FINAL TRANSCRIPT

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FRE - Q2 2008 Freddie Mac Earnings Conference Call

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CORPORATE PARTICIPANTS

Edward Golding
Freddie Mac - SVP - IR

Dick Syron
Freddie Mac - Chairman, CEO

Buddy Piszel
Freddie Mac - CFO

Patti Cook
Freddie Mac - Chief Business Officer

CONFERENCE CALL PARTICIPANTS

Paul Miller
Friedman, Billings, Ramsey Group, Inc. - Analyst

Bob Napoli
Piper Jaffray & Co. - Analyst

Gary Gordon
Portales Partners - Analyst

David Hochstim
Buckingham Research Group - Analyst

Howard Shapiro
Fox-Pitt Kelton Cochran Caronia Waller - Analyst

Moshe Orenbuch
Credit Suisse - Analyst

Brad Ball
Citigroup - Analyst

Bruce Harting
Lehman Brothers - Analyst

Richard Manuel
Fidelity Investments - Analyst

Ken Bruce
Merrill Lynch - Analyst

Robert Lacoursiere
Paulson & Co. - Analyst

Fred Cannon
Keefe, Bruyette & Woods - Analyst

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. We welcome you to the Freddie Mac second quarter 2008 financial results conference call. At this time all participants are in a listen-only mode. Later we will conduct a question and answer session. (OPERATOR INSTRUCTIONS) As a reminder, this conference is being recorded.

I would now like to turn the call over to our host, Mr. Edward Golding, Senior Vice President of Investor Relations.

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Edward Golding - *Freddie Mac - SVP - IR*

Thank you, Pamela. Good morning everyone, and welcome to our investor presentation and conference call where we present to you our financial results for the second quarter of 2008. Speaking today are Freddie Mac's Chairman and Chief Executive Officer, Dick Syron, our Chief Financial Officer, Buddy Piszel, and our Chief Business Officer, Patti Cook.

Before we begin, let me make two important points. First, we have posted on our website a slide presentation and core tables which include additional details on our second quarter results. You may want to have these available as Buddy walks through the numbers.

Second, please note that today we may make certain forward-looking statements regarding our business results. These statements are based upon a set of judgments, estimates, and assumptions about our key business drivers and other factors. Changes in these factors could cause our actual results to vary materially from our expectations. You will find a complete discussion of these factors in our Form 10 Registration Statement filed with the SEC on July 18, 2008 and in today's 10-Q, both of which are posted on our website. We strongly encourage you to review those factors carefully.

One final note, we would like as many people as possible to be able to ask questions today. Therefore, if you would limit yourself to one question and a follow up, I'd be grateful. Time permitting, we will come back for a second round.

Thanks, and now let me introduce our Chairman and CEO, Dick Syron.

Dick Syron - *Freddie Mac - Chairman, CEO*

Thank you, Ed. Good morning everyone, and thank you for taking your time. We have one simple goal for this call. And that is to provide significantly more information about our credit position so you will have a clearer picture, not only of the challenges we face but also an understanding of what we're doing about it to build a stronger and more profitable company.

Now we're going to give you a great deal of credit information in this call. And it breaks down into three areas. One, we'll give you our best estimate of what we think will happen as a result of deteriorating. Two, we'll provide you with a capital sensitivity analysis covering both credit and impairment of securities. Finally, we'll provide you with the hard, underlying data needed to let you do your own detailed analysis of our credit position, should you decide to do so. We have an interest in absolute, complete transparency.

As we're all painfully aware, the housing market correction has had a severe impact on the US economy. Lower residential construction, declining home equity, and weak consumer confidence have shaved about two points off US GDP growth. More recently, high fuel prices and increased job losses are straining household finances.

Nonetheless, the basic equation we gave you on our last call remains true. We said credit would continue to deteriorate, and it has, admittedly even faster than we thought. We also expect weaker credit to be mitigated in part by strong revenue growth. And, indeed, net interest income grew even more rapidly than we had projected.

Another constant has been our ability to keep serving our mission and our customers at a time when the markets, policy makers and US homeowners are depending on us a great deal for the health of the economy.

We had a net loss of $821 million for the second quarter. This reflects a large increase in provision in our expenses as well as the recognition of limited ABS impairments offset, in part, by gains on the revenue side.

In our single-family business, we benefited from significant volume increases. In the retained portfolio, Freddie entered into approximately $100 billion in new purchase commitments at good margins in order to help supply liquidity to the mortgage

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market. And I think you can see the impact of some of that spread in the mortgage market. The performance of these two core businesses drove a significant increase in revenue this quarter.

However, as we expected, credit continued to deteriorate during the quarter as declining home prices led to increased defaults. Home prices declined faster than anticipated in the first half of 2008, with the steepest decline in those markets that had the hottest booms earlier in the decade.

Since the date of our first quarter call, recent data has prompted us to increase our estimate of future house declines. Previously we said house prices would fall at least 15% nationally peak-to-trough. Today's challenging economic environment suggests that the housing market is far from stabilizing. As a result, we now believe that national home prices will fall 18% to 20% peak-to-trough, and that is by the metric that we use. That is the metric based on our mix of product. And as you know there are a lot of metrics out there. But the long and the short of it is we now think that we are about half way through the overall peak-to-trough decline.

While the pace of house decline has moderated recently, suggesting that the risks are more balanced than they were in May, there is still a very large amount of inventory to work its way through the system, and a record number of foreclosures continues to exacerbate the problem, pushing prices down further. As a result, we continue to plan for more severe stress scenarios.

The continued deterioration in the housing sector led us to recognize impairments in our ABS portfolio and higher total credit losses. Even as we continued to see improved credit quality on new business in the second quarter, we expect credit-related costs to remain high as the housing market searches for a bottom.

Despite increased credit costs, Freddie Mac ended the quarter with approximately $37 billion in capital. That's about $2.7 billion above our 20% mandatory target surplus, and $8.4 billion above the statutory minimum requirement. In order to provide additional flexibility in our capital planning, and subject to board approval, we will be reducing our common dividend from $0.25 to $0.05 or less. I should note that we intend to pay full dividends at the contractual level on our preferred stock.

Throughout the quarter, Freddie Mac continued to play a crucial stabilizing role in the housing finance marketing in the broader economy. For example, we insured continued credit access for America's homeowners by providing $162 million in liquidity to the housing finance market. Our multi-family business continued to grow, helping to stabilize that market and to make rental housing more affordable. That is something that is especially important to our mission in the current environment. We also helped more than 16,000 homeowners to stay in their homes through foreclosure prevention programs. And you've seen some recent efforts in that direction.

The recently passed housing legislation reaffirms the crucial role the GSEs play in American's mortgage finance system. We appreciate the work of secretary Paulson, his colleagues, director Lockhart, and particularly Congressman Frank and Senators Dodd and Shelby in getting this done. While we do not expect to draw on any of the new (inaudible) provided going forward, they provide important sources of reassurance and potential support in the event the financial and housing markets deteriorate even much more severely than we're currently expecting.

Although we're still reviewing the new law, and significant rule making is coming, it will create higher regulatory costs and more responsibilities for the GSEs. We believe these can be managed. We look forward to working closely with our new regulator as the law is implemented.

Finally, the company recently reached a major milestone, something that has been one of our major objectives for some substantial period of time, and we're very proud of that. On July 18th, Freddie Mac became an SEC registrant after many years of effort. I want to thank our employees whose hard work and commitment made this possible.

In closing, I think you can derive three main themes from today's call. One, credit quality is today's overriding issue for financial service companies everywhere. And as you know, none of us is immune. Two, we're working to manage our credit risk prudently,

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and we'll be taking considered steps to strengthen our capital position. Three, we're also focusing successfully on growing revenue and managing costs to insure a strong foundation for long term growth and profitability.

There is no doubt that we're all going to continue to operate in a very challenging housing and economic environment the second half of this year. At this point, neither we nor anyone else can predict when the housing market will fully recover, and it would be folly to try to do so. I can promise you that Freddie Mac will play a pivotal role in insuring that it does, however.

With that, let me turn it over to Buddy.

Buddy Piszel - *Freddie Mac - CFO*

Thanks Dick, and good morning, everyone. There are three main takeaways from my presentation this morning.

First, it's clear from our release that continued house price declines, coupled with higher delinquencies and severities, have caused credit performance to weaken during the second quarter. This has led us to recognize increased losses and provisions in our single-family business. It has also led us to recognized impairments on our private label ABS securities.

Second, while our second quarter results reflect worse than anticipated credit, a large portion of the credit impact was offset by improved revenues, primarily due to growth in the retained portfolio.

Third, while our bottom line results are down from the first quarter, we still believe that a capital raise in the $5.5 billion zone is the right target. We will evaluate this target subject to our needs and the market conditions. The bulk of my comments will focus on these three points.

With that, let's take a closer look at the second quarter's results. So if you would go to slide one, in the second quarter we recorded a loss of $821 million, or a $1.63 per share, compared to a loss of $151 million or $0.60 per share in our first quarter. On the revenue side, net interest shown here on line one, was $1.5 billion, an increase of $731 million from the first quarter. That interest margin also increased growing from 48 basis points to 80 basis points as we benefited from the high volumes put on attractive OAS margins since March, and we replaced existing debt with lower cost issuance.

The combined effect, the growth in improved rates in these second quarter volumes, accounted for roughly 20 basis points of this improvement. As we expected, we also benefited from the reversal of the compression we experienced at the short end of the curve in the first quarter.

Moving to the guarantee income, in the second quarter total management and guarantee income decreased by $32 million. This change has two components. First, contractual guarantee revenues increased by $21 million, or roughly 11%, on annualized basis, driven by growth in our underlying UPB balances.

Second, recognition of deferred fee amortization income slowed by $53 million during the quarter, as forecasted interest rates increased.

On line three, mark-to-market losses were lower in the second quarter versus the first quarter. Interest rate marks were negligible, and we did take about $1 billion in impairments.

On the credit side, credit related expenses, shown on line 8 were $2.8 billion, an increase of $1.4 billion from the first quarter, as higher loan loss severities and serious delinquency rates yielded a greater provision and higher REO expenses. This added about $2 billion to our net credit reserve.

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Lastly on taxes, included in our second quarter tax benefit is a tax settlement of $171 million with the IRS that favorably resolves a very old tax issue. The net result of all of this was a loss of $821 million for the quarter.

If you turn to slide two. It is clear that we have continued to benefit from reduced levels of interest rate sensitivity in our income statement. In the second quarter, despite a near 100 basis point move in the five year swap rate, mark-to-market items related to interest rates were close to zero. This outcome resulted from gains on our net pay-fixed swap position and guarantee asset that essentially offset mark to market losses on swaptions and trading assets, which lost value as rates went higher.

As we discussed in the first quarter call, we set a goal for the company of keeping our overall GAAP interest rate sensitivity down to about $10 million per basis point move. During the second quarter, our overall rate sensitivity declined further than that. While the trading portfolio reduced our rate risk, it does add incremental spread risk.

Keep in mind that our sensitivity changes with the market and could be higher in future periods. As a result, we still have work to do but we'll continue this focus since reduced volatility makes capital planning much easier.

Going to slide three. Along with reduced volatility, an additional shock absorber for future credit losses and capital needs is the reversal of past mark-to-market losses. Through the first half of the year, reversal of these items has added about $824 million to our pre-tax results. At the end of the quarter, we still had about $3.2 billion in accretable balances, which we expect will be recognized in future periods.

If you turn to slide four. As I noted earlier, continued house price declines, increasing delinquencies and higher severity rates led to significantly worse credit performance in the quarter. Credit losses -- that's actual charge-offs and REO expenses -- totaled $810 million or 17.3 basis points on an annualized basis, up from $528 million, or 11.6 basis points in the first quarter.

Our credit provision increased to $2.5 billion from $1.2 billion. This increase is the result of two main changes -- worse severities and higher default rates. Severities contributed about $1.1 billion to the increase. Of this amount, about $800 million was due to lower disposition proceeds observed in our REO properties. Severity rates moved significantly higher from 22% at the end of March to 26% at the end of June.

Slide five summarizes our credit results from the past several quarters. And as you can see, while credit has clearly deteriorated, we have consistently provisioned well in excess of emerging charge-offs. As a result, we believe that we remain appropriately reserved for our estimated incurred losses. Our reserve to annualize second quarter charge-offs is about 2.7 times compared to about 3 times in the first quarter.

If you turn to slide six. We continue to assess impairments the same way we have in prior quarters. Our impairments break into three buckets. The upper box reflects securities in which the cumulative defaults and pace of rising delinquencies were sufficient for us to conclude that it was probable that the credit enhancement would be pierced. Line six shows that we have taken $444 million in total charges on that bucket. It includes a small percentage of our all day securities, and the majority of our uninsured securities backed by second liens. As we indicated on the first quarter call these had been the highest concerns on our radar screen.

For the second bucket, line 10 shows that we took an impairment charge of $382 million on bonds where we determined that it was probable that we would take a future economic loss. And that was because we concluded that we couldn't rely on the monoline insurance protection provided by a counter party.

Finally, the third bucket, line 12, shows that we recorded an additional $214 million in impairments on shorter-term securities in our liquidity and contingency portfolios. Given the recent backstop actions related to our liquidity, we concluded that it was appropriate to recognize the unrealized loss on this portfolio so that, if needed, we could raise liquidity with no further reduction in our capital.

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One final and important point on impairments is that going forward we expect to recognize the reversal of a large portion of the accretable amount. That is the difference between the amount of the impairment and the estimated eventual economic loss. This will be recognized as additional revenues through our net interest income line. You can see these estimated annualized amounts on the right hand side of the slide on line 13, which totals approximately $338 million. This is effectively the same as the reversal of the other credit-related marks we discussed back on slide three.

You can also see that, given the shorter-term maturities that the charges that we took on the L&C assets will reverse more rapidly than those on the ABS portfolio.

So let's move to the remaining ABS exposure and let me start with slide nine. While we consider many factors in determining probability of loss, these charts focus on remaining break-even default rates. In determining these rates, we start out with the assumption that the vast majority, typically around 90% or more of the 60 plus delinquent population goes to default. We then calculate the break-even amount of the performing loans that would need to default in order to create a dollar of loss. This incremental default rate is then evaluated to determine if a loss is probable and thus an impairment charge is warranted.

Slide nine shows these incremental break-even rates for our sub prime portfolio. Despite poor delinquency performance today of 20% to 40% on the underlying loans, in order to incur a dollar of loss for 95% of the portfolio, it would require incremental default rates on the performing loans of greater than 50%.

On slides seven and eight, we present a similar analysis of break-even default rates on a disaggregated basis for Alt-A, as well as for our MTA holdings. A couple of points to make. We believe we have higher exposure in the Alt-A floaters and the MTA portfolios, and for the Alt-A fixed and the hybrid portfolios, since 70% or so were originated in '05 and prior, their performance has been considerably better, and they are fairly well insulated from loss.

Let's move to capital. On slide ten, this shows that at the end of June, we had a capital surplus of $2.7 billion above the 20% surplus requirement. As part of our first quarter earnings release, we discussed that at that point we had estimated a need for about $5.5 billion in new capital. Since that time, we have continued to refine our analysis. And the bullet points on the lower section of the slide convey the sources of financial flexibility that we have.

First, we are starting with a capital surplus of $2.7 billion over the 20%, and $8.4 billion over our statutory minimum. Second, we expect continued strong revenue growth and the restoration of earnings from the reversal of prior period mark to market and impairment charges.

Third, subject to board approval we're reducing the common dividend in the third quarter to $0.05 cents a share or less, and we expect to pay full dividends at the contractual level on our preferred stock. Finally, we continued to take actions to further reduce our interest rate sensitivity and manage the size of the retained portfolio.

For sometime we have been working very closely with Goldman Sachs and JPMorgan as lead advisors to our capital raise, and have also been advised by BlackRock. One of the key focuses for us has been the estimation of potential loan loss provisioning and impairments that could emerge in a much more difficult environment through the end of 2009.

On slide 11 we show the range of possible credit costs during this period. Inside the grid, we show our surplus over the OFHEO statutory minimums, assuming a $5.5 billion capital raise. This analysis relies on many assumptions, and as reflected in the notes. And it also assumes we hold the retained portfolio largely flat but do benefit from improved net interest margins on replacement purchases.

While we are not expecting the most severe outcomes reflected in this analysis, what it shows is that we can withstand approximately $40 billion of credit pain for all of '08 and '09 and essentially meet our minimum statutory capital requirements. And that is before additional flexibility through managing the size of the retained portfolio.

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So, given this, we remain committed to a capital raise of about $5.5 billion to be executed when market conditions are appropriate. We'll evaluate this raise based on our needs and on market conditions. In the meantime, we believe we can manage our capital in the near term to continue our capital adequacy.

To sum up, while credit has definitely worsened, growth in our revenues, a significant reserve build, flexibility on capital, and a capital raise of $5.5 billion gives us confidence that, even under severe emergence of losses, we expect to maintain a surplus above our statutory minimums through the end of '09. So we have the wherewithal and the earnings power to manage through this period and emerge a strong long-term competitor.

With that, let me turn it over the Patti.

Patti Cook - *Freddie Mac - Chief Business Officer*

Thanks Buddy. The second quarter continued to present us with house price declines, volatile financial markets, and significant credit losses. However, unlike last quarter, our revenues increased substantially, partially offsetting these credit costs. We also began to see some moderation in house price declines. In addition we continued to provide liquidity to the single-family and multi-family markets by guaranteeing and purchasing mortgages. I will focus my remarks on three topics.

First, credit losses continue to accelerate in our single-family g-fee business, and are highly concentrated in a portion of the portfolio. Second, given the weakening in credit performance, we have intensified the overall stress scenarios that we use to evaluate the ABS portfolio. Nonetheless, our expectations for economic losses remain contained. Third, credit terms and pricing on new business have improved substantially over the course of the year.

So, first, credit losses in the single-family business. During the quarter the seriously delinquent rate on all single-family loans increased to 1.04%. House prices declined another 1% on our index during the first quarter. To put this in perspective, house prices declined 4% in both the first quarter of '08 and the fourth quarter of '07. Despite this apparent moderation in house price declines, we are still expecting another 7% to 9% in house prices, bringing the peak to trough decline to 18% to 20%.

While we may be roughly half way through the eventual decline, we are still in the early stages of realized defaults. Since the beginning of 2007 through the second quarter, we have only realized about $2 billion in credit losses. So most of the expected losses are yet to be realized. Model projections of these future losses are uncertain, given both the magnitude of the house price decline, and the greater share of new products in the 2006 and 2007 vintages. It is therefore important to augment model output with additional analysis, observations, and intuition to assess credit losses and our capital needs.

At the end of the first quarter, with the expectation of a peak-to-trough house price decline of about 15%, we predicted lifetime defaults in the neighborhood of $15 billion to $20 billion. Since we have increased our house price decline to about 18% to 20%, our model expectations have increased. To supplement our model, we are providing additional tables that include defaults and severities that build on recent experience. We have designed these tables to highlight the distinctions that exist with respect to performance within our portfolio. This allows us to provide greater insight into the underlying drivers and expectations for future credit performance. These charts are on slide 12.

Let's look at what we know. We know that the Alt-A book has generated about 50% of the year-to-date losses. And on a vintage basis, we know that the 2006 and 2007 book have generated about 60% of the losses. A look at the delinquency rates in these cohorts and the remaining portfolio will allow us to make some assessments about the future.

A close look at the Alt-A portfolio reveals significant differences between it and the total Alt-A market. The bottom quintile of Alt-A has a 90-plus day delinquency rate of 11.4%. The remaining 80% has a serious delinquency rate of 2.2%. The bottom quintile has credit characteristics that are much worse in the remaining population. Most of it was originated through out bulk

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channel, which indicates products outside our standard guide. While some of the loans in the remaining 80% were also originated through the bulk channel, a significant portion was originated through our flow contract.

The overall credit statistics for the two cohorts are very different. Here is a summary of how these two cohorts compare. The average FICO of the bottom quintile is 696 versus 731 for the remaining 80%. Average CLTV 95% versus 73%. Farms, 93% versus 30%, and interest only, 86% versus 23%. While we were able to charge more for these loans than our standard flow loans, the fees proved insufficient for these increase in realized losses. As a result of these very different credit profiles, it is logical to use different expected levels of default and severities for these two components of the portfolio.

As you can see in the blue boxed portions of slide 12, we would expect the bottom quintile of Alt-A to default at a much higher level than the remaining 80%. In a very stressful scenario, a 50% default rate, which is about four times today's serious delinquent population, and 50% severities, would produce about $10 billion in EDC. A 10% default rate and a 45% severity for the remaining 80% of the population would produce a $7 billion loss.

Similarly, in the prime portfolio shown in the blue-boxed area of slide 12, there is a significant difference between the 2005 and prior book compared to the rest of the portfolio. This is due in part to the lower CLTV on the earlier book of approximately 57% versus 78% on the later vintages, which likely contributes to a lower delinquency rate today and likely will result in lower defaults over the life of the book.

The summary charts on slide 12 are meant to help with the intuition around possible lifetime EDC measures. You'll find there a simple matrix of possible defaults and severities that are anchored in what is observable today. You can use these tables to develop your own assessment of what is likely and what is possible.

This analysis supports the results from our models, which when run with a variety of different assumptions, produce results in the middle of this range. Given the range of numbers on this page, namely a lifetime low credit loss experience of $16 billion, up to a high of $42 billion, we believe a $5.5 billion capital raise would be enough for us to manage through 2009 with a sufficient cushion above the statutory requirement.

I should emphasize here that the capital sensitivity analysis that Buddy walked through contemplated a severe stress case of $29 billion in single-family credit expenses through 2009 compared to lifetime stress expenses shown here of up to $42 billion that would likely be recognized over the entire life of the underlying loan. I think that emphasizes how severe the case Buddy discussed actually is.

Next, let's turn to the ABS portfolio where the process is similar.

As Buddy has discussed how we determine impairments, I want to touch on scenarios for economic losses with the passage of time and therefore more experience and information, we have updated the stress test methodology we used in the white paper we published in connection with our 2007 financial release. Similar to the approach we have taken in the g-fee portfolio, we have moved to segmenting our portfolio by delinquency quartiles and by year of origination, and running stress scenarios tailored to the individual cohorts. In our base cases, our losses for all portfolios are still low in the more favorable scenarios. These charts are in the appendix and begin on page 36 and go through page 40.

More importantly, even in our most severe stress tests, losses will still total less than $5 billion. We have included individual pages detailing the stress test for each product that I will let you review on your own. It is important to note, though, that the realized loss expectation is considerably less than the mark to market loss we would incur with impairment. The difference would accrue back to income over the average life of the assets.

Third, growth in new business is the bright spot of the quarter. In all three businesses -- single family, multi-family and the retained portfolio -- we are providing needed liquidity at better credit terms and prices, and therefore at attractive returns. Freddie is one of the few games in town.

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Given the continued uncertainty in the housing marketing, we have picked our spots carefully, leveraging our position in the market to negotiate better returns. This, in turn, insures our ability to continue to provide the market this needed liquidity.

Slide 13 shows that the credit profile of the worst single-family quintile has continued to improve. Expected default costs for the quintile have declined 62 basis points from the 2007 peak to 35 basis points at the end of the quarter. This is the result of improvement in the key characteristics of FICO, TLTV, reduced documentation loans, and loans with second liens. This bodes well for the performance of the 2008 book in the months and years to come.

On to the multi-family business. The multi-family segment is continuing to play an important role in our business. Credit fundamentals have remained strong, our volumes are up from last year, and we are profiting from improved pricing.

And lastly, the retained portfolio. Substantial purchases in the retained portfolio of high credit quality agency mortgages have supported spreads and contributed to higher revenue. During the second quarter, through our purchases, we effectively bought back the supply we were originating, thus supporting 30-year fixed mortgage rates. Option adjusted spreads were wide, NIM was highly accretive, and the risk added to the balance sheet was minimal, including no additional credit risk and only incremental interest rate risks.

Put differently, because all of our new purchases in the retained portfolio were focused on agency mortgages, they added zero credit risk to the company. This means that as we grew the retained portfolio, the credit sensitivity of our overall revenue stream went down. Until our capital raising options are clear, we will approach additional growth cautiously.

So in summary, we continue to absorb and predict large credit losses. However, we believe they are manageable, and under any realistic scenario I hope the analysis we have presented here today has reinforced that message. Meanwhile, we are prudently supporting the mortgage market to attractive new business in all three of our business lines and that is continuing to serve the housing sector and the

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Dick Syron - *Freddie Mac - Chairman, CEO*

Thanks everybody. We've obviously provided you with an extraordinary amount of information. But I'm not going to apologize for that. I'm going to say that the reason we did that is we have always tried to have the company, in good times and in bad, be quite transparent. And we think particularly in the current situation, we want to provide you with as much information as you could possible need in order to not only look at our estimates, the views of others that we've talked to, but also to be able to make adjustments and adaptations to come to your own best view of what the future may hold. With that, I'll turn it over to questions.

QUESTIONS AND ANSWERS

Edward Golding - *Freddie Mac - SVP - IR*

Operator may we have the first question please.

Operator

Certainly. (OPERATOR INSTRUCTIONS) We ask that you please limit yourself to one question and one follow up. And we'll go first to the line of Paul Miller with FBR Capital Markets.

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Paul Miller - *Friedman, Billings, Ramsey Group, Inc. - Analyst*

Yes, thank you very much. Relative to managing a portfolio, you guys were big net buyers of mortgages all through the second quarter. And given the fact that you might be managing a portfolio and winding it down a little bit to conserve capital, what type of impact do you think that's going to have on the mortgage market, in general, and especially with mortgage rates?

Patti Cook - *Freddie Mac - Chief Business Officer*

Paul, it is a great question and a timely observation. Because I do think the market understands the environment that the GSEs are in right now, where we are cautious about managing our capital. And you know, spreads right now are a little bit wider than they have been recently, which probably reflects that expectation. Having said that, the base case assumption is that we keep the portfolio flat. And even with the portfolio flat, we think we can continue to support the market with our runoff, and continue to reposition the portfolio so that we can support the secondary mortgage market.

Paul Miller - *Friedman, Billings, Ramsey Group, Inc. - Analyst*

So you don't perceive it is going to have any negative impact on the market at this point?

Patti Cook - *Freddie Mac - Chief Business Officer*

Well, I think to some degree I guess I was suggesting at the beginning that it may already be. I think the market understands that the capital position of the GSEs right now is such that rapid growth in the retained portfolio in the near term is not likely.

Paul Miller - *Friedman, Billings, Ramsey Group, Inc. - Analyst*

Okay. Thanks a lot, Patti.

Patti Cook - *Freddie Mac - Chief Business Officer*

You're welcome.

Operator

Thank you. Next we go to the line of Bob Napoli with Piper Jaffray.

Bob Napoli - *Piper Jaffray & Co. - Analyst*

Thank you. Two questions. First, on the capital side, why did you hold off at the end of last quarter, and how long can you wait? I mean you have $2.7 billion of excess regulatory capital. Can you run that down for a couple quarters, down near-- where can you take that before you go out and raise money?

Dick Syron - *Freddie Mac - Chairman, CEO*

You're going to get a double-headed answer to this. We committed some substantial time ago, as you know, to raising $5.5 billion in capital. As you also know, one of the long term objectives for several years of this company was to become current, which we did, and to become SEC registered. So we're in a position where we're becoming SEC registered. And we were advised by counsel internally, externally, issuer counsel, that, among other things, this would not be a good idea for us to go ahead and

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do a raise while we were in the middle of the registration process. And the registration process, as you know, was completed relatively recently.

Buddy Piszel - *Freddie Mac - CFO*

Yes, Bob, as to where we are and how quickly we have to move, we have 2.8 over the 20% right now. We believe we can manage to maintain our capital position for some time. So we are not putting a date certain. And we're certainly poised and ready when market conditions are appropriate. But there is no need for us to rush.

Bob Napoli - *Piper Jaffray & Co. - Analyst*

You think you can maintain the 2.8 at that level for some time, or --?

Buddy Piszel - *Freddie Mac - CFO*

There is flexibility to be in that zone in a while.

Bob Napoli - *Piper Jaffray & Co. - Analyst*

And just my follow-on question. On the incremental margins in the second quarter, you said 80 basis points. It wasn't clear to me on what the run rate of the margin is, the net interest margin going into the third quarter, what you would expect.

Buddy Piszel - *Freddie Mac - CFO*

It is at the 80 basis points. So, in effect, what we did in the second quarter is we restored the margin compression that we lost in the first quarter, and we benefited from the spreads on new business. We'll continue to benefit on those spreads on new business for the balance of the year. So it could be a little bit higher but it is directionally at the right levels.

Bob Napoli - *Piper Jaffray & Co. - Analyst*

Thank you.

Operator

Thank you. Next we move to the line of Gary Gordon with Portales Partners.

Gary Gordon - *Portales Partners - Analyst*

Okay, thank you. First, you described on the ABS, you took impairment charges, and then you're going to reverse them. I don't understand the accounting behind taking an impairment charge and then assuming a reversal over time.

Buddy Piszel - *Freddie Mac - CFO*

We don't make the rules, we follow the rules. When we take an impairment, we're required to mark it down to fair value. And then, under the accounting rules, you're supposed to over the balancing maturity of the instrument, which we intend to hold to maturity, accrete it to its expected ultimate value. Which, we've said the probable loss on these securities is way, way less on

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a cash flow basis than today's mark. So you can see that approximately 90% of the impairment charge that we're taking is going to flow back through over the remaining maturity of the individual securities that we impair. And that's the rules.

Gary Gordon - *Portales Partners - Analyst*

Thanks. Follow up is on capital. You talked about when you were going over capital you were looking at the minimum capital standard as opposed to your full well-capitalized level. There is obviously a big zone in there. Does something happen if you go below your well-capitalized level that impact your behavior?

Dick Syron - *Freddie Mac - Chairman, CEO*

There probably is. We are not, by using that benchmark to develop these tables, implying, in any sense, that we intend to get down to the minimum capital level. The story is that we're now operating at a 20% surplus level over the minimum capital levels. There were various negotiations and agreements on what that number would be once we raised $5.5 billion. So you essentially have a moving target here.

And what we wanted to do was provide people with one common benchmark, if you will, that would apply independent of what we wanted to show what the impact of various scenarios would be, independent of what we're doing to raise capital. And that's why we went to, if you will, to try to speak a common language on that.

Now, Buddy has said it is our intent -- and it is our intent -- to raise $5.5 billion. We have been working with JPMorgan and Goldman Sachs on that. And actually we're prepared to go as early as today to raise that money. But we think, and have been advised, that that is not the right thing to do for our shareholders. To do it at a more propitious time. And how that rolls out will affect -- could affect how we run our business in the meantime because we have lots of different ways we can manage capital, as Patti talked about, with the retained portfolio and other things.

Operator

Thank you, and we'll move then to the line of David Hochstim with Buckingham Research.

David Hochstim - *Buckingham Research Group - Analyst*

Patti, on slide 12, when you showed the sensitivity to losses, the worst 20% of the Alt-A portfolio, is there anything in those loans in terms of underwriting that didn't meet guidelines that would allow you to put more of those loans back and reduce your ultimate credit losses? Or are those, just everything came through LP and just turned out they were bad?

Patti Cook - *Freddie Mac - Chief Business Officer*

No, those loans don't reflect a high probability of loans that we would be repurchasing. We have already taken that into account when we show you these statistics. Rather, what I'd say about that population is that there were a variety of considerations at the time when we looked at that portfolio. Combination of market share, mission, that we balanced when we made those decisions. So, clearly, in retrospect, that $38 billion of loans is not performing necessarily the way we would have liked. But nonetheless they are all consistent and meet our charter and guideline requirements.

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David Hochstim - *Buckingham Research Group - Analyst*

And then Fannie Mae earlier this week announced an increase in delivery fees on certain loans. You haven't done anything like that, I guess. And if you haven't, are those possible fee increases reflected in your assumptions and reflected in the capital requirement on 11, or is that another potential benefit? I mean, in theory, there is a spread between jumbo rates and conforming rates today, it's over 100 basis points. It would seem that you have a lot of room to capture some of that value for shareholders.

Patti Cook - *Freddie Mac - Chief Business Officer*

Well, first of all everything in our presentation today reflects the g-fee and delivery fees that are currently in force. We regularly constantly are reviewing the adequacy of those fees in this market environment, and will continue to do so and consider the appropriateness of our pricing. I think your comment on the jumbo markets -- the jumbo market is interesting. So far the volumes there have been really small. And we will continue to evaluate our pricing. But I don't see it right now as having meaningful impact on any of our financial results or our capital management.

Operator

Thank you and next we go to the line of Howard Shapiro with Fox-Pitt Kelton.

Howard Shapiro - *Fox-Pitt Kelton Cochran Caronia Waller - Analyst*

Hi, thank you very much. I guess this is a question for Dick. Are we at a point in time where the inherent contradiction between Freddie Mac's public policy mission and its responsibility to shareholders is unsustainable? And if you think you can continue as you are, can you just talk about how you are viewing balancing your public policy mission and your obligations to shareholders.

Dick Syron - *Freddie Mac - Chairman, CEO*

Thanks, Howard, for the question. It is obviously a very pertinent question. I don't think we're at a point to use -- to cut to the chase, the model doesn't work anymore. I think we are at a point where the model is more strapped than it has been at some points in the past. Ironically, while we're in this period, a lot of people raising questions about the GSEs in the past, it has become very evident that there is an essentiality to the GSEs right now for reasons beyond having long term fixed rate mortgages and the usual arguments.

I think we -- virtually everyone, including our critics, would say that this would be an extremely ugly mortgage market, if you were looking at a mortgage market now that didn't have the GSEs in, either buying in the retained portfolio, in compressing MBS spreads, which that has done, or providing liquidity at a time when liquidity has been necessary in the market -- in the straight market, let me put it that way. Not even in the secondary market.

I think there is one realization that is coming through this whole thing, and that is, the GSEs going forward -- and this is my view, I'm not claiming it's the corporate view or anything -- I think we'll need to be more, if I can use the term, elastic institutions. And there will be periods like the current one, it will be essential that the GSEs grow quickly for the economy. And there will be periods in which the pure private sector, if I can call it that, may reenter the market. When that will happen, I don't know. In that situation, you would expect, and I think it would be desirable from a point of national policy, to have the market share of the GSEs collectively come down.

But to deal with that, it is going to be very important that the GSEs operate in an environment where there is capital flexibility over time, and that capital is treated in a counter-cyclical rather than a pro-cyclical way. Excuse me for that very long economic diatribe.

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Howard Shapiro - *Fox-Pitt Kelton Cochran Caronia Waller - Analyst*

Thank you very much.

Operator

Thank you, and we move next to the line of Moshe Orenbuch with Credit Suisse.

Moshe Orenbuch - *Credit Suisse - Analyst*

Thanks. I was just wondering, because you laid out a couple of different scenarios, one in which the retained portfolio stays stable after you added about $80 billion to it in the second quarter. And then in some of the caveats you said you could even slow purchases in the guarantee book. Could you talk about the likely path that you're going to take? Because I think the revenue story that you're talking about is really contingent upon having the ability to make those new purchases, and to the extent the capital position really puts you where you can't, I think it does under mine that to some degree. It is not clear how you're going the improve capital position if, in fact, the portfolio doesn't decline from the level of June 30.

Buddy Piszel - *Freddie Mac - CFO*

Well, Moshe, again, our base case is assuming that we're able to maintain the size of the retained portfolio. And by virtue of doing that we'll continue to benefit from the spreads that we're putting on currently so that if you just think about it year-over-year, for the second half of the year, net investment income would continue to grow just because you have the full level of the portfolio running for the second half of the year. And net investment would grow again in '09 from the spreads from the second half of the year, and the full level, running the full year versus half the year in 2008. So that is where we're starting.

Now, what we're saying is, if we start going down some of the more stressful credit paths, one of the things we would be doing is reevaluating on a constant basis how much we allow the portfolio to run off. We wouldn't be selling first. We would be saying let's slow down our purchasing. And that would all gear based on which credit path we're going down. At this point, we don't know which one we're going down, so we can't tell you which path we're following.

Moshe Orenbuch - *Credit Suisse - Analyst*

Got it. And just a follow up, and I couldn't get on to a couple minutes of the call so if you've mentioned this, I apologize this. You said three months ago that you would evaluate your expectations for '09 when it came down to, after you saw the spring selling season. Any thoughts after the spring selling season?

Patti Cook - *Freddie Mac - Chief Business Officer*

I alluded to that in my comments, that the second quarter is a quarter that is generally good for house prices. And you saw it with substantial improvement, even on a seasonally adjusted basis. But I think, given all the uncertainty in the market, the rising population in REOs, the uncertainty around the economy, I think it would be too early at this point to say that house price declines have moderated. As Dick suggested in his remarks, and I in mine, we're continuing to anticipated further declines so that the order of magnitude peak to trough goes from roughly 18% to 20%.

Moshe Orenbuch - *Credit Suisse - Analyst*

So higher losses in '09 than you said three months ago?

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Patti Cook - *Freddie Mac - Chief Business Officer*

Higher losses -- what do you mean? Are you talking credit losses?

Moshe Orenbuch - *Credit Suisse - Analyst*

Credit losses. The 20 to 25 basis points.

Buddy Piszel - *Freddie Mac - CFO*

I would say at this point, again, we're trying to be cautious because we're trying to make sure that we're adequately capitalized to support the market all the way through 2009. In that, we have a more cautious view of the emergence of credit in '09. And we'll see how it plays out.

Patti Cook - *Freddie Mac - Chief Business Officer*

I guess lastly, what I'd add, what we tried to do today between some of the remarks that Buddy made, and the chart that we included on page 12, is to say that if the markets do continue to deteriorate, if house prices continue to decline, and our EDC estimates, or our estimates of defaults and severities were continuing to increase, how big could that number be? And Buddy has tied it back and told you how much we think we could take in '08 and '09 as a downpayment on that lifetime EDC number.

Moshe Orenbuch - *Credit Suisse - Analyst*

Thank you.

Operator

Thank you. And we'll move then to the line of Brad Ball with Citigroup.

Brad Ball - *Citigroup - Analyst*

Thanks. Actually, Patti, following up on what you just said on slide 12. The box furthest to the right, you indicate low, medium and high defaults and severities for each of the matrix boxes. Could you give us a little color around what those defaults and severity assumptions are? I know that you had previously talked about a 4% default rate and a 35% severity rate, and that that coincided with something like a $28 billion cumulative life of asset loss rate. Is that the very middle box on that chart rate. Is that how to read that?

Patti Cook - *Freddie Mac - Chief Business Officer*

So here is what we did. Rather than give you that one number on the overall portfolio, what we're suggesting is that by breaking it down into some sub components, we can get even better intuition around the numbers. So the box on the far right-hand side is just numerically adding the sub total for the prime box and the Alt-A box. So let me be specific.

To get to the $40 billion number, you would take the bottom right-hand corner of prime, so defaulting high, high 25 versus the 17 down at the bottom, that equals 42. And, if you bear with me for a minute, look at the prime box, and move to the left. That

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$25 billion in that bottom corner is the sum of the 14 and 11 in the two boxes prior. And there we have identified the default rate and the severity rate that we used to get that total.

And the point of this is to say -- and let's go to the Alt-A one, because I think it is the most dramatic. If you look at that box, all-day portfolio, the worst 20%. We're saying if that population defaults 30%, 40% or 50%, and has severities of 40, 45 and 50, those would be the losses. And to try and allow you to assess how likely that is, the other piece of information that is relevant is that 11.4% of it is currently seriously delinquent.

Said another way, in order to realize 50% default rates, if you assume everything that is currently delinquent, the 11.4% does in fact default, then about 38% of the remaining population would also have to default to get to 50. So, long answer to your question, but when you get to that right-hand box it is just a sum of the analysis to the left. And to the left is where you see the default rates and severities. You can compare it to what is currently seriously delinquent and begin to make some assessments yourself of what is possible.

Dick Syron - *Freddie Mac - Chairman, CEO*

And just to quickly add, because Patti went through this, actually did a very good -- she was a school teacher once -- she did a very good job of explaining the lesson. But we are not apologizing about providing all this information. But what we're essentially doing with this data and the data in the appendix is giving you an erector set which says, if I want to change something in a certain assumption, or have a different view on something, I can pull out that cell, if you will, and reinsert my own cell into the overall model and come up with your own views.

Patti Cook - *Freddie Mac - Chief Business Officer*

And Brad, the last comment I would make is that the numbers that do come out of the model are within that range of nominal life time default costs between the $16 billion and the $42 billion.

Brad Ball - *Citigroup - Analyst*

Right, and just real quickly, translating that box on page 12 into how it relates to the analysis on page 11, the difference is that page 12 talks about life of the asset --

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Patti Cook - *Freddie Mac - Chief Business Officer*

Exactly.

Brad Ball - *Citigroup - Analyst*

Whereas page 11 is cumulative over '08, '09, but it also includes ABS impairment.

Patti Cook - *Freddie Mac - Chief Business Officer*

Right, but I think what's helpful -- so again if you want to think about how you're going to think about 2009, depending on where you want to be on the box on page 12. Let's say your own analysis suggests that you think the number is $31 billion, you're medium and high in severity. Well then you can go back to the chart on page 11 and say, okay, if it's $31 billion, maybe they've got to take between 19 and 25 over the course of the next two years into '09, and therefore you can begin to drill in with some assumptions on impairments as to what that capital position is likely to be.

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Buddy Piszel - *Freddie Mac - CFO*

Yes, the other thing that I would add, Brad, is that we tried to be conservative in laying these expectations out. And in general the provisioning is around 70% in the first two years, which is very, very front-ended from what we've typically seen.

Brad Ball - *Citigroup - Analyst*

So the chart on page 11 includes the provisioning and the reserve that you have currently, plus losses that you have incurred to date, plus the assumption of the $5.5 billion of capital raised and earnings over the next six quarters.

Buddy Piszel - *Freddie Mac - CFO*

That's what's in the capital -- that is implied underneath the capital numbers. The provisioning and loss data across the top is pure P&L payment. It does not consider the existing reserves.

Brad Ball - *Citigroup - Analyst*

Got it, thanks very much.

Operator

Thank you. And our next question comes from the line of Fred Cannon with KBW.

Fred Cannon - *Keefe, Bruyette & Woods - Analyst*

Thank you and I just had a follow up on the capital issue. The analysis you presented seems to presuppose -- does presuppose -- that core capital is the key and constraining ratio. The new housing bill seems to give the new regulator a lot more discretion in terms of how they look at capital. And I was wondering if you could comment on other approaches to looking at capital for us to think about the potential capital needs of Freddie Mac going forward.

Dick Syron - *Freddie Mac - Chairman, CEO*

Well, there are obviously lots of different ways that people can look at capital. And various measures have various applications and various advantages and disadvantages. A lot of people in the academic community have raised concerns about GAAP and where it brings results.

You are correct, the legislation does provide a variety of approaches that could be taken to this. It would be, I'm afraid, on my part, pure speculation to get into exactly what approach the regulator would take at this time because, let's face it, the GSEs are in the strong head lamps now. They're necessary -- essential, I would argue -- for the health of the economy of the country because of the importance of the housing sector. And the framework that we're working within now is the statutory framework, and that is the reason that we have focused on it.

And we haven't seen any proposals from the regulator. I'm sure there will be proposals. There is an elaborate process to go through of making proposals going to the federal register. And subject to public rule-making process. So, the regulator and -- they're looking hard at this, and they're doing a good job, I think, of beginning to look at it. But this is going to take some substantial period of time with lots of input on what is the effect of this, not just on the institutions but on the economy.

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Fred Cannon - *Keefe, Bruyette & Woods - Analyst*

Okay. Thanks, and just a couple technical follow ups. In the $5.5 billion capital raised, could you give us any more insight on the mix in terms of preferred versus common, and how you're thinking about that today?

Buddy Piszel - *Freddie Mac - CFO*

Well, when we first put that out there we had a 50/50 mix that we were assuming. We're not bound by that. It will depend largely on the availability that is there in the marketplace. And so we'll work that through with our bankers when it comes time to do the capital raise.

Fred Cannon - *Keefe, Bruyette & Woods - Analyst*

Great. And finally, in your estimations on a go-forward basis, you said you're planning on keeping the portfolio flat in that scenario. What underlying assumption do you have for the guarantee business in terms of growth?

Patti Cook - *Freddie Mac - Chief Business Officer*

We are assuming the guarantee business will continue to grow at a rate of about 10%. That is slowing down from where it was last year. And I think the difference is, in '07, an even into end of '06, particularly in '07, you saw the GSE share of the conventional conforming market go up substantially. And, as a result, our growth rate last year was substantially above MDO. Now that our share of the overall market has leveled off, I would expect to see some leveling off in the growth. But from a capital planning perspective, assume that the portfolio continues to grow at 10% a year.

Fred Cannon - *Keefe, Bruyette & Woods - Analyst*

Thanks very much.

Operator

Thank you. We'll take our next question then from the line of Bruce Harting with Lehman Brothers.

Bruce Harting - *Lehman Brothers - Analyst*

Thanks. On page 11, if you just subtract from the loss provision and REO numbers across the top of the page, the $5.4 billion that you have already incurred, and then divide by the remaining six quarters left in '08 and '09, implies a $1.7 billion quarterly provision at the 15.5 level, and a $4 billion quarterly provision at the $29 billion level, using the two book ends. So, a lot of this seems to have to do with timing. And, Patti, you mentioned that the revenue growth was strong. But what is the rationale for continuing to do provisioning at a pretty high multiple of the actual charge-offs, since timing seems to be essential here in keeping capital in the bank?

And I'm just wondering that if you do, switching over to the next page, just picking, say, the mid-points of your total expected losses of $28 billion over the life time of the portfolio, can you give a little more specificity of how many years one should use for life time? Is that four years, six years, eight years?

And to this timing issue, it just seems that if you do take, say, the $19.4 billion or $25 billion number across the top, I mean your not assigning any probabilities, I think I hear you saying. You're not assigning any probabilities to any of these numbers. But

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this table is just to show the amount of excess capital you would have left. But I guess my question is when would we see, to your point about peak provisioning, the ratio provisioning to actual charge-offs coming down? And what would be the criteria to allow you to do that since the timing of these big provisioning numbers relative to 1.7 of revenues is pretty critical to starting to show, directionally, some better bottom line numbers. Thanks.

Buddy Piszel - *Freddie Mac - CFO*

Yes, okay, Bruce, a couple of things. First of all, we're not thinking about this on a ratable basis. So we did not divide by four -- divide by whatever by the remaining quarters over this period of time.

What we're trying to do is say, for purposes of evaluating our situation on capital, let's be cautious in the way that we stress the expected earnings over the next year and a half. And so we pulled -- we probably pulled more provisioning than will ultimately emerge forward in the curve to be able to say, even if it came up this fast, we would be able to manage our capital levels over this period of time with $5.5 billion.

In regards to what will actually take place, you're right. At this point our provisioning has been well in advance of the emergence of charge-offs. At the same time, when you looked at our underlying models, we are projecting the charge-offs are increasing dramatically, and the nature of the way that we're doing our provisioning is responding to that, and I think prudently, before it happens. So we're not trying to deliberately kill our capital levels, but we are trying to be prudent in the way that we're preparing for them. And we think that is the right place to be.

Dick Syron - *Freddie Mac - Chairman, CEO*

Bruce, can I just add one other thing which I think is very implicit in what you said. What we are doing is running the company as we are obligated to under accepted accounting conventions. If you were looking at this as an economic policy matter, you might take an entirely different approach.

Bruce Harting - *Lehman Brothers - Analyst*

Okay, I mean I'm just -- I guess implicit is the severity rate. If you just take the medium case, for example $28 billion over life time, that would seem to imply at the rate you're booking actually charge-offs of 800 in the quarter, a fairly long gestation period before you actually realize that. So I guess we're talking about the same thing. It just seems like the provisioning levels are -- I don't know if you're -- at one point, you said that you might see this year as a peak in provisioning. But that is no longer the case, but there is still no guidance at this point as to when we might see a peak in the the quarterly run rate.

Buddy Piszel - *Freddie Mac - CFO*

Yes, I wouldn't say we would give you when the peak is. The provisioning is very front-loaded. And in these scenarios, '08 is the peak provisioning year. And it comes down, and it assumes that the charge-offs, the ratio of today's charge-offs to the reserve is a little misleading because inherent in the charge-off forecast is a dramatic increase in charge-offs over time.

Operator

Thank you, and we'll move to the line of Richard Manuel with Fidelity.

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Richard Manuel - *Fidelity Investments - Analyst*

All right, thank you, I was going to ask the question that Bruce asked. So thank you, Bruce, but I was wondering if you could elaborate on page 12 what severities you're experiencing on the four sub portfolios at current levels. And if you could also comment on the cure rates that you're seeing out of this seriously delinquent buckets, back into performing, just to help guide which box ultimately we choose.

Patti Cook - *Freddie Mac - Chief Business Officer*

Two observations. One, if you notice, the severity rates are fairly consistent. They don't vary nearly as much as the default rates. And that reflects our current experience. So while you might expect your severity rates in California, Nevada, Florida, would be substantially different than what you experience in other parts of the country that in fact is not true. So we have kept our severity rates pretty constant going from 30 up to 50 in the extreme and Alt-A.

In terms of the seriously delinquent transition rates, I don't have that with me, but what I would suggest that you do is assume that a very high percent of those -- and that's what we're doing in the box -- if you think about it, will ultimately default. So we're not trying to improve, if you will, the outlook by assuming that a high percent of those ultimately cure, although some will. Rather, we're saying to look at the box and get some intuition around it. You could assume everything that is seriously delinquent defaults, and solve for what is a reasonable default rate in the remaining population.

Buddy Piszel - *Freddie Mac - CFO*

Dick, if we're looking at our actual ROE disposition rates at the end of the second quarter, they were around 73%. We see that drifting down to about 69% and ultimately into the mid-60s.

Richard Manuel - *Fidelity Investments - Analyst*

Okay. I have one follow up. I was wondering if you had a progress report on splitting the CEO and the Chairman seat so that if you do get the 5.5 done at some point in the future that you get the full 10% benefit from Director Lockhart.

Dick Syron - *Freddie Mac - Chairman, CEO*

Well, thanks Dick, for asking that question. I'm glad that you asked it. And let me get right to the bottom line with it. I have no intention, and you have every commitment from me, that as soon as we are able to get some benefit from a regulatory perspective of separating the Chairman and CEO, I am not wed at all to the kind of business card that I carry.

The second part -- the first part of your question, I answered the second part first -- was that all of this is tied, hopefully, to the process we're going through, and have been going through for some time, to get a new CEO for the company. We are very actively engaged in that. I shouldn't say we, I should say the search committee of the board is very actively engaged in that. They have seen a number of very attractive candidates, but candidly it is taking longer than we had hoped.

To reiterate what I said in the first place, when we get the other things done that we need to do, I'm not going to stand in the way in any form of something that benefits the company and our shareholders.

Operator

Thank you. And we'll go then to the line of Ken Bruce with Merrill Lynch.

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Ken Bruce - *Merrill Lynch - Analyst*

Good morning. First, thank you for providing the additional disclosure. I think that will be very helpful. My question is building off some of the earlier questions on capital. I think, Buddy, you mentioned that the analysis of capital adequacy was making an assumption that you would recycle investments into the current spread environment. And I was wondering if you could provide some sensitivity around how that would change either the behavior of the company or the capital adequacy if the spreads were to compress back to more normal levels please?

And secondly on top of that, if there are any triggers that potentially could create the temporary impairment in the private label securities being moved to a permanent impairment status.

Buddy Piszel - *Freddie Mac - CFO*

On the spreads, we were putting new assets on, with GAAP spreads of 150 basis points. When we modeled that out, we contracted that to 120. You could just look at the runoff on the replacement, Ken, to be able to calculate what the implications would be if the spreads came in further than that. Because your run off replacement is about $12 billion to $15 billion a month. So that's one way of just getting a sense for that.

As far as the conclusion about temporary versus permanent, I don't know if it matters, because, unless your question is do we believe that the fair value is the expected ultimate realization. And I would say if that is the question the answer is no because when we really get inside the cash flows and look at what we're ultimately going to receive on the ABS, it is way higher than today's mark.

Ken Bruce - *Merrill Lynch - Analyst*

I guess where I was going with that is there is some concern that if it is moved to a permanent status then it would affect your regulatory capital and thus would be an issue on your capital adequacy more so than it today where it is being reversed out.

Buddy Piszel - *Freddie Mac - CFO*

To my knowledge, there is no regulatory rule that would make a difference between permanent impairments and temporary impairments. It follows our capital gears off of GAAP. And the GAAP treatment is exactly what we're doing which is taking today's fair value loss and then determining what the eventual realized loss would be and amortizing that difference. So, to my knowledge, there is no regulatory exception.

Ken Bruce - *Merrill Lynch - Analyst*

Okay, and as it relates to the loss expectations, I know in the past you had indicated that you had an assumption as to the benefits for loan put backs to sellers for poor loan quality. And I was hoping that you would be able to provide some commentary around what that expectation is or how to work with that.

Patti Cook - *Freddie Mac - Chief Business Officer*

As you might imagine, in this environment, our repurchases, which is the activity you are referring to, certainly have gone up substantially from where they were a year ago. And we are working through those issues with our customers. When we reflect to you expected losses, we are taking into account our expectation of what that repurchase activity would yield. And as of right now, while there is a bit of a backlog building, we are constructively working through that inventory with out customers.

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Edward Golding - *Freddie Mac - SVP - IR*

Operator, can we take one more question please?

Operator

Absolutely, and that question will come from the line of Robert Lacoursiere with Paulson.

Robert Lacoursiere - *Paulson & Co. - Analyst*

Great, thank you. I'd like to ask a question about -- get a little more view on the deferred tax asset. It is about $18.4 billion right now, which exceeds your common and your preferred equity. And clearly it is a pretty big number relative to your excess regulatory capital. My question relates to your update on the internal control over financial reporting in which you talk about the tax basis balance sheet which you have not finished the remediation. In fact, you actually talked about they do not maintain a tax basis balance sheet to support the deferred tax asset.

The question is, when do you think you will complete that? And do you think that the regulator in this change of new rules would actually change the acceptability of deferred tax assets? Because under commercial banks, other regulatory institutions, they're only allowed to account, in regulatory capital, the deferred tax assets that they can use in one year.

Buddy Piszel - *Freddie Mac - CFO*

So Robert, let me give you a couple of points. One is the bulk of the deferred tax asset gears off of AFS portfolio, and the mark to market, largely on the ABS portfolio. And when you think about the implication to real taxable losses from that, it is de minimis, because those marks will reverse over time and ultimately you can evaluate, make your own consideration of what the realization is going to be, of actual cash on the ABS portfolio. But that does not result in any significant taxable loss or really book loss at the end of the day. So that just reverses out. So that is $11 billion of the deferred taxes.

$5 billion or so is around derivative marks that, again, just work themselves out over time. And only a small part of the deferred tax asset is related to the differential between taking a credit provision today versus the way charge-offs will flow through taxable income.

So, we grant you that it is a large number relative to capital. If you look at what is inside of it, it's not the kind of risky asset that may exist with banks. So we've taken a look at banking regulations to see whether or not, if you even applied that rule to us, whether there could be carve-outs for the nature of the items that are giving rise to the deferred tax assets. So at least at this point, we do not believe that the deferred tax asset should be seen as some kind of an impaired asset, nor should it be looked at from that standpoint from a regulator for determining capital.

In regard to the tax basis balance sheet, we have been working on the tax basis balance sheet for a while. We've gone back. We should be done with that by the end of the year. We do not believe it will have any significant impact on anything. All it does it strengthen our bookkeeping on a going forward basis. So it should not be a factor at all in the evaluation of our deferred tax asset.

Edward Golding - *Freddie Mac - SVP - IR*

Operator, I think that concludes the call. Can we have the play back number announced?

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Operator

Certainly. And ladies and gentlemen, this conference is being made available for replay after 12:30 p.m. today until August 20th at midnight. You may access the AT&T executive play back service at any time by dialing 1-800-475-6701, and entering the access code, 951871. International participants, please dial 1-320-365-3844. And, again, those numbers are 1-800-475-6701, international participants, 1-320-365-3844, with the access code 951871.

That does then conclude our conference for today. We thank you for your participation and for using AT&T's executive teleconference service. You may now disconnect.

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