FINAL TRANSCRIPT

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PRESENTATION

Operator

Ladies and gentlemen, thank you very much for standing by. Welcome to the Fannie Mae investors conference call. (Operator Instructions). As a reminder, today's call is being recorded. We will now turn the call over to your host, Mary Lou Christy. Please go ahead.

Mary Lou Christy - *Fannie Mae - VP, Interim Head, IR*

Good afternoon. Before we begin, let me remind you that this call is being recorded by Fannie Mae and is copyrighted material. No recording, broadcast or other distribution of this call in whole or in part is permitted without Fannie Mae's permission. Your continued participation on this call implies your consent.

Fannie Mae reminds you that this conference call includes forward-looking statements that are based on Fannie Mae's management's beliefs, assumptions and plans including statements about its restatement, accounting issues, market conditions and future business performance. Future results or events could differ materially from what is described in these forward-looking statements. For information regarding Fannie Mae's forward-looking statements and factors that may cause actual results to differ, please see the Company's Form 12b-25 filed today.

Lastly, as an SEC registrant and a regulated company of OFHEO, there are legal and practical constraints as to what Fannie Mae can address in connection with regulatory issues and the restatement. Fannie Mae very much appreciates your patience as this process unfolds.

Dan Mudd, Fannie Mae's President and Chief Executive Officer, will host today's call. After Dan's remarks, we will have comments from Enrico Dallavecchia, our Chief Risk Officer; Bob Blakely our Chief Financial Officer; and Rob Levin, Chief Business Officer. After these opening remarks, they will be joined by other members of senior management for the question-and-answer session. Now, I will turn the call over to Dan Mudd.

Dan Mudd - *Fannie Mae - President, President and CEO*

Good day, everybody. Thanks for joining us and thanks for your continued interest in the Company. Since the last call, I and other folks around the table have continued to meet with investors. I would say you've asked a lot of good, tough questions, and in them are some recurring themes which I will address now and also during the Q&A. You've asked about the restatement; the dividend; the business plan we submitted to our regulator, OFHEO; our view of the market and the competitive positioning of the Company going forward. We're going to touch on these, and then Bob and Enrico and Rob will also discuss some of these key issues.

I think all of you who have joined us over the course of the past year on these calls have heard kind of a mantra of change, progress and more to do. And I think that mantra holds true now. We continue to move more and more items from the inbox into the outbox here. But like you, I want to have it all done twice as fast at half the expense. I think our focus on getting it right at the start, getting consensus at the start, building routines and controls and procedures, systematizing them into everything we do, has been the right way to do it. I think that helps me feel assured that we're going to do this right the first and the only time.

Let me turn then to the restatement. The disclosure has three key items related to restatement. The first is, I'm pleased to say, we've reached a significant milestone with the completion of our internal review of accounting policy. We believe that we have now identified all of the accounting issues that will require restatement. I would also add that we're now well into the production stage of the effort, running the numbers and actually starting the audit process on the numbers that that produces.

Second key item with respect to the restatement -- we have changed our estimate of losses related to the general area of mortgage commitments. We now expect a significant reduction in our previous estimate of $2.4 billion for that amount. Just a quick recap -- we told you in the March 2006 12b-25 that we concluded a good portion -- that we concluded that a good portion of our mortgage commitments that we entered into from '01 to '04 should have been accounted for as derivatives, but were not. We have now completed the pricing of our derivative mortgage commitments including the population of commitments that were made prior to mid 2003 when interest rates were generally declining. We have now determined that there are gains associated with this population of commitments. When we complete the last step in this process, which is amortizing all the gains and the losses, we'll be able to quantify the exact impact on restated earnings.

But if you look at prepayments and prepayment speeds during that period, the trends in these factors will drive a significant amortization of the gains and to a lesser degree any losses. So we believe that the net effect of restating the mortgage commitments will be significantly less than the $2.4 billion that we previously disclosed.

Third item with respect to the restatement, we are reaffirming our expectation that we will complete the restatement by the end of this year. And we expect that subsequent filings will begin cascading out from the 2004 restatement behind that in a matter of months; although, we're not in a position today to disclose or to give you some guidance on the timing of those filings.

So I guess a summary with respect to restatement, we've made significant progress. We still do have a lot of work ahead of us. I assure you again that until this is done and until this is done right, all of the resources that we have at our disposal are focused on getting this done as a top priority. And Bob will give you some more color in a minute.

On capital with respect to today's disclosure, the key point is that we have continued to build on the capital surplus since OFHEO's last classification, which was March 31, '06. At that point, we had in excess of approximately $3 billion above that 30% surplus required by OFHEO. At every meeting I have had with investors and analysts, I'm asked a variation of the same question regarding capital which is essentially, "When are we going to see it?" And I'm going to reaffirm what I've said in the past. We understand that this is a matter of extreme importance to our investors. As we work through the remediation and the restatement, this is a top issue on the corporate and the Board agenda.

Third, I'll talk a second about organization and the reorganization here at Fannie Mae. I think that we have made great strides in terms of developing an organization with clearly defined roles and responsibilities, robust checks and balances and open channels of communication. And on the personnel side, as we try to show on these calls and in other forums, we've added a lot of experience and talent and energy to the senior ranks of the Company. I mentioned on the last call that we have completed the build-out of all of my direct reports to the senior leadership team in the Company with the hiring of Enrico Dallavecchia as the Chief Risk Officer. Enrico comes to us with 20 years of experience in banking and in risk management. And for the past 10, he was at one of the nation's largest financial institutions, JPMorgan Chase, focused on building out a market risk management organization with a particular focus on mortgage products. So, he has done this before. He knows the product, he knows the marketplace and we're delighted to have him. What I wanted to do now was just pause for a minute and get Enrico to give you a sense of his priorities and impressions. Enrico?

Enrico Dallavecchia - *Fannie Mae - Chief Risk Officer*

I'd like to say first that I look forward to providing periodic updates on these calls and meeting with investors. It has been gratifying for me that over the years, investors have come to see and view risk management as a more and more fundamental piece of a company's value proposition.

Let me first speak about my priorities, and then I will spend a few moments on my views on Fannie Mae's risk position. My immediate priority clearly is building out a team of top-quality professionals to lead the risk organization. We have made some very strong hires to date, including an SVP of credit risk oversight and an SVP of operational risk oversight. Second, we are focused on the build-out of our control infrastructure and ensuring that transparency and quality of the risk information which is flowing up to the Board. My dual reporting relationship to Dan and the Risk Policy and Capital Committee of the Board supports this objective.

Operational risk is clearly a priority, and we have started to address this area with the hiring of senior professionals and by establishing operational risk programs. And as we work on these priorities, we're also mindful of the changing shape of our market and the possibility–although as you may well expect that we don't know about the timing—of cycling into a less-benign credit environment. I believe that Fannie Mae's risk position as it relates to both credit and interest rate risk is solid.

Let me give you some facts on the credit side. We have strong credit characteristics on our existing single-family book of business. The original loan to value is 70%, and the mark-to-market loan to value is 54% as of June 30. Less than 8% of our book has an original loan to value of over 90%, and less than 2.4% has a mark-to-market LTV over 90%, with over 92% of the book with a mark-to-market LTV lower than 80%.

Touching on the credit quality of our average FICO score was 721 as of the end of the second quarter, with over 43% of the book with a FICO score of over 740. And less than 5% of our book has a FICO score below 620. The proportion of our credit book backed by investor loans was only 5.4%. ARMs are currently about 13% of our current [credit book], and the average loan size is $132,634 for those who like accuracy.

Moving to our interest rate risk position, I note first that we have taken on purpose a conservative approach to the management of interest rate risk. And this is an approach that is a matter of policy overseen by the Board and reviewed regularly with our regulator. Unlike many mortgage investors, we typically offset 50-80% of the optionality in our mortgages by issuing callable debt or issuing interest rate options. We also actively rebalance our portfolio to maintain a close match between assets and liabilities. And this is reflected in our monthly average duration gap measure, which has not exceeded plus or minus one month for any month since October 2004.

So my first impression is that Fannie Mae is a company on a solid risk footing. Market risk exposure remains low. The credit risk profile remains strong. Our exposure to and management of interest rate risk are conservative. In closing, I recognize the challenges ahead, and I have a team taking shape that I'm confident will be able to meet them. I'm excited about leading the development of a strong and effective risk organization that I believe will benefit all of our stakeholders going forward. Reverting to you, Dan.

Dan Mudd - *Fannie Mae - President, President and CEO*

I'll cover a couple more areas. Controls -- Enrico's job encompasses a significant portion of one of our major undertakings, which I've described in previous calls as "bulletproofing" our controls to ensure that we never face any issues like those we've faced over the past 18 months. Related to that, in today's filing we've identified material weaknesses as defined by the Sarbanes-Oxley Act that fall into eight categories. We have a plan to address these issues, and we're moving forward and have been moving forward in executing that plan. Importantly, as we stressed I think throughout the calls, we are focused every day on building the corporate and business culture that supports the foundation of strong controls and is appropriate, I think, to the scope and complexity of this Company.

Let me turn for a second to the Capital Markets business plan. Building out our controls was a key issue that we considered when we were putting together the business plan that we submitted to OFHEO for their review and approval. A few comments about the plan -- as we stated, we did not request any relief from the limitation of the mortgage portfolio during 2006. I owe you an explanation why. First, we did not believe that the limitation will have a near-term impact on our ability to execute our capital markets' strategies or to effectively manage our risk positions. Secondly, I think it's a strong indication that we're committed to work with our regulator to ensure that we have safe and effective controls in place to govern our business operations. And I think this is an example of the principles that we've adhered to in terms of regulatory or legislative policy. These temporary limitations on the portfolio are an example of an effective regulator exercising prudent controls. I think that's been consistent with where we are.

Business strategies. In the midst of all this, we've done a lot of work on remediation but we've also maintained an intense focus on our businesses and I think are running them more effectively today and are developing strategies to actually strengthen our competitive stance as the market continues to evolve. We have just completed an intensive strategic planning process, all the way up from the business divisions through the Board level that looked at all of our business options over the next three to five years. We're going to be rolling out specific elements of that plan over the remainder of the year and beyond.

The key themes, I think, kind of boil down to five. The first is building the foundation that I talked about: outstanding risk management and strong, effective controls. The second is optimizing our business within our current charter. The third theme that I saw in this discussion was increasing our ability to touch product along a broader range of the available credit spectrum in ways that I believe represent an attractive use of our shareholders' capital. Fourthly, reorienting and reinventing our business culture to be more nimble and more market focused with decisions informed by a deep understanding of the risk and the return and the value behind the market numbers. The last theme is something that I've talked about a great deal over the past 18 months, which is to rebuild a culture that is founded on a commitment to exceptional service and engagement.

So, you will see all of these changes taking shape as you follow the Company. Some will be sooner; some will be later. But collectively, this was a very robust process that I think will strengthen our competitive stance in the marketplace, and that translates into businesses that are better positioned to deliver value for our shareholders and to achieve our mission objectives. So with that, let me turn the mike over to Bob Blakely to bring you up to speed on finance and the restatement. Bob.

Bob Blakely - *Fannie Mae - CFO*

Let me begin by expanding on our progress with regard to the restatement and next steps. And I'm pleased it's all good news. First, as Dan said, we are on schedule. The accounting policy work is complete. We are really in the second phase of the restatement. We've completed testing of systems, and the systems are deployed. Pricing and commitment data is all complete for the restatement. We are currently running the numbers, getting it through the execution phase using the new accounting policies and the new systems.

Let me give you just a little bit of color on the approach. The restatement was comprised of 63 separate work streams, which are collections of related activities. Examples are debt, commitments and the liquid investment portfolio. We have completed our work on 70% of these work streams, and I would estimate that the balance, or 26%, will be completed in the next few weeks.

Just an update on one of the larger work streams—loans—which is certainly significant, as you would appreciate. It's been run and it has now moved into the audit phase. Work is also underway in preparing the 10-K for 2004.

I think, as you would all appreciate, the work on controls and the SOX opinion is an integral part of the 10-K. So in parallel to the work we are doing on the restatement, we've completed an internal control review as it relates to financial reporting for both the years 2004 and in 2005. And, as Dan mentioned, we have identified material weaknesses in eight broad categories. Importantly, we've undertaken a comprehensive and detailed work plan to address these control deficiencies - kind of by area. It's the development of new internal control processes including automated workflow processes, the hiring of new people, a substantial amount of work in the area of policies and procedures and also some reorganization to support the controls.

I'd also say I'm very encouraged. There's been a very positive impact on our day-to-day activities. And I think generally, we moved in a direction to more formally -- to a controls environment that is more formal in Fannie Mae.

In conclusion, let me just turn to one more topic -- administrative expenses. Our forecast for administrative expenses that relate to the restatement and the related expenses -- the disclosure is exactly the same as it was in the March 12b-25 at over $800 million. Our second-quarter expenses in this category, as you have noted I'm sure in the 12b-25, were $286 million. We would expect those expenses to ramp down through the balance of the year and particularly in the fourth quarter. In today's filing, we also reduced our estimate of after-tax losses associated with Katrina and Rita from a range of $170 to $280 million to a range of $130 million to $210 million. And with that, I will turn it over to Rob Levin.

Rob Levin - *Fannie Mae - Chief Business Officer*

As a jumping off point, I'd like to address a question that I get frequently from investors which is, "How is the morale on the business side of the Company, considering what's going on with the restatement?" And the answer to that question is -- on net, the morale on the business side of the Company is positive. I'd like to share with you five reasons for that.

The first reason is that the restatement and the remediation of controls are seen as enablers inside the Company — and business people like enablers. They see this as the building of infrastructure on which business initiatives will run into the future.

Secondly, our securities, both mortgage-backed securities and debt, continue to trade very well in the marketplace. I was recently in Europe and in Asia meeting with our fixed-income investors, and the meetings were very good. We continue to see that overseas investors account for over 40% of the demand for our benchmark notes.

Third reason why morale is good is that conversations with our lender customers are normal. That means that when we talk to our lender customers, we talk about their business needs and how Fannie Mae can satisfy them. And the upshot of all that is that we've had success in acquiring customers, retaining customers and winning business.

Fourth, there is strength in the underlying numbers of the business. And you know, the principal blessing of the numbers is the market that we are in -- mortgage debt outstanding, which we expect will grow at 10% this year, and we expect will grow somewhere between 5% and 8% into the future, which are numbers that will be in excess of GDP growth.

The other set of numbers I would like to emphasize are numbers that Enrico went over earlier in the presentation. And that is the 54% mark-to-market loan to value ratio[, which] just gives the book enormous strength for us to build upon. But the other number I want to emphasize is one that we have not talked much about in these calls, which is the average loan size of the Company being around $132,000. That, if you think about it for a minute, really differentiates our Company from other players in the mortgage industry. And while there are a lot of folks that are worried about weakness in the real estate markets and where we see weaknesses on the high end, I think it's just very important to understand the market that Fannie Mae serves, with an average loan size in the book of $132,000.

Finally, the fifth reason why morale is pretty good on the business side is that our people are motivated by the mission of the Company. Just to give you some examples, we were -- the senior management team was out in Los Angeles a couple of weeks ago, and we took the opportunity to visit a neighborhood there called Skid Row, which is an area with a lot of homeless folks. The management team, and I think especially some of the new management that you've met over the last couple of conference calls, were very impressed by the problems there, the opportunities there and how Fannie Mae can be a force to find solutions.

Second area of the mission is the work we are doing post-Katrina in the Gulf Coast. We currently have 700 families that are living in foreclosed homes that the Company owns. We're also making special efforts to make special investments in the Gulf Coast to help rebuild. And I think maybe on a future phone call, we might want to go into more detail on that. Just the final comment about the mission is on the HUD goals. We are finding them challenging, but we are working hard to meet them for this year. And that's my presentation.

Dan Mudd - *Fannie Mae - President, President and CEO*

I think we are ready to turn to questions. Mary Lou?

Mary Lou Christy - *Fannie Mae - VP, Interim Head, IR*

I would ask everyone to try and limit to one question, so we can try and answer as many questions as possible.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mike Vinciquerra, Raymond James.

Mike Vinciquerra - *Raymond James - Analyst*

I just want to clarify on one of the statistics on page 10 -- I think Enrico touched on this -- was the loan to value at 54%, the credit score at 721. But it excluded I think 8% of your loans, which I assume are non-conventional. Can you provide just a little more data on what is exactly excluded? Is it just the non-amortizing loans and what would those statistics be if you had 100% of the guaranteed portfolio?

Mary Lou Christy - *Fannie Mae - VP, Interim Head, IR*

Unfortunately, we don't have loan level data on 8% of the book, so it's other [non-Fannie Mae] securities that we've purchased. So we are not able to give you -- that's why we give you the numbers and we just say that does exclude a small percentage because we don't have the data available to provide that.

Mike Vinciquerra - *Raymond James - Analyst*

Separate question. A number of lenders this quarter had reported a surge in loans that they are being forced to repurchase due to early payment, default and things like that. I don't know if you guys have been a part of that. I know some of the investment banks that buy and securitize have been pushing back a lot of loans. Is there any sense to what's going on there, or is it just a tighter enforcement of the rules that have been outstanding for some time?

Dan Mudd - *Fannie Mae - President, President and CEO*

Yes, we will answer your second question. Why don't I turn to Tom Lund, who runs the single-family business to give you some sense of that?

Tom Lund - *Fannie Mae - EVP, Single Family Mortgage Business*

I think what you're hearing is partly a change in the real estate environment that exists. And a number of players in the market are beginning to see earlier delinquencies. There have been more issues associated with loss around that. When that occurs, there have been times where people are going to put those loans back and we have seen a more aggressive stance, particularly in the private-label markets around that. One of the things that we pride ourselves on, quite frankly, is taking a very consistent approach to how we do business, and I think our lenders are very comfortable that regardless of good times/bad times that we are there working against a set of guidelines, working with them consistently about what is good delivery and not good delivery. So I think what you are beginning to feel are other folks, who are [SHOULD "ARE" BE "WERE"?]getting potentially a little bit more aggressive as a result of a changing real estate environment.

Operator

Ken Bruce, Merrill Lynch.

Ken Bruce - *Merrill Lynch - Analyst*

I will restrain myself to one question and get back in queue. I was hoping you might be able to expand on your comments, Dan, about touching additional products along the credit spectrum. Just in light of the dynamic as it relates to credit, how are you feeling in terms of comfort level and getting down the credit spectrum? And how do you look to position yourself there?

Dan Mudd - *Fannie Mae - President, President and CEO*

Let me say that we want to enter these other markets -- I think as a broad matter what has happened is that the distinctions that used to exist in the mortgage market between the various categories of credit have diminished if not disappeared due to the actions of the capital markets on those loans. So whereas there used to be quite a sharp break between prime and non-prime, prime and sub-prime, Alt-A, A-, etc., what has happened is that the distinctions between those loans have diminished. Therefore, looking at the creditworthiness of a loan that in the olden days was on one side of the prime/sub prime line versus the other side, it's very hard to tell anymore. So that puts an emphasis -- one, on our ability to assess the risk upfront but also on our ability to remain relevant to a market where increasingly the products are customized to the risk.

So, we have stood back, as you know, through this cycle from some segments of the market unless we were really comfortable with the originators and the servicers. We now see some opportunities where spreads are opening up a bit. And we want to remain relevant to those customers, which are the folks Tom takes care of. So maybe if you could give a paragraph or two to build on what I said, Tom, that would be great.

Tom Lund - *Fannie Mae - EVP, Single Family Mortgage Business*

Sure. If you remember, we've talked on this call in the past about what we saw the market dynamics were, made some noise about some of the product trends we were seeing. Since that point in time, there has been some proposed guidance that has come out from regulators that we believe will take effect over the course of the next couple of months when it goes final. We believe that has had some impact on the marketplace in general and how people have begun to think about products and consumers and the right borrowers and the right loans.

Secondly, honestly, with the view and kind of the reintroduction of some risk into the real estate markets, we believe that over time that will bring potentially the appropriate set of pricing economics to the risk in the marketplace. And we will need to be prepared to be engaged in that activity when we believe that that is appropriately placed in the market relative to the risk and the pricing in the market.

Dan Mudd - *Fannie Mae - President, President and CEO*

I would say as we enter those markets, we will typically go in with more third-party credit enhancement. We will typically require more loan level data so that we can understand the geographies, the type of owners. And we also like to partner with the seller-servicers that we have a good, strong, long-standing relationship with, understand how their processes and their servicing actually works.

Ken Bruce - *Merrill Lynch - Analyst*

Loans and securities?

Dan Mudd - *Fannie Mae - President, President and CEO*

Yes.

Operator

David Hochstim, Bear Stearns.

David Hochstim - *Bear Stearns - Analyst*

I have a question and then a clarification hopefully. The question relates to some of the expectations for portfolio balances over the remainder of the year and kind of the mix between replacing loans that have liquidated and loans that have sold with some purchases and sort of how easily can you go back to the regulator this year if necessary if there is a dramatic change in market conditions to try and provide some additional liquidity in the market?

Dan Mudd - *Fannie Mae - President, President and CEO*

Was that the question or the clarification?

David Hochstim - *Bear Stearns - Analyst*

That was the question. The clarification is on the growing pool of excess capital because you now indicated there's another billion or some significant number of that $2.4 billion that comes in as excess. I guess it's not going to be in the second quarter. Maybe you can explain when it will show up. But without any portfolio growth and with building capital, you have an even bigger problem in terms of dealing with the surplus that you've indicated you will deal with. I just wonder again what the timing might be on that.

Dan Mudd - *Fannie Mae - President, President and CEO*

Not a forward look on the timing of distribution, but the timing in terms of when the capital comes back in — goes through the ordinary process of the restatement, to clarify that.

With respect to the portfolio, with $12 billion to $14 billion a month of liquidations, the portfolio left to its own devices gives us a lot of ability to move around, shift, to rebalance, manage our risk position. I would also say that throughout the discussions that we have had with OFHEO, I think both the regulatee and the regulator have been quite conscious of the fact that we would have a very quick discussion in the event of a market disruption or a dislocation or some other exogenous cause. In the ordinary course of putting together the plan for the business that we submitted to the regulator, we didn't see that as being obvious. But that is a placeholder for that eventuality. Peter Niculescu is here, and he can add some more color to that.

Peter Niculescu - *Fannie Mae - EVP, Capital Markets*

I think that mortgages today are a relatively low-risk asset class for investors. And on a return basis, on a spread basis, they are not at an historically very attractive level. I … think that TBA fixed-rate mortgages certainly would not provide an acceptable or reasonable return for our shareholders at this point. So we are left today in acquiring those classes of mortgage-backed securities and mortgage loans that are historically less liquid, which is what we've been doing for a while.

We had expected to see some cheapening in mortgages in the second quarter. We did see that, but it wasn't substantial. We did see some increase in participation by US commercial banks in the mortgage market. In the last couple of weeks, I think there has been some movement even from Asian investors, who have been quiet, and [from] non-US investors back into the mortgage market.

One category where we are pretty attentive and are seeing continued flow are in mortgage loans and mortgage-backed securities that are particularly focused on housing goals for us -- regulatory housing goals, our mission activities. That remains a major priority of the Company, and we are deploying the balance sheet in that area with some focus. I'd expect we'll continue to do that really for the balance of the year. I know that meshes as well with our liquidity [function], but many of these securities and loans are somewhat less liquid as well as being -- as well as being heavily goal-oriented. So for the moment, I would say our expectations will be relatively modest purchases for the next few months unless there is some sort of a disruption in the market.

David Hochstim - *Bear Stearns - Analyst*

In the second quarter, you noted an increase in fixed-rate purchases. Is that continuing into the third quarter?

Peter Niculescu - *Fannie Mae - EVP, Capital Markets*

We did note an increase in the second quarter. That will change day-by-day. That will simply change day-by-day. I would've probably given you a different answer two or three weeks ago than I would today, but it's probably not real helpful for me to speculate.

Operator

Lloyd Zeitman, Bernstein.

Lloyd Zeitman - *Sanford C. Bernstein - Analyst*

Regarding administration expenses, there's a paragraph in your 12b-25 that states that there is some other costs outside of the restatement costs that I guess cover periods subsequent to '04. And if we look at the restatement costs themselves, outside -- excuse me -- if we look at the administrative costs excluding the restatement costs, they were up by about $61 million quarter to quarter -- first quarter to second quarter. And I was wondering if you could give us some idea as to what kind of trend we can expect in these particular costs – the, let's say, ongoing administrative expenses at Fannie Mae.

Bob Blakely - *Fannie Mae - CFO*

It's Bob Blakely. Most of that -- a significant majority relates to one-time compensation accruals, so it will not be in the run rate. There is a very small amount, less than $10 million, that relates to headcount. So I wouldn't extrapolate that $60 million out.

Operator

Moshe Orenbuch, Credit Suisse.

Moshe Orenbuch - *Credit Suisse - Analyst*

There was a reference in the filing to filing a new plan in early 2007 for the portfolio. And maybe could you kind of talk about just your thought process as to what you could think of asking for and what you think you would need to have done by that time in order to get some consideration as it were from OFHEO?

Dan Mudd - *Fannie Mae - President, President and CEO*

Yes, I think the first and foremost issue was continued progress on controls process remediation. I tried to give a sense of the progress that we're making. There will be some bona fides in that, in the context of both our restatement and the audit process on the subsequent years. There is ongoing and continuing regular examination work by OFHEO on site. We have put an awful lot of focus on ensuring that the processes by which we roll out new products or develop new ideas are done in a safe and sound way with an independent review by our Chief Risk Officer, who you heard from and so forth. So I think the main thing is continued progress on those issues that we are working on. The secondary thing is where opportunities are in the marketplace at that point in time. How that would translate into a growth percentage, I'm not really prepared to have that conversation yet.

Moshe Orenbuch - *Credit Suisse - Analyst*

But have you had any kind of discussion with OFHEO as to how those milestones would be interpreted?

Dan Mudd - *Fannie Mae - President, President and CEO*

We obviously have ongoing conversations with the regulator, and we had some broad discussions during the discussion about submitting that plan. And that's as far as I should go without delving too deeply into the regulatee/regulator discussion.

Operator

Robert Lacoursiere, Banc of America Securities.

Robert Lacoursiere - *Banc of America Securities - Analyst*

I'm just wondering if you could confirm for us -- because in the statement, you talked about the review of the accounting policies is done; although, you haven't – you’re not comfortable quantifying its effects yet. In that review, could you confirm that you also cleared off and removed any potential problems relating to the backdating of stock options that are running around?

Dan Mudd - *Fannie Mae - President, President and CEO*

It wasn't contemplated in the course of that review. I don't see on the basis of everything we've reviewed -- our policies don't permit any movement off of the actual grant date. Obviously, being avid readers of the news media, that was something that we took a very quick look at. But that said, it always pays to double check in case anything slipped through the cracks. But I feel pretty good about where we are from a policy compliance standpoint right now.

Robert Lacoursiere - *Banc of America Securities - Analyst*

So if I understood correctly, you took a quick look at it. You still would like to do a double check on it.

Dan Mudd - *Fannie Mae - President, President and CEO*

I think you are putting a couple of words in my mouth. But our policy doesn't allow the type of flexibility that seems to have led to issues in other companies. In terms of actually ensuring that every "i" is dotted and "t" is crossed in that process, we're making sure that that is happening in kind of a belt and suspenders way. But it's not been subject or contemplated in the process of the restatements.

Operator

Paul Miller, Friedman, Billings, Ramsey.

Annett Franke - *Friedman, Billings, Ramsey - Analyst*

This is actually Annett Franke for Paul Miller. I have a quick question on the restatement-related expenses. You've talked about it a little bit. For the $800 million forecast for this year and the decline in the second half versus the first half, can you just kind of tell us a little bit where you see the reduction would be coming from, given that the restatement process is still going on. And then even if we get restated numbers by the end of this year, you'll be still going through the process of becoming current. So just wanted to get some color in terms of where this reduction should be coming from.

Bob Blakely - *Fannie Mae - CFO*

It's Bob Blakely. I think the best way to think about that is there was a tremendous amount of onetime effort in the restatement activities. All the dating on the commitments, all the pricing information, the contractors that helped and assisted in the accounting policy area -- to get through this the first time, there was just a one-time investment which is very significant. As we get into the audit process, which I talked about earlier, that kind of activity ramps down.

The other thing I would say in building the opening balance sheet 12/31/01, you actually have to go back and trace in time and history all the securities and loans that ended up being on the balance sheet at that date. So there was a significant investment of time that went all the way back through the '90s, and all of that ramps down quite considerably as we move later into the year.

You do correctly point out there will be some continuing support from contractors for the restatement, and we will also have audit expenses for the '05 and the '06 audit. But to contemplate it, it's much, much lower than what we're seeing currently as we really get through the crunch and if I could say that I'm getting this restatement into the audit phase.

Annett Franke - *Friedman, Billings, Ramsey - Analyst*

So would you see also the level of contractors to decline once you move into this more of a customary process?

Bob Blakely - *Fannie Mae - CFO*

It's work in process frankly. We are re-baselining that. But I just don't have a good number, other than to give you the directional commitment that it's going to be significantly lower.

Operator

Eric Wasserstrom, UBS.

Eric Wasserstrom - *UBS - Analyst*

Dan, could you talk a little bit about what the Board's priorities are right now and to what extent they are moving ahead with their reviews of various of the staff members?

Dan Mudd - *Fannie Mae - President, President and CEO*

I will give you part of it but not all of it. The staffing review is an independent review by independent members of the Board, so I don't have any particular insight into it, nor probably would it be appropriate if I did. I think the Board's priorities broadly speaking go to three areas. One is ensuring an appropriate level of governance interaction between the Company and the various committees as well as the Chairman. As you know from other calls, our Chairman, Steve Ashley, is down here in the Company a lot of the time. I think some members of the Board have changed over, so bringing them on board and getting the Board team working together is up there.

I already told you that the dividend is high. The use of capital and distribution of capital are items that are high on the Board agenda list. Thirdly, I guess the most concentrated period of time that we've spent with the Board subsequent to the strategic planning process I talked about was the several-day off-site that we did with the Board to review the business strategies and direction going forward. I think I would say that both the Board as well as the management that participated really enjoyed spending a concentrated period of time talking about the future of the business, the important choices, the demands of the marketplace, those traditional components of the planning process. As we go into the fall cycle, obviously, I think capital will remain high as well as the review as you pointed out as well as the format of the compensation plans on a going-forward basis.

Operator

Ken Bruce, Merrill Lynch.

Ken Bruce - *Merrill Lynch - Analyst*

It looks like your notional derivative portfolio is about the same size as your mortgage portfolio. Could you shed some light as to maybe what the net position is or what the general derivative portfolio is made up of please?

Peter Niculescu - *Fannie Mae - EVP, Capital Markets*

Sure, I would be happy to. This is Peter Niculescu. This is a combination of swaps and options -- swaptions -- with a very relatively small number of caps. So you are adding up apples and oranges in a sense. You're adding a fixed-rate instrument at swap, a synthetic instrument with an option. You put the two together, and you'll effectively get callable debt.

In addition, we have at any given point some offsetting paid-fixed and received-fixed swaps. We will do receive-fixed swaps as a matter of course when we have to rebalance or in anticipation of debt issuances, we will do paid-fixed swaps again when we have to rebalance or fund the portfolio. And at times, we will get offsetting positions as we do have now. So the notional balances tend to become a little bit larger than you would think if you just compared them with debt outstanding. So generically, what is in there are swaps and options and that's about it.

Ken Bruce - *Merrill Lynch - Analyst*

Is there any way for the disclosure to be enhanced to provide a little bit better clarity as to what the pieces are so we can understand what the net exposure is?

Peter Niculescu - *Fannie Mae - EVP, Capital Markets*

Absolutely, I appreciate the question. We used to do that. We would just certainly contemplate doing that in the future as we move toward a current financial reporting stance. We'll look at doing what's most helpful to you.

Operator

There are no further questions in queue.

Dan Mudd - *Fannie Mae - President, President and CEO*

Thank you all very much for joining us and thanks very much for hanging in there with us. We talked in the beginning about the mantra of change, progress and more to do. And I hope this call has really focused -- I would tell you inside the Company, we feel very positive and very encouraged by the progress that we're making. So I hope that you are seeing that. It is a long process. It's headed in the right direction when you look at the restatement, the reorganization as well as the performance of the business in the midst of all of that. I think that each day and each week that goes by, our goal is, our hope is, our intention is to strip off more of the uncertainties and add for you, for us a clear definition of where we're going, moving ahead. So, it's kind of an exercise of both fixing problems as well as setting a course for the future, reminding ourselves that it is a marathon and not a sprint. But we're pretty far through it.

I think our future sets of disclosures will be of increasing interest to you in terms of the release of the restatement. And as we talked about earlier, in the course of that, having a discussion that encompasses the overall business strategies, the segments, the products, the organization that we are in and giving you an increase in confidence that this is a company that's going to perform to your expectations. So we are very excited and looking forward to having those conversations. So thank you very much for your engagement today, and I look forward to seeing many of you between now and the time of our next call.

Operator

Ladies and gentlemen, a replay of this call will be available beginning at 5:30 PM today Eastern Time through midnight on August 23rd. Domestic callers may access the replay by calling 1-800-475-6701. International callers may call 320-365-3844. The confirmation code is 837282. This call is also available via audio webcast by accessing www.fanniemae.com through the Internet and will be available for 30 days after the call. That does conclude the call for today. Thank you for your participation and for using the AT&T Executive Teleconference Service. You may now disconnect.