando Falcon, Jr.  
Director

Enclosures.

FEDERAL HOME LOAN MORTGAGE CORPORATION  
Minimum Capital Level  
March 31, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE MINIMUM CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	18,150
OFF-BALANCE SHEET OBLIGATIONS	
MBS and Equivalents	3,121
Commitments	220
OTHER OFF-BALANCE SHEET OBLIGATIONS	
Interest Rate and Foreign Exchange Rate Contracts	110
Sold Portfolio Remittances Pending	46
Other Off-Balance Sheet Obligations	126
MINIMUM CAPITAL LEVEL	21,773
CORE CAPITAL	26,107
SURPLUS/(DEFICIENCY)	4,334

Note: Totals may not add due to rounding.

FEDERAL HOME LOAN MORTGAGE CORPORATION  
Critical Capital Level  
March 31, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE CRITICAL CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	9,075
OFF-BALANCE SHEET OBLIGATIONS	2,013
CRITICAL CAPITAL LEVEL	11,088
CORE CAPITAL	26,107
<u>SURPLUS/(DEFICIENCY)</u>	<u>15,019</u>

Note: Totals may not add due to rounding.

FEDERAL HOME LOAN MORTGAGE CORPORATION  
Risk-Based Capital Level  
March 31, 2003

SUMMARY

(Dollars in millions)

STRESS TEST SCENARIO RESULTS	
UP-RATE SCENARIO	5,198
DOWN-RATE SCENARIO	5,198
RISK-BASED CAPITAL LEVEL	5,198
TOTAL CAPITAL	26,512
<u>SURPLUS/(DEFICIENCY)</u>	<u>21,314</u>

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United States Senate  
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FEDERAL HOME LOAN MORTGAGE CORPORATION  
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Critical Capital Level  
March 31, 2003

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Risk-Based Capital Level  
March 31, 2003

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RICHARD SHELBY, ALABAMA, CHAIRMAN

ROBERT F. BENNETT, UTAH  
 WAYNE ALLARD, COLORADO  
 MICHAEL B. ENZI, WYOMING  
 CHUCK HAGEL, NEBRASKA  
 RICK SANTORUM, PENNSYLVANIA  
 GUY BURNING, KENTUCKY  
 JAE CRAPPO, IDAHO  
 J. E. SUNUNU, NEW HAMPSHIRE  
 ELIZABETH DOLE, NORTH CAROLINA  
 LINCOLN D. CHAPPEE, RHODE ISLAND

PAUL S. SARBANES, MARYLAND  
 CHRISTOPHER J. DODD, CONNECTICUT  
 TIM JOHNSON, SOUTH DAKOTA  
 JACK REED, RHODE ISLAND  
 CHARLES E. SCHUMER, NEW YORK  
 EVAN BAYH, INDIANA  
 ZELL MILLER, GEORGIA  
 THOMAS R. CARPER, DELAWARE  
 DEBBIE STABENOW, MICHIGAN  
 JON S. CORZINE, NEW JERSEY

KATHLEEN CASEY, STAFF DIRECTOR AND COUNSEL  
 STEVEN B. HARRIS, DEMOCRATIC STAFF DIRECTOR AND CHIEF COUNSEL

## United States Senate

COMMITTEE ON BANKING, HOUSING, AND  
 URBAN AFFAIRS

WASHINGTON, DC 20510-6075

July 9, 2003

The Honorable Armando Falcon, Jr.  
 Director  
 Office Of Federal Housing Enterprise Oversight  
 1700 G Street, NW  
 Washington, D.C. 20552

Dear Director Falcon:

On behalf of the Committee on Banking, Housing, and Urban Affairs, I invite you to testify before the full Committee at our hearing entitled "Regulatory Oversight of Government Sponsored Enterprise Accounting Practices." The hearing will be on July 17, 2003 at 10:00 a.m. in the Dirksen Senate Office Building, Room 538.

Your testimony and written statement should focus on OFHEO's oversight of Fannie Mae's and Freddie Mac's accounting procedures and OFHEO's oversight effort to date with respect to events surrounding Freddie Mac's earnings restatement and recent termination of Freddie Mac executive officers. Also, please address the following:

1. OFHEO's examination procedures for evaluating safety and soundness of the Government Sponsored Enterprises.
2. The resources, in terms of number of employees and the expertise of those employees, that OFHEO dedicates to overseeing the accounting and corporate governance of the government sponsored enterprises it oversees.
3. The role OFHEO plays in approving termination agreements for the executive officers of Freddie Mac and Fannie Mae, including involvement in the recent termination agreements of Freddie Mac's executive officers.
4. Implementation of OFHEO's August 2002 Corporate Governance rule.

For purposes of the Committee Record and printing, your written statement must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect (or other comparable program) format and typed double spaced. Also, two ORIGINAL copies of the statement must be included for the printers, along with 73 copies for the use of Committee members and staff. As per the rules of the Committee, a one page summary of your testimony should be submitted along with your testimony. These copies are due to the Committee not later than 24 hours prior to the hearing.

RICHARD SHELBY, ALABAMA, CHAIRMAN

ROBERT F. BENNETT, UTAH  
WAYNE ALLARD, COLORADO  
MICHAEL B. ENZI, WYOMING  
JACK HAGEL, NEBRASKA  
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KATHLEEN CASEY, STAFF DIRECTOR AND COUNSEL  
STEVEN B. HARRIS, DEMOCRATIC STAFF DIRECTOR AND CHIEF COUNSEL

# United States Senate

COMMITTEE ON BANKING, HOUSING, AND  
URBAN AFFAIRS

WASHINGTON, DC 20510-6075

If you have any questions regarding this hearing, please have your staff contact Mark A. Calabria at 202-224-3223, Bryan Corbett at 202-224-1568, or Peggy Kuhn at 202-224-1576.

Sincerely,



Sen. Richard Shelby  
Chairman



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800  
*Office of the Director*

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July 14, 2003

The Honorable Christopher Bond  
Chairman  
Subcommittee on VA, HUD and Independent Agencies  
Committee on Appropriations  
United States Senate  
S-137 Dirksen Senate Office Building  
Washington, DC 20510

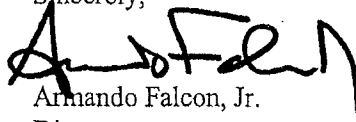
Dear Mr. Chairman:

This letter requests your support to secure a \$4.5 million in FY 2003 supplemental appropriation for the Office of Federal Housing Enterprise Oversight (OFHEO) for the oversight of Freddie Mac and Fannie Mae for the remainder of fiscal year 2003. Since OFHEO is funded through assessments on the companies we regulate, this request will not have a budgetary impact.

The requested funds will support two critical objectives. First, the funds will support the on-going special investigation of Freddie Mac. The investigation is already well underway and is building on information gathered over the course of the restatement process in which the company is currently engaged. The requested resources are necessary to obtain contract services for investigative support and forensic accounting experts. Second, OFHEO intends to conduct a special accounting review of Fannie Mae. The special review would independently evaluate the accounting policies at Fannie and examine whether their implementation is resulting in a high level of conformance to GAAP. While I do not have a specific concern about Fannie Mae's accounting practices, such a review would be most prudent under the circumstances.

OFHEO's goal of concluding the investigation of Freddie Mac expeditiously is dependent on receiving these funds as soon as possible. We will of course provide you with any additional information you request. Thank you for your consideration.

Sincerely,



Armando Falcon, Jr.  
Director

Copy to: Barbara A. Mikluski, Ranking Minority Member, Subcommittee on VA, HUD and Independent Agencies



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September 30, 2003

Honorable Paul E. Kanjorski  
Ranking Minority Member  
Capital Markets, Insurance and Government  
Sponsored Enterprises Subcommittee  
U.S. House of Representatives  
2129 Rayburn House Office Building  
Washington, DC 20515

Dear Congressman Kanjorski:

I am pleased to transmit the Office of Federal Housing Enterprise Oversight's (OFHEO) Strategic Plan for Fiscal Years 2003-2008. In accordance with the Government Performance and Results Act of 1993, the plan provides a framework for implementing OFHEO's mission of promoting housing and a strong economy by ensuring the safety and soundness of Fannie Mae and Freddie Mac (the Enterprises) and fostering the strength and vitality of the nation's housing finance system. As the safety and soundness regulator of these Enterprises, OFHEO has three principal regulatory responsibilities. These are: 1) ensure the Enterprises are adequately capitalized; 2) conduct safety and soundness examinations; and 3) undertake research and analysis on emerging Enterprise-related matters. All three responsibilities are linked to achieve our plan's goals and objectives.

In developing the Strategic Plan, OFHEO sought input from stakeholders and the general public through an announcement in the Federal Register and through our web site, [www.ofheo.gov](http://www.ofheo.gov). OFHEO also consulted with Congress on the plan. The Office's final Strategic Plan will be available to the public via our web site. OFHEO's staff and I look forward to continuing to work with all of our stakeholders as we implement this plan over the next several years. Should you have any questions, I can be reached at (202) 414-3801.

Sincerely,

A handwritten signature in black ink, appearing to read "Armando Falcon, Jr.", written in a cursive style.

Armando Falcon, Jr.  
Director

Enclosure



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
*1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800*

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September 30, 2003

Honorable Christopher Bond  
Chairman  
Veterans Affairs, HUD and Independent  
Agencies Subcommittee  
United States Senate  
130 Dirksen Senate Office Building  
Washington, DC 20510-6032

Dear Mr. Chairman:

I am pleased to transmit the Office of Federal Housing Enterprise Oversight's (OFHEO) Strategic Plan for Fiscal Years 2003-2008. In accordance with the Government Performance and Results Act of 1993, the plan provides a framework for implementing OFHEO's mission of promoting housing and a strong economy by ensuring the safety and soundness of Fannie Mae and Freddie Mac (the Enterprises) and fostering the strength and vitality of the nation's housing finance system. As the safety and soundness regulator of these Enterprises, OFHEO has three principal regulatory responsibilities. These are: 1) ensure the Enterprises are adequately capitalized; 2) conduct safety and soundness examinations; and 3) undertake research and analysis on emerging Enterprise-related matters. All three responsibilities are linked to achieve our plan's goals and objectives.

In developing the Strategic Plan, OFHEO sought input from stakeholders and the general public through an announcement in the Federal Register and through our web site, [www.ofheo.gov](http://www.ofheo.gov). OFHEO also consulted with Congress on the plan. The Office's final Strategic Plan will be available to the public via our web site. OFHEO's staff and I look forward to continuing to work with all of our stakeholders as we implement this plan over the next several years. Should you have any questions, I can be reached at (202) 414-3801.

Sincerely,

A handwritten signature in black ink, appearing to read "Armando Falcon, Jr.", written in a cursive style.

Armando Falcon, Jr.  
Director

Enclosure



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

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September 30, 2003

Honorable Richard C. Shelby  
Chairman  
Committee on Banking, Housing  
And Urban Affairs  
US Senate  
534 Dirksen Senate Office Building  
Washington, DC 20510

Dear Mr. Chairman:

I am pleased to transmit the Office of Federal Housing Enterprise Oversight's (OFHEO) Strategic Plan for Fiscal Years 2003-2008. In accordance with the Government Performance and Results Act of 1993, the plan provides a framework for implementing OFHEO's mission of promoting housing and a strong economy by ensuring the safety and soundness of Fannie Mae and Freddie Mac (the Enterprises) and fostering the strength and vitality of the nation's housing finance system. As the safety and soundness regulator of these Enterprises, OFHEO has three principal regulatory responsibilities. These are: 1) ensure the Enterprises are adequately capitalized; 2) conduct safety and soundness examinations; and 3) undertake research and analysis on emerging Enterprise-related matters. All three responsibilities are linked to achieve our plan's goals and objectives.

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Sincerely,

A handwritten signature in black ink, appearing to read "Armando Falcon, Jr." with a stylized flourish at the end.

Armando Falcon, Jr.  
Director

Enclosure



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
*1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800*

---

September 30, 2003

Honorable Barney Frank  
Ranking Minority Member  
Committee on Financial Services  
U.S. House of Representatives  
B301C Rayburn House Office Building  
Washington, DC 20515-6050

Dear Congressman Frank:

I am pleased to transmit the Office of Federal Housing Enterprise Oversight's (OFHEO) Strategic Plan for Fiscal Years 2003-2008. In accordance with the Government Performance and Results Act of 1993, the plan provides a framework for implementing OFHEO's mission of promoting housing and a strong economy by ensuring the safety and soundness of Fannie Mae and Freddie Mac (the Enterprises) and fostering the strength and vitality of the nation's housing finance system. As the safety and soundness regulator of these Enterprises, OFHEO has three principal regulatory responsibilities. These are: 1) ensure the Enterprises are adequately capitalized; 2) conduct safety and soundness examinations; and 3) undertake research and analysis on emerging Enterprise-related matters. All three responsibilities are linked to achieve our plan's goals and objectives.

In developing the Strategic Plan, OFHEO sought input from stakeholders and the general public through an announcement in the Federal Register and through our web site, [www.ofheo.gov](http://www.ofheo.gov). OFHEO also consulted with Congress on the plan. The Office's final Strategic Plan will be available to the public via our web site. OFHEO's staff and I look forward to continuing to work with all of our stakeholders as we implement this plan over the next several years. Should you have any questions, I can be reached at (202) 414-3801.

Sincerely,

A handwritten signature in black ink, appearing to read "Armando Falcon, Jr.", written in a cursive style.

Armando Falcon, Jr.  
Director

Enclosure



**OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT**  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

September 30, 2003

Richard C. Shelby, Chairman  
Committee on Banking, Housing,  
and Urban Affairs  
United States Senate  
Washington, DC 20510-6075

**Re: Capital Classification at June 30, 2003**

Dear Mr. Chairman:

In accordance with §§ 1362 and 1364 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and 12 CFR § 1750, the Office of Federal Housing Enterprise Oversight (OFHEO) is required to determine the capital level and classification of the Federal Home Loan Mortgage Corporation (Freddie Mac) not less than quarterly, and to report the results to Congress. OFHEO hereby reports that Freddie Mac is classified as adequately capitalized at June 30, 2003.

On September 22, 2003, OFHEO issued a notice of proposed action indicating its intention to classify Freddie Mac as adequately capitalized at June 30, 2003. Freddie Mac had until September 26, 2003, to submit for OFHEO's consideration any information relevant to the notice of proposed action. Freddie Mac did not submit additional information and agreed with the minimum and risk-based capital requirements as calculated by OFHEO.

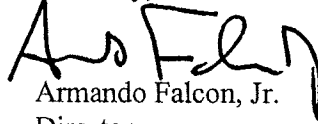
As indicated in the enclosures, Freddie Mac's minimum capital requirement was \$22.688 billion, its critical capital level was \$11.540 billion, and its risk-based capital level was \$4.720 billion at June 30, 2003. Thus, Freddie Mac's core capital of \$28.958 billion on that date exceeded the minimum requirement by \$6.270 billion and the critical level by \$17.418 billion. Freddie Mac's total capital of \$29.340 billion on that date exceeded the risk-based capital requirement by \$24.620 billion.

Freddie Mac's capital classification is based on financial information and application of accounting policies currently undergoing re-audit and restatement. The accounting changes will impact minimum capital surpluses but have less of an impact on risk-based capital surpluses as the cash flows modeled and the economics of the various transactions have not changed. Freddie Mac will resubmit appropriate financial data after publishing financial results for 2003, and the Director will determine whether a recalculation of regulatory capital is necessary at that time.



Please contact me if you should have any questions or concerns regarding this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Armando Falcon, Jr.", written in a cursive style.

Armando Falcon, Jr.  
Director

Enclosures

**FEDERAL HOME LOAN MORTGAGE CORPORATION**  
**Minimum Capital Level**  
**June 30, 2003**

**SUMMARY**

(Dollars in millions)

<b>COMPONENTS OF THE MINIMUM CAPITAL LEVEL</b>	
<b>ON-BALANCE SHEET ASSETS</b>	<b>19,156</b>
<b>OFF-BALANCE SHEET OBLIGATIONS</b>	
MBS and Equivalents	3,028
Commitments	217
<b>OTHER OFF-BALANCE SHEET OBLIGATIONS</b>	
Interest Rate and Foreign Exchange Rate Contracts	111
Sold Portfolio Remittances Pending	57
Other Off-Balance Sheet Obligations	119
<b>MINIMUM CAPITAL LEVEL</b>	<b>22,688</b>
<b>CORE CAPITAL</b>	<b>28,958</b>
<b>SURPLUS/(DEFICIENCY)</b>	<b>6,270</b>

Note: Totals may not add due to rounding.

**FEDERAL HOME LOAN MORTGAGE CORPORATION**  
**Critical Capital Level**  
**June 30, 2003**

**SUMMARY**

(Dollars in millions)

<b>COMPONENTS OF THE CRITICAL CAPITAL LEVEL</b>	
<b>ON-BALANCE SHEET ASSETS</b>	<b>9,578</b>
<b>OFF-BALANCE SHEET OBLIGATIONS</b>	<b>1,962</b>
<b>CRITICAL CAPITAL LEVEL</b>	<b>11,540</b>
<b>CORE CAPITAL</b>	<b>28,958</b>
<b>SURPLUS/(DEFICIENCY)</b>	<b>17,418</b>

Note: Totals may not add due to rounding.

**FEDERAL HOME LOAN MORTGAGE CORPORATION**  
**Risk-Based Capital Level**  
**June 30, 2003**

**SUMMARY**

(Dollars in millions)

<b>STRESS TEST SCENARIO RESULTS</b>	
<b>UP-RATE SCENARIO</b>	<b>4,720</b>
<b>DOWN-RATE SCENARIO</b>	<b>4,720</b>
<b>RISK-BASED CAPITAL LEVEL</b>	<b>4,720</b>
<b>TOTAL CAPITAL</b>	<b>29,340</b>
<b>SURPLUS/(DEFICIENCY)</b>	<b>24,620</b>

Note: Totals may not add due to rounding.



**OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT**  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

September 30, 2003

Honorable Richard C. Shelby, Chairman  
Committee on Banking, Housing,  
and Urban Affairs  
United States Senate  
Washington, DC 20510-6075

**Re: Capital Classification at June 30, 2003**

Dear Mr. Chairman:

In accordance with §§ 1362 and 1364 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and 12 CFR § 1750, the Office of Federal Housing Enterprise Oversight (OFHEO) is required to determine the capital level and classification of the Federal National Mortgage Association (Fannie Mae) not less than quarterly, and to report the results to Congress. OFHEO hereby reports that Fannie Mae is classified as adequately capitalized at June 30, 2003.

On September 22, 2003, OFHEO issued a notice of proposed action indicating its intention to classify Fannie Mae as adequately capitalized at June 30, 2003. Fannie Mae had until September 26, 2003, to submit for OFHEO's consideration any information relevant to the notice of proposed action. Fannie Mae did not submit additional information and agreed with the minimum and risk-based capital requirements as calculated by OFHEO.

As indicated in the enclosures, Fannie Mae's minimum capital requirement was \$29.147 billion, its critical capital level was \$14.912 billion, and its risk-based capital level was \$18.114 billion at June 30, 2003. Thus, Fannie Mae's core capital of \$30.675 billion on that date exceeded the minimum requirement by \$1.527 billion and the critical level by \$15.762 billion. Fannie Mae's total capital of \$31.469 billion on that date exceeded the risk-based capital requirement by \$13.355 billion.

Please contact me if you should have any questions or concerns regarding this matter.

Sincerely,

Armando Falcon, Jr.  
Director

Enclosures



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

September 30, 2003

Honorable Barney Frank  
Ranking Minority Member  
Committee on Financial Services  
House of Representatives  
Washington, DC 20515-6050

**Re: Capital Classification at June 30, 2003**

Dear Congressman Frank:

In accordance with §§ 1362 and 1364 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and 12 CFR § 1750, the Office of Federal Housing Enterprise Oversight (OFHEO) is required to determine the capital level and classification of the Federal Home Loan Mortgage Corporation (Freddie Mac) not less than quarterly, and to report the results to Congress. OFHEO hereby reports that Freddie Mac is classified as adequately capitalized at June 30, 2003.

On September 22, 2003, OFHEO issued a notice of proposed action indicating its intention to classify Freddie Mac as adequately capitalized at June 30, 2003. Freddie Mac had until September 26, 2003, to submit for OFHEO's consideration any information relevant to the notice of proposed action. Freddie Mac did not submit additional information and agreed with the minimum and risk-based capital requirements as calculated by OFHEO.

As indicated in the enclosures, Freddie Mac's minimum capital requirement was \$22.688 billion, its critical capital level was \$11.540 billion, and its risk-based capital level was \$4.720 billion at June 30, 2003. Thus, Freddie Mac's core capital of \$28.958 billion on that date exceeded the minimum requirement by \$6.270 billion and the critical level by \$17.418 billion. Freddie Mac's total capital of \$29.340 billion on that date exceeded the risk-based capital requirement by \$24.620 billion.

Freddie Mac's capital classification is based on financial information and application of accounting policies currently undergoing re-audit and restatement. The accounting changes will impact minimum capital surpluses but have less of an impact on risk-based capital surpluses as the cash flows modeled and the economics of the various transactions have not changed. Freddie Mac will resubmit appropriate financial data after publishing financial results for 2003, and the Director will determine whether a recalculation of regulatory capital is necessary at that time.

Please do contact me if you should have any questions or concerns regarding this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Armando Falcon, Jr.", written in a cursive style.

Armando Falcon, Jr.

Director

Enclosures

**FEDERAL HOME LOAN MORTGAGE CORPORATION**  
Minimum Capital Level  
June 30, 2003

**SUMMARY**

(Dollars in millions)

<b>COMPONENTS OF THE MINIMUM CAPITAL LEVEL</b>	
<b>ON-BALANCE SHEET ASSETS</b>	19,156
<b>OFF-BALANCE SHEET OBLIGATIONS</b>	
MBS and Equivalents	3,028
Commitments	217
<b>OTHER OFF-BALANCE SHEET OBLIGATIONS</b>	
Interest Rate and Foreign Exchange Rate Contracts	111
Sold Portfolio Remittances Pending	57
Other Off-Balance Sheet Obligations	119
<b>MINIMUM CAPITAL LEVEL</b>	22,688
<b>CORE CAPITAL</b>	28,958
<b>SURPLUS/(DEFICIENCY)</b>	6,270

Note: Totals may not add due to rounding.



**FEDERAL HOME LOAN MORTGAGE CORPORATION**

**Critical Capital Level**

**June 30, 2003**

**SUMMARY**

(Dollars in millions)

<b>COMPONENTS OF THE CRITICAL CAPITAL LEVEL</b>	
<b>ON-BALANCE SHEET ASSETS</b>	<b>9,578</b>
<b>OFF-BALANCE SHEET OBLIGATIONS</b>	<b>1,962</b>
<b>CRITICAL CAPITAL LEVEL</b>	<b>11,540</b>
<b>CORE CAPITAL</b>	<b>28,958</b>
<b>SURPLUS/(DEFICIENCY)</b>	<b>17,418</b>

Note: Totals may not add due to rounding.

**FEDERAL HOME LOAN MORTGAGE CORPORATION**  
**Risk-Based Capital Level**  
**June 30, 2003**

**SUMMARY**

(Dollars in millions)

<b>STRESS TEST SCENARIO RESULTS</b>	
<b>UP-RATE SCENARIO</b>	<b>4,720</b>
<b>DOWN-RATE SCENARIO</b>	<b>4,720</b>
<b>RISK-BASED CAPITAL LEVEL</b>	<b>4,720</b>
<b>TOTAL CAPITAL</b>	<b>29,340</b>
<b>SURPLUS/(DEFICIENCY)</b>	<b>24,620</b>

Note: Totals may not add due to rounding.



**OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT**  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

September 30, 2003

Honorable Barney Frank  
Ranking Minority Member  
Committee on Financial Services  
House of Representatives  
Washington, DC 20515-6050

**Re: Capital Classification at June 30, 2003**

Dear Congressman Frank:

In accordance with §§ 1362 and 1364 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and 12 CFR § 1750, the Office of Federal Housing Enterprise Oversight (OFHEO) is required to determine the capital level and classification of the Federal National Mortgage Association (Fannie Mae) not less than quarterly, and to report the results to Congress. OFHEO hereby reports that Fannie Mae is classified as adequately capitalized at June 30, 2003.

On September 22, 2003, OFHEO issued a notice of proposed action indicating its intention to classify Fannie Mae as adequately capitalized at June 30, 2003. Fannie Mae had until September 26, 2003, to submit for OFHEO's consideration any information relevant to the notice of proposed action. Fannie Mae did not submit additional information and agreed with the minimum and risk-based capital requirements as calculated by OFHEO.

As indicated in the enclosures, Fannie Mae's minimum capital requirement was \$29.147 billion, its critical capital level was \$14.912 billion, and its risk-based capital level was \$18.114 billion at June 30, 2003. Thus, Fannie Mae's core capital of \$30.675 billion on that date exceeded the minimum requirement by \$1.527 billion and the critical level by \$15.762 billion. Fannie Mae's total capital of \$31.469 billion on that date exceeded the risk-based capital requirement by \$13.355 billion.

Please contact me if you should have any questions or concerns regarding this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Armando Falcon, Jr.", written in a cursive style.

Armando Falcon, Jr.  
Director

Enclosures

**FEDERAL NATIONAL MORTGAGE ASSOCIATION**  
**Minimum Capital Level**  
**June 30, 2003**

**SUMMARY**

**(Dollars in millions)**

<b>COMPONENTS OF THE MINIMUM CAPITAL LEVEL</b>	
<b>ON-BALANCE SHEET ASSETS</b>	<b>23,050</b>
<b>OFF-BALANCE SHEET OBLIGATIONS</b>	
MBS and Equivalents	5,569
Commitments	362
<b>OTHER OFF-BALANCE SHEET OBLIGATIONS</b>	
Interest Rate and Foreign Exchange Rate Contracts	112
Other Off-Balance Sheet Obligations	54
<b>MINIMUM CAPITAL LEVEL</b>	<b>29,147</b>
<b>CORE CAPITAL</b>	<b>30,675</b>
<b>SURPLUS/(DEFICIENCY)</b>	<b>1,527</b>

Note: Totals may not add due to rounding.

**FEDERAL NATIONAL MORTGAGE ASSOCIATION**  
**Risk-Based Capital Level**  
**June 30, 2003**

**SUMMARY**

**(Dollars in millions)**

<b>STRESS TEST SCENARIO RESULTS</b>	
<b>UP-RATE SCENARIO</b>	<b>18,114</b>
<b>DOWN-RATE SCENARIO</b>	<b>10,558</b>
<b>RISK-BASED CAPITAL LEVEL</b>	<b>18,114</b>
<b>TOTAL CAPITAL</b>	<b>31,469</b>
<b>SURPLUS/(DEFICIENCY)</b>	<b>13,355</b>

Note: Totals may not add due to rounding.

RICHARD SHELBY, ALABAMA, CHAIRMAN

ROBERT F. BENNETT, UTAH  
WAYNE ALLARD, COLORADO  
MICHAEL B. ENZI, WYOMING  
CHUCK HAGEL, NEBRASKA  
RICK SANTORUM, PENNSYLVANIA  
JIM BUNNING, KENTUCKY  
MICHAEL CRAPO, IDAHO  
JOHN E. SUNUNU, NEW HAMPSHIRE  
ELIZABETH DOLE, NORTH CAROLINA  
LINCOLN D. CHAFEE, RHODE ISLAND

PAUL S. SARBANES, MARYLAND  
CHRISTOPHER J. DODD, CONNECTICUT  
TIM JOHNSON, SOUTH DAKOTA  
JACK REED, RHODE ISLAND  
CHARLES E. SCHUMER, NEW YORK  
EVAN BAYH, INDIANA  
ZELL MILLER, GEORGIA  
THOMAS R. CARPER, DELAWARE  
DEBBIE STABENOW, MICHIGAN  
JON S. CORZINE, NEW JERSEY

KATHLEEN CASEY, STAFF DIRECTOR AND COUNSEL  
STEVEN B. HARRIS, DEMOCRATIC STAFF DIRECTOR AND CHIEF COUNSEL

# United States Senate

COMMITTEE ON BANKING, HOUSING, AND  
URBAN AFFAIRS

WASHINGTON, DC 20510-6075

November 11, 2003

The Honorable Armando Falcon, Jr.  
Director  
Office of Federal Housing Enterprise Oversight  
1700 G Street NW, 4th Floor  
Washington, DC 20552

Dear Mr. Falcon:

Thank you for testifying October 23 at the Banking Committee's hearing on "Proposals for Improving the Regulation of the Housing GSEs." In order to complete the hearing record, we would appreciate your answers to the enclosed questions from myself and Senator Reed as soon as possible.

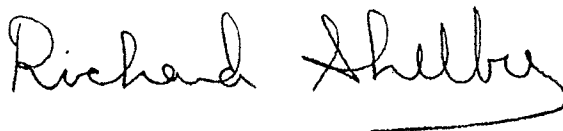
Please set forth each question, then your answer to it, and single-space both question and answer. Please do not use all capitals.

Send your reply to Mr. John Paul Green, the Committee's Deputy Chief Clerk. He will transmit copies to the appropriate offices, including the Committee's publications office. Due to current procedures regarding Senate mail, it is recommended that you send replies:

- via Department staff member with official I.D. to 534 Dirksen Building
- or
- via e-mail attachment to [JP\\_Green@banking.senate.gov](mailto:JP_Green@banking.senate.gov)

If you have any questions about this letter, please contact Mr. Green at (202) 224-7391.

Sincerely,



Richard Shelby  
Chairman

JPG/kc

**Chairman Richard Shelby**  
**Questions for Armando Falcon**  
**October 23, 2003**

**Question 1: Capital Standards**

In your written statement, you proposed that any new regulator be given “full discretion in setting capital standards”.

- For the record, what is the value of having both a minimum capital standard and a risk-based capital standard? That is, what purpose does each standard serve?

**Question 2: Enhanced Conservator Authority**

The Administration has suggested that the new regulatory agency should have more than the powers associated with conservatorship.

- Should one of the GSEs under your watch encounter serious financial difficulties, do you believe that the existing authority of your agency would be sufficient to manage the crisis?

**Question 3: Prompt Corrective Action Authority**

OFHEO and the Finance Board clearly do not have the complete arsenal of prompt corrective action tools that the OCC and other bank regulators have. In fact, the Finance Board has no statutory Prompt Corrective Action authority.

- Do you believe that a new regulator must have the same Prompt Corrective Action tools as the bank regulators?

**Sen. Reed's Questions for the Record**  
**Senate Banking Committee**  
**"Proposals for Improving the Regulation of the Housing Government Sponsored**  
**Enterprises (GSEs)"**  
**October 23, 2003**

**Questions for Mr. Falcon/OFHEO**

1. In your testimony, you suggested that the current minimum capital standard of 2.5% is sufficient to ensure the safety and soundness of the GSEs. However, you argued that the new proposed safety and soundness regulator should have the absolute discretion to change both the risk-based *and* minimum capital requirements, since, as you characterized it, the minimum capital standards acts as a "fail-safe mechanism" to capture risks that allegedly cannot be addressed in the risk-based rule.
  - a. Please explain in detail why the risk-based capital rule cannot address these alleged risks to the safety and soundness to the GSEs.
  - b. If these risks cannot be quantified, on what basis would the regulator change the minimum capital requirements in order to act as a "fail-safe mechanism"?
  - c. How would this basis for changing the minimum capital standard be different from the basis for determining the risk-based capital rule?
  - d. Do you believe that it would harm the ability of Fannie and Freddie's regulator to perform its oversight functions if Congress placed restrictions on its ability to adjust the minimum capital standards? Why or why not?
2. Do you believe the current separation of regulatory authority that gives the power to oversee new GSE programs and activities to HUD, and safety and soundness oversight to OFHEO, has undermined your ability to oversee the safety and soundness of Fannie and Freddie? Why or why not?
3. You testified that while you have been OFHEO Director, HUD has never approved (or declined to withhold approval) a new GSE program or product that you believed would have undermined Fannie and/or Freddie's safety and soundness.

In light of this history, why do you believe that the authority to approve any new GSE programs or products must be included in the oversight authority of the GSE safety and soundness regulator? What is wrong with the current GSE program and product review system, which includes OFHEO in a consultative role?

4. At the July 17, 2003, GSE oversight hearing, you testified that OFHEO would conduct a special investigation of the accounting practices of Freddie Mac. The report of the investigation is now expected to be completed in November.

Has the investigation provided you with any insights or further recommendations about how Congress might improve the oversight of the GSEs?





*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

December 31, 2003

Honorable Barney Frank  
Ranking Minority Member  
Committee on Financial Services  
House of Representatives  
Washington, DC 20515-6050

**Re: Capital Classification at September 30, 2003**

Dear Congressman Frank:

In accordance with §§ 1362 and 1364 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and 12 CFR § 1750, the Office of Federal Housing Enterprise Oversight (OFHEO) is required to determine the capital level and classification of the Federal Home Loan Mortgage Corporation (Freddie Mac) not less than quarterly, and to report the results to Congress. OFHEO hereby reports that Freddie Mac is classified as adequately capitalized at September 30, 2003.

On December 3, 2003, OFHEO issued a notice of proposed action indicating its intention to classify Freddie Mac as adequately capitalized at September 30, 2003. Freddie Mac had until December 19, 2003, to submit for OFHEO's consideration any information relevant to the notice of proposed action. Freddie Mac did not submit additional information and agreed with the minimum and risk-based capital requirements as calculated by OFHEO.

As indicated in the enclosures, Freddie Mac's minimum capital requirement was \$24.052 billion, its critical capital level was \$12.220 billion, and its risk-based capital level was \$1.319 billion at September 30, 2003. Thus, Freddie Mac's core capital of \$28.129 billion on that date exceeded the minimum requirement by \$4.077 billion and the critical level by \$15.909 billion. Freddie Mac's total capital of \$28.486 billion on that date exceeded the risk-based capital requirement by \$27.168 billion.

Freddie Mac's capital classification is based on financial information and application of accounting policies currently involved in the restatement process. The classification is also based upon capital requirements in effect for this time period. The accounting changes will impact minimum capital surpluses but have less of an impact on risk-based capital surpluses as the cash flows modeled and the economics of the various transactions have not changed. The \$5 billion capital increase reflected in Freddie Mac's restated 2002 financials is not reflected in the September 2003 results. Freddie Mac will

resubmit appropriate financial data after publishing financial results for 2003, and the Director will determine whether a recalculation of regulatory capital is necessary at that time.

Please do contact me if you should have any questions or concerns regarding this matter.

Sincerely,

  
Armando Falcon, Jr.  
Director

Enclosures

FEDERAL HOME LOAN MORTGAGE CORPORATION  
 Minimum Capital Level  
 September 30, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE MINIMUM CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	20,551
OFF-BALANCE SHEET OBLIGATIONS	
MBS and Equivalents	2,987
Commitments	252
OTHER OFF-BALANCE SHEET OBLIGATIONS	
Interest Rate and Foreign Exchange Rate Contracts	123
Sold Portfolio Remittances Pending	23
Other Off-Balance Sheet Obligations	115
MINIMUM CAPITAL LEVEL	24,052
CORE CAPITAL	28,129
SURPLUS/(DEFICIENCY)	4,077

Note: Totals may not add due to rounding.

FEDERAL HOME LOAN MORTGAGE CORPORATION  
Critical Capital Level  
September 30, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE CRITICAL CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	10,275
OFF-BALANCE SHEET OBLIGATIONS	1,945
CRITICAL CAPITAL LEVEL	12,220
CORE CAPITAL	28,129
SURPLUS/(DEFICIENCY)	15,909

Note: Totals may not add due to rounding.

FEDERAL HOME LOAN MORTGAGE CORPORATION  
Risk-Based Capital Level  
September 30, 2003

SUMMARY

(Dollars in millions)

STRESS TEST SCENARIO RESULTS	
UP-RATE SCENARIO	1,319
DOWN-RATE SCENARIO	1,319
RISK-BASED CAPITAL LEVEL	1,319
TOTAL CAPITAL	28,486
SURPLUS/(DEFICIENCY)	27,168

Note: Totals may not add due to rounding.



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

December 31, 2003

Honorable Richard C. Shelby, Chairman  
Committee on Banking, Housing,  
and Urban Affairs  
United States Senate  
Washington, DC 20510-6075

**Re: Capital Classification at September 30, 2003**

Dear Mr. Chairman:

In accordance with §§ 1362 and 1364 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and 12 CFR § 1750, the Office of Federal Housing Enterprise Oversight (OFHEO) is required to determine the capital level and classification of the Federal Home Loan Mortgage Corporation (Freddie Mac) not less than quarterly, and to report the results to Congress. OFHEO hereby reports that Freddie Mac is classified as adequately capitalized at September 30, 2003.

On December 3, 2003, OFHEO issued a notice of proposed action indicating its intention to classify Freddie Mac as adequately capitalized at September 30, 2003. Freddie Mac had until December 19, 2003, to submit for OFHEO's consideration any information relevant to the notice of proposed action. Freddie Mac did not submit additional information and agreed with the minimum and risk-based capital requirements as calculated by OFHEO.


As indicated in the enclosures, Freddie Mac's minimum capital requirement was \$24.052 billion, its critical capital level was \$12.220 billion, and its risk-based capital level was \$1.319 billion at September 30, 2003. Thus, Freddie Mac's core capital of \$28.129 billion on that date exceeded the minimum requirement by \$4.077 billion and the critical level by \$15.909 billion. Freddie Mac's total capital of \$28.486 billion on that date exceeded the risk-based capital requirement by \$27.168 billion.

Freddie Mac's capital classification is based on financial information and application of accounting policies currently involved in the restatement process. The classification is also based upon capital requirements in effect for this time period. The accounting changes will impact minimum capital surpluses but have less of an impact on risk-based capital surpluses as the cash flows modeled and the economics of the various transactions have not changed. The \$5 billion capital increase reflected in Freddie Mac's restated 2002 financials is not reflected in the September 2003 results. Freddie Mac will

resubmit appropriate financial data after publishing financial results for 2003, and the Director will determine whether a recalculation of regulatory capital is necessary at that time.

Please contact me if you should have any questions or concerns regarding this matter.

Sincerely,

A handwritten signature in black ink, appearing to read 'A. Falcon, Jr.', written in a cursive style.

Armando Falcon, Jr.  
Director

Enclosures

FEDERAL HOME LOAN MORTGAGE CORPORATION  
Minimum Capital Level  
September 30, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE MINIMUM CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	20,551
OFF-BALANCE SHEET OBLIGATIONS	
MBS and Equivalents	2,987
Commitments	252
OTHER OFF-BALANCE SHEET OBLIGATIONS	
Interest Rate and Foreign Exchange Rate Contracts	123
Sold Portfolio Remittances Pending	23
Other Off-Balance Sheet Obligations	115
MINIMUM CAPITAL LEVEL	24,052
CORE CAPITAL	28,129
SURPLUS/(DEFICIENCY)	4,077

Note: Totals may not add due to rounding.



FEDERAL HOME LOAN MORTGAGE CORPORATION  
Critical Capital Level  
September 30, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE CRITICAL CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	10,275
OFF-BALANCE SHEET OBLIGATIONS	1,945
CRITICAL CAPITAL LEVEL	12,220
CORE CAPITAL	28,129
SURPLUS/(DEFICIENCY)	15,909

Note: Totals may not add due to rounding.

FEDERAL HOME LOAN MORTGAGE CORPORATION  
Risk-Based Capital Level  
September 30, 2003

SUMMARY

(Dollars in millions)

STRESS TEST SCENARIO RESULTS	
UP-RATE SCENARIO	1,319
DOWN-RATE SCENARIO	1,319
RISK-BASED CAPITAL LEVEL	1,319
TOTAL CAPITAL	28,486
SURPLUS/(DEFICIENCY)	27,168

Note: Totals may not add due to rounding.



OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

December 31, 2003

Honorable Richard C. Shelby, Chairman  
Committee on Banking, Housing,  
and Urban Affairs  
United States Senate  
Washington, DC 20510-6075

**Re: Capital Classification at September 30, 2003**

Dear Mr. Chairman:

In accordance with §§ 1362 and 1364 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and 12 CFR § 1750, the Office of Federal Housing Enterprise Oversight (OFHEO) is required to determine the capital level and classification of the Federal National Mortgage Association (Fannie Mae) not less than quarterly, and to report the results to Congress. OFHEO hereby reports that Fannie Mae is classified as adequately capitalized at September 30, 2003.

On December 3, 2003, OFHEO issued a notice of proposed action indicating its intention to classify Fannie Mae as adequately capitalized at September 30, 2003. Fannie Mae had until December 19, 2003, to submit for OFHEO's consideration any information relevant to the notice of proposed action. Fannie Mae did not submit additional information and agreed with the minimum and risk-based capital requirements as calculated by OFHEO.

As indicated in the enclosures, Fannie Mae's minimum capital requirement was \$31.435 billion, its critical capital level was \$16.050 billion, and its risk-based capital level was \$27.853 billion at September 30, 2003. Thus, Fannie Mae's core capital of \$32.752 billion on that date exceeded the minimum requirement by \$1.316 billion and the critical level by \$16.701 billion. Fannie Mae's total capital of \$33.542 billion on that date exceeded the risk-based capital requirement by \$5.689 billion.

Please contact me if you should have any questions or concerns regarding this matter.

Sincerely,

Armando Falcon, Jr.  
Director

Enclosures

FEDERAL NATIONAL MORTGAGE ASSOCIATION  
Minimum Capital Level  
September 30, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE MINIMUM CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	25,449
OFF-BALANCE SHEET OBLIGATIONS	
MBS and Equivalents	5,450
Commitments	337
OTHER OFF-BALANCE SHEET OBLIGATIONS	
Interest Rate and Foreign Exchange-Rate Contracts	144
Other Off-Balance Sheet Obligations	56
MINIMUM CAPITAL LEVEL	31,435
CORE CAPITAL	32,752
<b>SURPLUS/(DEFICIENCY)</b>	<b>1,316</b>

Note: Totals may not add due to rounding.

FEDERAL NATIONAL MORTGAGE ASSOCIATION  
Critical Capital Level  
September 30, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE CRITICAL CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	12,724
OFF-BALANCE SHEET OBLIGATIONS	3,326
CRITICAL CAPITAL LEVEL	16,050
CORE CAPITAL	32,752
SURPLUS/(DEFICIENCY)	16,701

Note: Totals may not add due to rounding.

FEDERAL NATIONAL MORTGAGE ASSOCIATION  
Risk-Based Capital Level  
September 30, 2003

SUMMARY

(Dollars in millions)

STRESS TEST SCENARIO RESULTS	
UP-RATE SCENARIO	(675)
DOWN-RATE SCENARIO	27,853
RISK-BASED CAPITAL LEVEL	27,853
TOTAL CAPITAL	33,542
SURPLUS/(DEFICIENCY)	5,689

Note: Totals may not add due to rounding.



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

December 31, 2003

Honorable Barney Frank  
Ranking Minority Member  
Committee on Financial Services  
House of Representatives  
Washington, DC 20515-6050

**Re: Capital Classification at September 30, 2003**

Dear Congressman Frank:

In accordance with §§ 1362 and 1364 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and 12 CFR § 1750, the Office of Federal Housing Enterprise Oversight (OFHEO) is required to determine the capital level and classification of the Federal National Mortgage Association (Fannie Mae) not less than quarterly, and to report the results to Congress. OFHEO hereby reports that Fannie Mae is classified as adequately capitalized at September 30, 2003.

On December 3, 2003, OFHEO issued a notice of proposed action indicating its intention to classify Fannie Mae as adequately capitalized at September 30, 2003. Fannie Mae had until December 19, 2003, to submit for OFHEO's consideration any information relevant to the notice of proposed action. Fannie Mae did not submit additional information and agreed with the minimum and risk-based capital requirements as calculated by OFHEO.

As indicated in the enclosures, Fannie Mae's minimum capital requirement was \$31.435 billion, its critical capital level was \$16.050 billion, and its risk-based capital level was \$27.853 billion at September 30, 2003. Thus, Fannie Mae's core capital of \$32.752 billion on that date exceeded the minimum requirement by \$1.316 billion and the critical level by \$16.701 billion. Fannie Mae's total capital of \$33.542 billion on that date exceeded the risk-based capital requirement by \$5.689 billion.

Please contact me if you should have any questions or concerns regarding this matter.

Sincerely,

Armando Falcon, Jr.  
Director

Enclosures

FEDERAL NATIONAL MORTGAGE ASSOCIATION  
Minimum Capital Level  
September 30, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE MINIMUM CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	25,449
OFF-BALANCE SHEET OBLIGATIONS	
MBS and Equivalents	5,450
Commitments	337
OTHER OFF-BALANCE SHEET OBLIGATIONS	
Interest Rate and Foreign Exchange Rate Contracts	144
Other Off-Balance Sheet Obligations	56
MINIMUM CAPITAL LEVEL	31,435
CORE CAPITAL	32,752
SURPLUS (DEFICIENCY)	1,316

Note: Totals may not add due to rounding.



FEDERAL NATIONAL MORTGAGE ASSOCIATION  
Critical Capital Level  
September 30, 2003

SUMMARY

(Dollars in millions)

COMPONENTS OF THE CRITICAL CAPITAL LEVEL	
ON-BALANCE SHEET ASSETS	12,724
OFF-BALANCE SHEET OBLIGATIONS	3,326
CRITICAL CAPITAL LEVEL	16,050
CORE CAPITAL	32,752
<del>SURPLUS/(DEFICIENCY)</del>	<del>16,701</del>

Note: Totals may not add due to rounding.

FEDERAL NATIONAL MORTGAGE ASSOCIATION  
Risk-Based Capital Level  
September 30, 2003

SUMMARY

(Dollars in millions)

STRESS TEST SCENARIO RESULTS	
UP-RATE SCENARIO	(675)
DOWN-RATE SCENARIO	27,853
RISK-BASED CAPITAL LEVEL	27,853
TOTAL CAPITAL	33,542
SURPLUS/(DEFICIENCY)	5,689

Note: Totals may not add due to rounding.



*OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT*  
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800  
*Office of the Director*

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December 17, 2003

Honorable Richard Shelby  
Chairman  
Committee on Banking, Housing, and  
Urban Affairs  
US Senate  
534 Dirksen Senate Office Building  
Washington, DC 20510

Dear Chairman Shelby:

Enclosed are OFHEO's responses to questions for the hearing record from the Committee's October 23 hearing on "Proposals for Improving the Regulation of the Housing GSEs." Thank you again for the opportunity to testify on this important issue.

I look forward to working with you further as the Committee considers these matters more next year.

Sincerely,



Armando Falcon, Jr.  
Director

Enclosure

**Responses of Armando Falcon, Jr., Director of OFHEO**  
**To**  
**Questions for the Record from Chairman Richard Shelby,**  
**Committee on Banking, Housing, and Urban Affairs**  
**Hearing on**  
**“Proposals for Improving the Regulation of the Housing Government Sponsored**  
**Enterprises (GSEs)”**  
**October 23, 2003**

**Question:** In your written statement, you proposed that any new regulator be given ‘full discretion in setting capital standards’.

- For the record, what is the value of having both a minimum capital standard and a risk-based capital standard? That is, what purpose does each standard serve?

**Answer:** Capital standards are designed to ensure that regulated institutions can survive periods of significant misfortune involving sizeable financial losses. In theory, a single standard that encompassed all relevant considerations would suffice to determine capital adequacy. In practice, that would be very difficult, and Congress has wisely required OFHEO and all depository institution regulators to implement both a leverage-based standard and a more finely tuned risk-based standard.

Evaluation of capital adequacy entails a broad range of considerations including not only an institution’s current book of business; but also the current and prospective risk environment, its business strategies and potential changes in those strategies, the strength of its customer and supplier relationships, the strength of its internal controls, potential fragility if the markets in which it buys and sells, the structure of those markets and potential changes in the way those markets function, the vulnerability of the institution’s reputation, the systemic importance of the institution, and many other factors.

Issues of practicality constrain the determinants of capital requirements to a small subset of these factors. Thus, for example, OFHEO’s risk-based standard focuses on each Enterprise’s current book of business and two possible future risk environments. It requires sufficient capital to cover losses or current positions in extended, specific adverse circumstances. This is a highly detailed rule that examines this aspect of capital adequacy in depth. It is important that the Enterprises be able to meet this requirement, but does not necessarily imply that capital is adequate. A high degree of protection against interest rate and credit risk can reduce the risk-based requirement to very low or zero levels, without addressing other risks.

The minimum capital (leverage-based) standard is a fail-safe mechanism that ensures a substantial amount of capital regardless of measured interest rate and credit risks. Incorporating all other risks into the risk-based standard would be problematic. They generally do not fit well into the scenario format because the range of possibilities is essentially infinite. Also, the magnitudes of other risks generally are not easily quantifiable, but rather are more a matter of judgment.

A separate standard that encompasses these judgments makes sense. While it would be possible to add the two requirements to make a single rule that would produce an overall requirement that would be considerably more volatile than the current combination, and might usually be higher than necessary. So far, the judgment exercised by Congress in setting the ratios used to determine the minimum capital requirements has worked satisfactorily. However, institutions and their business environments change over time. An expert safety and soundness regulator is best able to judge if and when changes to a leverage-based ratio should be made. Accordingly, Congress should give the regulator of Fannie Mae and Freddie Mac the same authority it has given depository institution regulators to adjust all capital requirements if necessary.

**Question:** The Administration has suggested that the new regulatory agency should have more than the powers associated with conservatorship.

- Should one of the GSEs under your watch encounter serious financial difficulties, do you believe that the existing authority of your agency would be sufficient to manage the crisis?

**Answer:** OFHEO has strong conservatorship authority that it may bring to bear should an enterprise under its jurisdiction encounter problems that merit appointment of a conservator. This authority, while sufficient to manage a crisis, does not provide all the tools a safety and soundness regulator should have. OFHEO has supported legislative clarification of its authority to support its interpretation of the law. Additionally, OFHEO has called for legislative action to provide receivership authority that is available to other federal financial regulators. It should be noted that existing statutory law permits the charters of the Enterprises only to be revoked by Congress, thus receivership would enhance the ability to oversee the Enterprises, and assure the markets of a full range of remedies available to the safety and soundness regulator while preserving congressional control over charter termination.

**Question:** OFHEO and the Finance Board clearly do not have the complete arsenal of prompt corrective action tools that the OCC and other bank regulators have. In fact, the Finance Board has no statutory Prompt Corrective Action authority.

- Do you believe that a new regulator must have the same Prompt Corrective Action tools as the bank regulators?

**Answer:** Yes, and OFHEO has an array of prompt corrective action tools. Modeled on bank regulations, the prompt corrective action regulations are broad and tied to capital levels. However, OFHEO has proposed legislative enhancements that would conform OFHEO's statutory authorities even more closely to the bank regulators; that is, express authority to act on safety and soundness matters.

It also should be noted that OFHEO has added to its prompt corrective action rules a section on prompt supervisory response. This section provides an orderly procedure for OFHEO to act in cases where capital may not be impaired and provides both a description of key situations as well

as an order for OFHEO actions. Thus, OFHEO has a regulatory structure that provides for action before capital levels are reached that trigger prompt corrective actions.

**Responses of Armando Falcon, Jr., Director of OFHEO  
To  
Questions for the Record from Senator Jack Reed,  
Committee on Banking, Housing, and Urban Affairs  
Hearing on  
“Proposals for Improving the Regulation of the Housing Government Sponsored  
Enterprises (GSEs)”  
October 23, 2003**

**Question:** In your testimony, you suggested that the current minimum capital standard of 2.5% is sufficient to ensure the safety and soundness of the GSEs. However, you argued that the new proposed safety and soundness regulator should have the absolute discretion to change both the risk-based **and** minimum capital requirements, since, as you characterized it, the minimum capital standards acts as a “fail-safe mechanism” to capture risks that allegedly cannot be addressed in the risk-based rule.

- a. Please explain in detail why the risk-based capital rule cannot address these alleged risks to the safety and soundness to the GSEs.
- b. If these risks cannot be quantified, on what basis would the regulator change the minimum capital requirements in order to act as a “fail-safe mechanism”?
- c. How would this basis for changing the minimum capital standard be different from the basis for determining the risk-based capital rule?
- d. Do you believe that it would harm the ability of Fannie and Freddie’s regulator to perform its oversight functions if Congress placed restrictions on its ability to adjust the minimum capital standards? Why or why not?

**Answer:** Capital standards are designed to ensure that regulated institutions can survive periods of significant misfortune involving sizeable financial losses. In theory, a single standard that encompassed all relevant considerations would suffice to determine capital adequacy. In practice, that would be very difficult, and Congress has wisely required OFHEO and all depository institution regulators to implement both a leverage-based standard and a more finely risk-based standard.

Evaluation of capital adequacy entails a broad range of considerations including not only an institution’s current book of business; but also the current and prospective risk environment, its business strategies and potential changes in those strategies, the strength of its customer and supplier relationships, the strength of its internal controls, potential fragility if the markets in which it buys and sells, the structure of those markets and potential changes in the way those markets function, the vulnerability of the institution’s reputation, the systemic importance of the institution, and many other factors.

Issues of practicality constrain the determinants of capital requirements to a small subset of these factors. Thus, for example, OFHEO's risk-based standard focuses on each Enterprise's current book of business and two possible future risk environments. It requires sufficient capital to cover losses or current positions in extended, specific adverse circumstances. This is a highly detailed rule that examines this aspect of capital adequacy in depth. It is important that the Enterprises be able to meet this requirement, but does not necessarily imply that capital is adequate. A high degree of protection against interest rate and credit risk can reduce the risk-based requirement to very low or zero levels, without addressing other risks.

The minimum capital (leverage-based) standard is a fail-safe mechanism that ensures a substantial amount of capital regardless of measured interest rate and credit risks. Incorporating all other risks into the risk-based standard would be problematic. They generally do not fit well into the scenario format because the range of possibilities is essentially infinite. Also, the magnitudes of other risks generally are not easily quantifiable, but rather are more a matter of judgment.

A separate standard that encompasses these judgments makes sense. While it would be possible to add the two requirements to make a single rule that would produce an overall requirement that would be considerably more volatile than the current combination, and might usually be higher than necessary. So far, the judgment exercised by Congress in setting the ratios used to determine the minimum capital requirements has worked satisfactorily. However, institutions and their business environments change over time. An expert safety and soundness regulator is best able to judge if and when changes to a leverage-based ratio should be made. Accordingly, Congress should give the regulator of Fannie Mae and Freddie Mac the same authority it has given depository institution regulators to adjust all capital requirements if necessary.

**Question:** Do you believe the current separation of regulatory authority that gives the power to oversee new GSE programs and activities to HUD, and safety and soundness to OFHEO, has undermined your ability to oversee the safety and soundness of Fannie and Freddie? Why or why not?

**Answer:** The separate regulatory authority for new program review by HUD does not undermine OFHEO's safety and soundness authority.

OFHEO has endorsed bringing new program authority into the safety and soundness regulator as this is the case with other financial regulators. This will also permit the examination and on-site expertise of OFHEO to be brought to bear in making decisions on new programs and potentially produce fuller and quicker review of new programs. All of these benefits may occur without any adverse impact on housing mission or safety and soundness. Congressional goals on Enterprise housing mission are in statute and must be followed by the safety and soundness regulator and, indeed, today in applying safety and soundness rules under its jurisdiction, OFHEO abides by congressional

housing policy in such areas as low and moderate income programs undertaken by the Enterprises.

**Question:** You testified that while you have been OFHEO Director, HUD has never approved (or declined to withhold approval) a new GSE program or product that you believed would have undermined Fannie and/or Freddie' safety and soundness.

In light of this history, why do you believe that the authority to approve any new GSE programs or products must be included in the oversight authority of the GSE safety and soundness regulator? What is wrong with the current GSE program and product review system, which includes OFHEO in a consultative role?

**Answer:** HUD has addressed few new program proposals over the years since passage of the 1992 Act that required OFHEO to review the matters for safety and soundness consideration. Thus, our experience is not one of problems with the current situation insofar as safety and soundness is concerned, as noted in my response to Question #2 above.

However, OFHEO's "consultative" role may create a potential conflict should a situation arise where HUD and OFHEO have differing views on a particular program. For the reasons stated in my response to Question #2, it is my belief that the benefits of a new structure are more than sufficient to review the existing separation of functions. It would be beneficial, as is the case with other financial regulators, to have independent authority to review new programs for charter compliance.

**Question:** At the July 17, 2003, GSE oversight hearing, you testified that OFHEO would conduct a special investigation of the accounting practices of Freddie Mac. The report of the investigation is now expected to be completed in November.

Has the investigation provided you with any insights or further recommendations about how Congress might improve the oversight of the GSEs?

**Answer:** Yes, the investigation gave the Agency insights into additional authority OFHEO needs to be better able to accomplish its regulatory goals. These are included in the report of our special examination of Freddie Mac.