



## Fannie to Spend \$800 Mln on Restatement; Finds Errors (Update6)

May 9 (Bloomberg) -- Fannie Mae, the biggest source of money for U.S. home loans, said it will spend \$800 million this year on accountants and lawyers to correct \$10.8 billion in bookkeeping mistakes, bringing the total bill to \$1.37 billion.

The money will be used to pay auditor Deloitte & Touche LLP, law firm Paul, Weiss, Rifkind, Wharton & Garrison and hundreds of consultants, Fannie Mae said today in a filing with the Securities and Exchange Commission. Fannie Mae also said it uncovered errors related to off-balance sheet trusts used to sell \$25.5 billion of mortgage-backed securities.

Fannie Mae said even with the new mistakes, it meets the capital reserve requirement mandated by its federal regulator, a sign to some investors that the government-chartered company is making headway under Chief Executive Officer Daniel Mudd to clean up accounting left over from prior management. The company reiterated that it plans to complete an earnings restatement in the second half of the year.

"There's a very high probability that there isn't a dark cloud out there" that will increase the restatement, said Arvind Sachdeva, who oversees \$3 billion at Victory Capital Management in Cleveland, Ohio, including Fannie Mae stock.

Shares of Fannie Mae, which buys loans from mortgage lenders, rose \$1.48 to \$51.62 at 1:53 p.m. in New York Stock Exchange composite trading. The stock is up 6 percent this year after falling 31 percent in 2005, its worst performance since 1984. It hasn't filed quarterly financial results since 2004.

Banc of America Securities LLC today raised its recommendations on Fannie Mae to "neutral" from "sell," and on Freddie Mac to "buy" from "neutral."

### Expenses

Total administrative expenses during the first quarter were \$729 million, with \$287 million of that going toward the restatement, Fannie Mae said. Costs related to the restatement totaled \$569 million in 2005.

"We are committed to devoting all resources necessary to complete the restatement as expeditiously as possible," Fannie Mae said in the SEC filing.

Fannie Mae said it won't know the impact of the new errors until it completes the restatement, which covers the period from 2001 to mid-2004. It also reduced its estimated after-tax losses resulting from Hurricanes Katrina and Rita to a range of \$170 million to \$280 million from \$250 million to \$400 million.

Fannie Mae's federal regulator, the Office of Federal Housing Enterprise Oversight, ordered an accounting overhaul after finding in 2004 that the company deferred expenses to minimize earnings volatility and broke rules in accounting for hedges on its then-\$905 billion portfolio.

#### 'Substantially Complete'

The "accounting review is substantially complete," Fannie Mae said in the filing. The company "plans to provide an update on any remaining issues" after finishing the review and discussions with Ofheo, the audit committee and its auditor, Deloitte & Touche LLP, it said.

An investigation led by former New Hampshire Senator Warren Rudman and commissioned by the Fannie Mae board reported on Feb. 23 that much of the blame for the accounting mistakes rested with former Chief Financial Officer Timothy Howard.

The board of directors in December 2004 ousted Howard and Chief Executive Officer Franklin Raines and later promoted Mudd to chief executive from chief operating officer.

#### New Errors

The new mistakes relate to certain trusts failing to qualify as special purpose entities, Fannie Mae said. The result is that the company will have to include the securities contained in the trusts on its balance sheet, increasing both assets and liabilities. The amount is \$25.5 billion, or less than 2 percent of the \$1.6 trillion in Fannie Mae mortgage-backed bonds outstanding, on its balance sheet.

Fannie Mae will need \$926 million of capital to support the transfer of the securities to its balance sheet, said Edwin Groshans, an analyst in New York at Fox-Pitt Kelton Inc. At the end of 2005, the company had \$1.13 billion of excess capital, "which should be sufficient to support these assets."

Fannie Mae also erred in accounting for income from its business of guaranteeing mortgage-backed securities, as well as in recording reductions in guarantee assets and obligations, the company said.

"The continued positive affirmation that the restatement is substantially complete is comforting," said James Vogel, head of the research department responsible for Fannie Mae debt at FTN Financial in Memphis, Tennessee. "They are in reasonable shape."

#### Government Ties

Congress created Fannie Mae and McLean, Virginia-based Freddie Mac to expand homeownership by increasing mortgage financing. The companies own or guarantee about 40 percent of the \$8.5 trillion residential U.S. mortgage market. They are the biggest borrowers in the U.S. after the federal government.

The companies generate about two-thirds of their profits on the difference between their costs to borrow in the bond market and the returns on mortgages in their combined \$1.4 trillion mortgage portfolios. They also earn money by charging lenders a fee for guaranteeing credit on mortgage-backed bonds.

Fannie Mae's mortgage portfolio stood at \$721.5 billion as of the end of March, down from \$864.9 billion a year earlier.