

FEDERAL NATIONAL MORTGAGE ASSOCIATION FANNIE MAE  
Form 10-Q  
November 07, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
☒ 1934

For the quarterly period ended September 30, 2013

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934

For the transition period from     to

Commission File No.: 0-50231

Federal National Mortgage Association

(Exact name of registrant as specified in its charter)

Fannie Mae

Federally chartered corporation

52-0883107

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

3900 Wisconsin Avenue, NW

20016

Washington, DC

(Zip Code)

(Address of principal executive offices)

Registrant's telephone number, including area code:

(202) 752-7000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of September 30, 2013, there were 1,158,080,657 shares of common stock of the registrant outstanding.

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## PART I—FINANCIAL INFORMATION

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

We have been under conservatorship, with the Federal Housing Finance Agency ("FHFA") acting as conservator, since September 6, 2008. As conservator, FHFA succeeded to all rights, titles, powers and privileges of the company, and of any shareholder, officer or director of the company with respect to the company and its assets. The conservator has since delegated specified authorities to our Board of Directors and has delegated to management the authority to conduct our day-to-day operations. Our directors do not have any fiduciary duties to any person or entity except to the conservator and, accordingly, are not obligated to consider the interests of the company, the holders of our equity or debt securities or the holders of Fannie Mae MBS unless specifically directed to do so by the conservator. We describe the rights and powers of the conservator, key provisions of our agreements with the U.S. Department of the Treasury ("Treasury"), and their impact on shareholders in our Annual Report on Form 10-K for the year ended December 31, 2012 ("2012 Form 10-K") in "Business—Conservatorship and Treasury Agreements."

You should read this Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") in conjunction with our unaudited condensed consolidated financial statements and related notes and the more detailed information in our 2012 Form 10-K.

This report contains forward-looking statements that are based on management's current expectations and are subject to significant uncertainties and changes in circumstances. Please review "Forward-Looking Statements" for more information on the forward-looking statements in this report. Our actual results may differ materially from those reflected in our forward-looking statements due to a variety of factors including, but not limited to, those discussed in "Risk Factors" and elsewhere in this report and in "Risk Factors" in our 2012 Form 10-K.

You can find a "Glossary of Terms Used in This Report" in the "MD&A" of our 2012 Form 10-K.

### INTRODUCTION

Fannie Mae is a government-sponsored enterprise ("GSE") that was chartered by Congress in 1938. Our public mission is to support liquidity and stability in the secondary mortgage market, where existing mortgage-related assets are purchased and sold, and increase the supply of affordable housing. Our charter does not permit us to originate loans or lend money directly to consumers in the primary mortgage market. However, as the leading source of residential mortgage credit in the secondary market, we indirectly enable families to buy, refinance or rent a home. We securitize mortgage loans originated by lenders into Fannie Mae mortgage-backed securities that we guarantee, which we refer to as Fannie Mae MBS. We also purchase mortgage loans and mortgage-related securities. We use the term "acquire" in this report to refer to both our securitizations and our purchases of mortgage-related assets. We obtain funds to support our business activities by issuing a variety of debt securities in the domestic and international capital markets.

Like the mortgage finance industry we serve, Fannie Mae is undergoing significant transformation. Since entering into conservatorship in September 2008, our senior management, constituencies and priorities have changed. More than 85% of our current senior management team, and every member of our management committee, has been hired or promoted into their current role since we entered into conservatorship. More than half of our employees were hired after conservatorship began. Moreover, instead of being run for the benefit of shareholders, our company is managed in the overall interest of taxpayers, which is consistent with the substantial public investment in us. Ultimately, we help fill the role of enabling families to buy, refinance or rent a home.

Our conservatorship has no specified termination date, and we do not know when or how the conservatorship will be terminated, whether we will continue to exist following conservatorship, or what changes to our business structure will be made during or following the conservatorship. Our agreements with Treasury that provide for financial support also include covenants that significantly restrict our business activities. We provide additional information on the conservatorship, the provisions of our agreements with Treasury, and their impact on our business in our 2012 Form 10-K in "Business—Conservatorship and Treasury Agreements" and "Risk Factors." We discuss the uncertainty of our future and its impact on us in "Executive Summary—Outlook" in this report and in "Risk Factors" in our 2012 Form 10-K. We describe recent proposals for GSE reform that could materially affect our business in "Legislative and Regulatory Developments—GSE Reform" in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013 ("Second Quarter 2013 Form 10-Q") and in "Business—Legislative and Regulatory Developments" in our 2012 Form 10-K.



Although Treasury owns our senior preferred stock and a warrant to purchase 79.9% of our common stock and has made a commitment under a senior preferred stock purchase agreement to provide us with funds to maintain a positive net worth under specified conditions, the U.S. government does not guarantee our securities or other obligations. Our common stock is traded in the over-the-counter market and quoted on the OTC Bulletin Board under the symbol "FNMA." Our debt securities are actively traded in the over-the-counter market.

## EXECUTIVE SUMMARY

We are focused on paying Treasury for taxpayers' investment in Fannie Mae, which can be accomplished by supporting the housing recovery, helping struggling homeowners and laying the foundation for a better housing finance system going forward.

Our actions to accomplish these objectives are having a positive impact:

**Financial Results and Treasury Dividend Payments.** Our financial results for the third quarter of 2013 continued to be strong. With our net income of \$8.7 billion for the third quarter of 2013, we ended the quarter with a positive net worth of \$11.6 billion as of September 30, 2013. We will pay \$8.6 billion of that net worth as a dividend on the senior preferred stock to Treasury in the fourth quarter of 2013. With this dividend payment, we will have paid a total of \$113.9 billion in dividends to Treasury on the senior preferred stock. We expect to remain profitable for the foreseeable future. See "Summary of Our Financial Performance" below for an overview of our financial performance for the third quarter and first nine months of 2013, as compared with the third quarter and first nine months of 2012. For more information regarding our expectations for our future financial performance, see "Outlook" and "Strengthening Our Book of Business—Expectations Regarding Future Revenues" below.

**Providing Liquidity and Support to the Mortgage Market.** We continued to be the leading provider of liquidity to the mortgage market in the third quarter of 2013. As described below under "Contributions to the Housing and Mortgage Markets Since Entering Conservatorship—2013 Acquisitions and Market Share," we remained the largest single issuer of mortgage-related securities in the secondary market during the quarter and remained a constant source of liquidity in the multifamily market.

- **Strong New Book of Business.** Single-family loans we have acquired since the beginning of 2009 constituted 75% of our single-family guaranty book of business as of September 30, 2013, while the single-family loans we acquired prior to 2009 constituted 25% of our single-family guaranty book of business. We refer to the single-family loans we have acquired since the beginning of 2009 as our "new single-family book of business" and the single-family loans we acquired prior to 2009 as our "legacy book of business." As described below in "Strengthening Our Book of Business—Credit Risk Profile," we expect that our new single-family book of business will be profitable over its lifetime.

**Credit Performance.** Our single-family serious delinquency rate continued to decline from its peak of 5.59% as of February 28, 2010, and was 2.55% as of September 30, 2013, compared with 3.41% as of September 30, 2012. See "Credit Performance" below for additional information about the credit performance of the mortgage loans in our single-family guaranty book of business.

**Reducing Credit Losses and Helping Homeowners.** We continued to execute on our strategies for reducing credit losses on our legacy book of business, which are addressed in "Business—Executive Summary—Reducing Credit Losses on Our Legacy Book of Business" in our 2012 Form 10-K. As part of our strategy to reduce defaults, we provided approximately 55,000 loan workouts in the third quarter of 2013 to help homeowners stay in their homes or otherwise avoid foreclosure.

We also continued our efforts to help build a new housing finance system, including pursuing the strategic goals identified by our conservator: build a new infrastructure for the secondary mortgage market; gradually contract our dominant presence in the marketplace while simplifying and shrinking our operations; and maintain foreclosure prevention activities and credit availability for new and refinanced mortgages. We discuss these goals in our 2012 Form 10-K in "Business—Executive Summary—Helping to Build a New Housing Finance System." In March 2013, the Acting Director of FHFA released 2013 corporate performance goals and related targets for Fannie Mae and Freddie Mac, referred to as the 2013 conservatorship scorecard, that build upon these strategic goals. See our current report on Form 8-K filed with the Securities and Exchange Commission (the "SEC") on March 8, 2013 for a description of the 2013 conservatorship scorecard.



In addition to working on FHFA's conservatorship scorecard objectives, we are also working on additional related projects to help prepare our business and infrastructure for potential future changes in the structure of the U.S. housing finance system.

For example, one of our priorities is to modernize our technological infrastructure to give us the flexibility that may be required as the housing system undergoes transition. These projects will likely take several years to implement. We are devoting significant resources to and incurring significant expenses in implementing FHFA's objectives and these additional related projects.

#### Summary of Our Financial Performance

Our financial results for the third quarter and first nine months of 2013 reflected continued improvements in the housing and mortgage markets, resulting in a further reduction in our loss reserves, and continued stable revenues. In addition, the increase in interest rates during the first nine months of 2013 resulted in improvements in the fair value of financial instruments that we mark to market in our earnings, resulting in fair value gains primarily related to derivatives. Although the increase in interest rates had a positive impact on the fair value of our financial instruments, the increase in interest rates had a negative impact on our loss reserves.

We expect our revenues to continue to be stable; however, as we discuss more fully in "Strengthening Our Book of Business—Expectations Regarding Future Revenues," we expect the source of our revenue to shift in the future. Additionally, we expect volatility from period to period in our financial results due to changes in market conditions that result in periodic fluctuations in the estimated fair value of the financial instruments that we mark to market through our earnings. These instruments include trading securities and derivatives. The estimated fair value of our trading securities and derivatives may fluctuate substantially from period to period because of changes in interest rates, credit spreads and interest rate volatility, as well as activity related to these financial instruments. While the estimated fair value of our derivatives that serve to mitigate certain risk exposures may fluctuate, some of the financial instruments that generate these exposures are not recorded at fair value in our condensed consolidated financial statements. In addition, our credit-related income or expense can vary substantially from period to period primarily due to changes in home prices, borrower payment behavior and economic conditions.

#### Comprehensive Income

#### Quarterly Results