

Fannie Mae Callable Issuance in the First Half of 2011

May/June 2011

In the current low interest rate environment, investors may seek to invest in callable securities for enhanced yield over duration-matched noncallable debt and Treasuries.

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During the first six months of 2011, Fannie Mae continued to issue callable securities via the reverse inquiry process. Despite callable issuance levels declining compared to the record callable issuance levels in 2010, Fannie Mae issued approximately \$53.6 billion in callable securities during the first half of 2011. In the current low interest rate environment, investors may seek to invest in callable securities for enhanced yield over duration-matched noncallable debt and Treasuries. The trend of callable investors favoring the Bermudan-call option over the European-call option continued from 2010 into the first half of 2011, as investors remained willing to take on more optionality in terms of call style in search of additional

Callable Issuance Characteristics for the First Half of 2011

1H2011		
Callable Characteristic	Total Notional Amount (\$ millions)	Percentage of Total Issued
Lockout Period		
3 months	\$275.0	0.5%
6 months	\$32,152.0	60.0%
1 year	\$19,248.0	36.0%
Greater than 1 year	\$1,894.0	3.5%
Maturity Term		
Less than or equal to 2 years	\$2,060.0	3.8%
Greater than 2 years and less than or equal to 3 years	\$15,455.0	28.9%
Greater than 3 years and less than or equal to 5 years	\$17,625.0	32.9%
Greater than 5 years and less than or equal to 10 years	\$9,044.0	16.9%
Greater than 10 years	\$9,385.0	17.5%
Coupon Type		
Standard Fixed	\$33,361.0	62.3%
Step Up	\$19,808.0	37.0%
Convertible Floating	\$400.0	0.7%
Call Option		
American	\$1,035.0	1.9%
Bermudan	\$26,384.0	49.3%
European	\$26,150.0	48.8%
Notional Size		
Less than or equal to \$50 million	\$29,770.0	55.6%
Greater than \$50 million and less than or equal to \$100 million	\$6,600.0	12.3%
Greater than \$100 million and less than or equal to \$500 million	\$11,199.0	20.9%
Greater than \$500 million and less than or equal to \$1 billion	\$6,000.0	11.2%

Source: Fannie Mae

Figure 1

yield. This edition of *FundingNotes* examines the characteristics of Fannie Mae callable notes issued in the first half of 2011; compares callables issued in the first half of 2011 versus the first six months of 2010; reviews reasons why investors may have a preference for callable securities; and, highlights the expected decline in our funding needs going forward.

First Half of 2011 Callable Characteristics

During the first half of 2011, Fannie Mae issued \$53.6 billion in callable debt. As shown in **Figure 1**, the vast majority of the callable securities, approximately 96.5 percent of total callable issuance, had lockout periods of one-year or less. In terms of maturity, three-year and five-year final maturities were most popular among callables issued, totaling \$13.6 billion and \$11.2 billion, respectively. Maturity terms that were greater than two years and less than ten years accounted for nearly 69.3 percent of all callables issued in the first half of 2011. (**Figure 2**) In regards to coupon structure, 62.3 percent of callables issued in the first half of 2011 had a fixed coupon and 37.0 percent had a step-up coupon with the remaining 0.7 percent having a float-to-fixed coupon formula. During the first six months of 2011, Fannie Mae issued a vast number of callable structures. **Figure 3** details the three most commonly issued callable structures issued during the first half of 2011. These three callable structures made up more than a third of all callables issued, approximately 36.1 percent, and reinforce the trend of short lockout periods, either six-months or one-year, and maturity terms of either three years or five years.

From 2009 to 2010, the Bermudan-style call option surpassed the European-style call option to become the most commonly issued call option amongst callables issued, increasing from 33.6 percent in 2009 to 52.1 percent in 2010. This trend continued into the first half of 2011 with Bermudan-style call options maintaining a slight edge over European-style call options. The American-style call option remained a minor part of callable issuance in the first half of 2011. (**Figure 4**) In the current low interest rate environment, investors appear to value the pick-up in yield with the Bermudan-call option compared to the European-style call option.

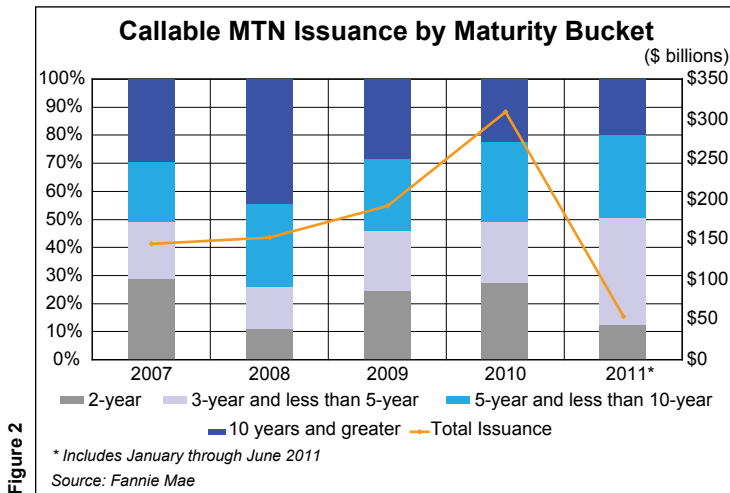


Figure 3

Top Three Most Commonly Issued Callable Structures in the First Half of 2011

Callable Structure	Percentage of Total Callable Issuance
Three-year non-call one-year (3NC1)	12.8%
Three-year non-call six-months (3NC6mo)	12.0%
Five-year non-call six-months (5NC6mo)	11.3%

Source: Fannie Mae

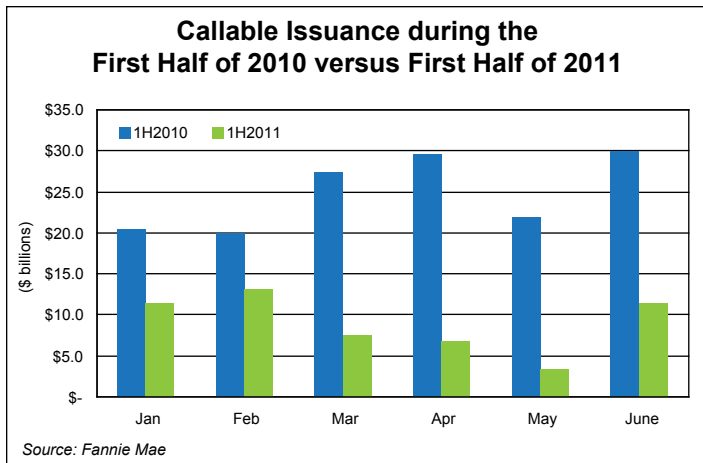
Figure 4

Callable Issuance by Call Structure

Callable MTN Issuance (in millions)	2008	2009	2010	1H 2011
American Options*	\$8,341	\$11,070	\$5,740	\$1,035
Bermudan Options	47,593	64,505	161,070	26,409
European Options	96,601	116,204	142,381	26,150
Total Callable MTN Issuance	\$152,535	\$191,778	\$309,191	\$53,594
% American Options	5.5%	5.8%	1.9%	1.9%
% Bermudan Options	31.2%	33.6%	52.1%	49.3%
% European Options	63.3%	60.6%	46.0%	48.8%
Average 5-Year UST Yield	2.80%	2.20%	1.93%	1.96%

Issuance figures are limited to long term callable debt issuance.
Source: Fannie Mae

Figure 5

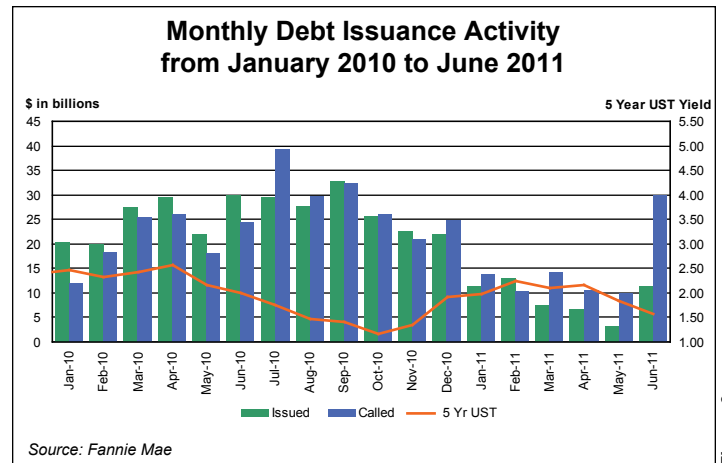


1H2011 versus 1H2010

Callable issuance during the first half of 2010 totaled \$149.1 billion compared with \$53.6 billion for the first half of 2011, a decrease of approximately 64.6 percent, as illustrated in **Figure 5**. Concurrently, the amount of Fannie Mae callables that were called during the first half of 2011 declined by 25 percent compared to the first six months of 2010. **Figure 6** depicts the activity in Fannie Mae callables, both issued and redeemed, from January 2010 to June 2011.

The coupon type of the callables issued in the first half of 2011 remained comparable to those issued in the first half of 2010 with the fixed-rate coupon accounting for 62.3 percent in 1H2011 and 62.8 percent in 1H2010 and the step-up coupon making up 37.0 percent and 31.2 percent, respectively.

Figure 6



Investor Preference for Callable Securities

Investors may have a preference for callable securities because callables typically provide higher yields than duration-matched noncallable debt and Treasury securities. Callable securities may also be index eligible for those callables that qualify for the \$250 million index inclusion requirement. Additionally, investors may appreciate Fannie Mae's flexibility to issue callable debt with various defined coupon payment dates to meet specific needs, such as a local municipality that strives to match its timed cash outlays with callable interest receipts. Finally, Fannie Mae long-term unsecured debt, such as callables, currently receives the highest credit rating of AAA by the three major credit rating agencies, Standard & Poor's, Moody's, and Fitch. The high credit rating of Fannie Mae callables helps investment officers meet the requirements of their investment guidelines.

Future Funding Needs

As part of the Treasury Senior Preferred Stock Purchase Agreement, Fannie Mae is required to reduce its mortgage portfolio by ten percent from the maximum allowable limit from the prior year. With the ten percent reduction in the mortgage portfolio going forward, Fannie Mae's overall funding needs, including callable securities, are expected to decline commensurately. However, even with the ten percent mortgage portfolio reduction, Fannie Mae callables will continue to play an active role in the overall funding strategy. Furthermore, callable securities help Fannie Mae maintain its asset/liability management strategies.

Conclusion

Despite declining funding needs in 2011 compared to a record year of callables in 2010, Fannie Mae remains committed to its callable medium-term notes (MTN) program, which allows investors to tailor securities with specific structures to meet their investment criteria. In the current low interest rate environment, callable securities provide an investment alternative that may provide enhanced yield over duration-matched noncallable debt or Treasuries and also currently have the highest credit rating. Fannie Mae will continue to underwrite callables based upon its funding needs, investor preference, and interest rate levels.



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Fannie Mae Funding Liabilities and Debt Outstanding 2008 through May 31, 2011

Funding Liabilities and Debt Outstanding (in millions)	12/31/08	12/31/09	12/31/10	5/31/11
Federal Fund Borrowings	\$ -	\$ -	\$ -	\$ -
Other Short Term Funding Liabilities ¹	77	-	52	-
Total Federal Funds Purchased and Securities Sold under Agreements to Repurchase	\$ 77	\$ -	\$ 52	\$ -
Average maturity (in days)	-	-	11	-
Discount Notes	\$ 324,479	\$ 200,116	\$ 151,627	\$ 157,788
FX Discount Notes	402	401	386	329
Other Short Term Debt ²	7,661	50	-	1
Total Short Term Debt³	\$ 332,542	\$ 200,567	\$ 152,013	\$ 158,118
Average maturity (in days)	102	82	88	79
Benchmark Notes & Bonds ⁴	\$ 251,315	\$ 280,245	\$ 300,639	\$ 270,639
Callable Benchmark Notes ⁴	-	-	-	-
Subordinated Benchmark Notes	7,398	7,398	7,398	4,898
Callable Fixed Rate MTNs ^{5,6}	190,950	206,310	217,179	186,642
Noncallable Fixed Rate MTNs ^{5,6}	50,131	45,032	41,579	54,943
Callable Floating Rate MTNs ^{5,6}	1,530	3,871	2,625	2,075
Noncallable Floating Rate MTNs ^{5,6}	45,470	39,005	69,823	67,569
Other Long Term Debt ⁷	3,763	3,347	2,622	2,489
Total Long Term Debt^{8,9}	\$ 550,557	\$ 585,208	\$ 641,865	\$ 589,255
Average maturity (in months)	66	60	51	51
Total Federal Funds Purchased and Securities Sold under Agreements to Repurchase and Debt Outstanding	\$ 883,176	\$ 785,775	\$ 793,930	\$ 747,373
Average maturity (in months)	42	45	42	41

Fannie Mae Funding Liabilities and Debt Issuance 2008 through May 31, 2011

Funding Liabilities and Debt Issuance (in millions)	2008	2009	2010	2011
Federal Fund Borrowings	\$ 5,617	\$ 1,000	\$ 6,450	\$ -
Other Short Term Funding Liabilities ¹	60,888	5,822	5,930	1,410
Total Federal Funds Purchased and Securities Sold under Agreements to Repurchase	\$ 66,505	\$ 6,822	\$ 12,380	\$ 1,410
Discount Notes	\$ 1,547,462	\$ 1,373,711	\$ 438,146	\$ 182,111
FX Discount Notes	2,583	1,060	615	262
Other Short Term Debt ¹⁰	8,661	50	-	2
Total Short Term Debt³	\$ 1,558,706	\$ 1,374,821	\$ 438,761	\$ 182,375
Benchmark Notes & Bonds	\$ 50,500	\$ 75,500	\$ 82,000	\$ 18,000
Subordinated Benchmark Notes	-	-	-	-
Callable Fixed Rate MTNs ⁶	150,255	187,983	306,560	42,043
Noncallable Fixed Rate MTNs ⁶	4,336	4,517	8,834	2,000
Callable Floating Rate MTNs ⁶	1,280	3,846	2,630	100
Noncallable Floating Rate MTNs ⁶	41,284	23,180	63,100	3,825
Other Long Term Debt ⁷	743	249	259	178
Total Long Term Debt⁸	\$ 248,399	\$ 295,275	\$ 463,383	\$ 66,146
Total Federal Funds Purchased and Securities Sold under Agreements to Repurchase and Debt Issued	\$ 1,873,610	\$ 1,676,918	\$ 914,524	\$ 249,931
Net Issuance Long Term Debt¹¹	\$ (18,363)	\$ 34,511	\$ 56,610	\$ (52,667)

Please see the Endnotes on the following page for more detail.

Endnotes

Footnotes for Tables 1 and 2

- ¹ Other Short Term Funding Liabilities includes Benchmark repos, contingency repo lending, and other short term funding liabilities.
- ² Other Short Term Debt includes coupon bearing short term notes.
- ³ Short term debt consists of borrowings with an original contractual maturity of one year or less.
- ⁴ Outstanding Benchmark Notes & Bonds with expired call options are reported as Benchmark Notes & Bonds.
- ⁵ Outstanding MTNs with expired call options are reported as Noncallable MTNs.
- ⁶ MTNs include all long term non-Benchmark Securities such as globals, zero coupon securities, medium term notes, Final Maturity Amortizing Notes, and other long term debt securities.
- ⁷ Other Long Term Debt consists of long term foreign currency debt, investment agreements and other long term securities.
- ⁸ Long term debt consists of borrowings with an original contractual maturity of greater than one year.
- ⁹ Unamortized discounts and issuance costs of long term zero coupon securities are approximately \$14.8 billion at December 31, 2008, \$14.9 billion at December 31, 2009, \$11.8 billion at December 31, 2010 and \$9.9 billion at May 31, 2011.
- ¹⁰ Other Short Term Debt includes coupon bearing short term notes.
- ¹¹ Net Issuance Long Term Debt amounts represent the difference between long term debt issued and long term debt repaid during the period. For any period, a positive value indicates that the amount of long term debt issued was greater than the amount of long term debt repaid, and a negative value indicates that the amount of long term debt repaid was greater than the amount of long term debt issued.

General

Reported amounts represent the unpaid principal balance as of each reporting period or, in the case of the long term zero coupon bonds, at maturity. Unpaid principal balance does not reflect the effect of debt basis adjustments, including unamortized discounts, premiums, issuance costs and fair value adjustments.

Numbers may not foot due to rounding.

Debt Securities Index Reports

	May % of BIG	May Total ROR	Last 3 mos Total ROR	Last 6 mos Total ROR	YTD Total ROR	Last 12 mos Total Return		May % of Agg	May Total ROR	Last 3 mos Total ROR	Last 6 mos Total ROR	YTD Total ROR	Last 12 mos Total Return
Citigroup							Barclays Capital						
Fannie Mae Index:	2.08	0.78	1.78	0.92	1.86	4.07	Fannie Mae Index:	2.31	0.78	1.76	1.06	1.92	3.86
1-10 Years	1.96	0.67	1.57	0.91	1.64	3.67	1-10 Years	2.13	0.68	1.58	1.05	1.73	3.49
10+ Years	0.12	2.36	4.80	0.85	4.86	8.82	10+ Years	0.18	1.96	3.99	1.10	4.19	7.76
Callable	0.18	0.37	1.03	0.67	1.09	2.00	Callable	0.60	0.50	1.26	1.02	1.39	2.19
Noncallable	1.90	0.83	1.87	0.92	1.94	4.42	Noncallable	1.71	0.88	1.94	1.04	2.11	4.64
Globals*	1.96	0.77	1.76	0.90	1.82	3.98	Globals	1.84	0.79	1.78	0.96	1.89	4.04
Agency:	5.38	0.90	1.71	0.73	1.80	4.46	Agency:	6.61	0.76	1.67	1.01	1.82	3.59
Callable	0.27	0.40	1.06	0.78	1.09	1.99	Callable	1.29	0.46	1.17	0.97	1.33	1.94
Noncallable	5.11	0.92	1.75	0.71	1.84	4.70	Noncallable	5.32	0.83	1.79	1.01	1.95	4.04
Globals	4.47	0.78	1.76	0.91	1.85	3.95	Globals****	4.80	0.71	1.58	0.95	1.71	3.56
Citigroup							Barclays Aggregate						
Index**:	100.00	1.33	2.63	1.75	2.95	5.65	Index:	100.00	1.31	2.65	1.91	3.02	5.84
U.S. Treasury	35.21	1.52	2.62	0.71	2.49	4.41	U.S. Treasury	32.79	1.56	2.67	0.72	2.57	4.49
GSE***	6.68	0.91	1.83	0.87	1.98	4.54	Government-Related***	11.83	1.23	2.57	1.90	2.95	5.07
Credit	24.32	1.44	3.11	2.89	3.96	8.92	Corporate	19.82	1.44	3.05	3.12	4.07	9.51
MBS	33.58	1.13	2.44	2.23	2.89	4.96	MBS	32.95	1.07	2.47	2.21	2.78	4.84
ABS	0.21	0.91	2.14	1.54	2.50	6.79	ABS	0.27	0.79	1.75	1.38	2.39	4.91

* In July 2009 the definition of Globals changed due to a change in index methodology. Previously, if a bond was classified as the Eurodollar Index, then it was "Global." Currently, if a bond is cleared in DTC, Euroclear/Clearstream and/or other clearances, then it is "Global."

** Components of Broad (BIG) Index: Treasury, GSE, Corporate, Mortgage

*** Includes US agencies

**** Includes World Bank global issues

This data has been compiled from reports supplied by Citigroup and Barclays Capital and is reproduced here with their permission. The indexes are constructed according to rules developed by these firms and the index values are calculated by them.

Summary Breakdown of 2011 Debt Issuances

Includes all settled callable debt issues with maturities greater than one year.

Fannie Mae Callable Debt

Maturity/Call (Year)	May 2011 Par Amount (in thousands)	# Issues	YTD 2011 Par Amount (in thousands)	# Issues	Maturity/Call (Year)	May 2011 Par Amount (in thousands)	# Issues	YTD 2011 Par Amount (in thousands)	# Issues
2.00 NC 0.50			2,060,000,000	10	5.00 NC 0.50	310,000,000	8	4,828,000,000	90
2.25 NC 0.50			400,000,000	4	5.00 NC 1.00	690,000,000	23	3,330,000,000	73
2.49 NC 0.49			50,000,000	1	5.00 NC 2.00	35,000,000	1	335,000,000	6
2.50 NC 0.50			265,000,000	5	5.50 NC 0.50			750,000,000	13
2.50 NC 1.00			50,000,000	1	5.50 NC 0.75			75,000,000	2
2.67 NC 0.33			75,000,000	2	5.50 NC 1.00			150,000,000	3
2.73 NC 0.39			75,000,000	2	5.50 NC 1.50			50,000,000	1
2.75 NC 0.50			250,000,000	3	5.51 NC 0.50	100,000,000	4	225,000,000	7
2.92 NC 0.42			425,000,000	11	5.51 NC 1.00	25,000,000	1	325,000,000	3
3.00 NC 0.24			50,000,000	1	5.75 NC 0.50			50,000,000	1
3.00 NC 0.50			5,025,000,000	30	6.00 NC 0.50			125,000,000	4
3.00 NC 0.75			50,000,000	1	6.00 NC 1.00			230,000,000	5
3.00 NC 1.00	125,000,000	5	6,140,000,000	48	6.00 NC 2.00			50,000,000	1
3.00 NC 2.00			100,000,000	1	6.50 NC 1.00			160,000,000	5
3.01 NC 1.00			250,000,000	1	6.51 NC 1.00	25,000,000	1	25,000,000	1
3.24 NC 0.50			75,000,000	1	6.92 NC 0.42			100,000,000	1
3.25 NC 0.50			250,000,000	1	7.00 NC 0.50			150,000,000	3
3.25 NC 1.00	25,000,000	1	130,000,000	4	7.00 NC 1.00	50,000,000	2	50,000,000	2
3.42 NC 0.42	25,000,000	1	25,000,000	1	7.00 NC 2.00	25,000,000	1	25,000,000	1
3.50 NC 0.25			125,000,000	1	7.50 NC 0.50			50,000,000	1
3.50 NC 0.50	80,000,000	3	980,000,000	15	7.50 NC 1.00	25,000,000	1	25,000,000	1
3.50 NC 0.75			250,000,000	2	8.50 NC 0.50	25,000,000	1	25,000,000	1
3.50 NC 1.00	50,000,000	1	300,000,000	7	8.50 NC 1.00	25,000,000	1	25,000,000	1
3.67 NC 0.50			50,000,000	1	10.00 NC 0.25	25,000,000	1	25,000,000	1
3.75 NC 0.50			165,000,000	3	10.00 NC 0.50	225,000,000	4	2,715,000,000	62
3.75 NC 0.75			150,000,000	3	10.00 NC 1.00	100,000,000	4	1,015,000,000	26
3.99 NC 1.00			25,000,000	1	10.00 NC 1.50			50,000,000	1
3.99 NC 1.99			50,000,000	1	10.00 NC 2.00			50,000,000	1
4.00 NC 0.50	25,000,000	1	882,000,000	17	12.00 NC 0.50	275,000,000	11	810,000,000	22
4.00 NC 0.75			50,000,000	1	12.00 NC 1.00	75,000,000	3	125,000,000	4
4.00 NC 1.00	125,000,000	4	680,000,000	18	12.50 NC 1.00	50,000,000	2	50,000,000	2
4.00 NC 1.50			75,000,000	2	15.00 NC 0.50	150,000,000	6	3,890,000,000	72
4.00 NC 2.00			200,000,000	3	15.00 NC 0.51	75,000,000	3	75,000,000	3
4.25 NC 1.00	50,000,000	2	100,000,000	3	15.00 NC 1.00	185,000,000	6	627,655,000	14
4.50 NC 0.50	50,000,000	2	175,000,000	5	15.00 NC 3.00			125,000,000	1
4.50 NC 1.00	200,000,000	5	200,000,000	5	15.00 NC 4.00			50,000,000	1
4.76 NC 1.00	50,000,000	1	50,000,000	1	20.00 NC 1.00	25,000,000	1	1,125,000,000	13
					TOTAL	\$3,325,000,000	111	\$42,142,655,000	666

2011 Debt Redemptions

Callable Debt Redeemed (in billions)

January	\$	14.2
February	\$	11.3
March	\$	14.8
April	\$	10.9
May	\$	9.9
TOTAL	\$	61.1

Summary Breakdown of 2011 Benchmark Notes Issuance

Fannie Mae Noncallable Benchmark Notes

Maturity	May 11 Par Amount	# Issues	YTD 2011 Par Amount	# Issues
2 Years			5,000,000,000	1
3 Years	4,000,000,000	1	9,000,000,000	2
5 Years			4,000,000,000	1
TOTAL NEW ISSUANCE	4,000,000,000	1	18,000,000,000	4

Recent Benchmark Notes Transaction

Benchmark Securities	Size/Cusip	Lead-Managers	Co-Managers	Pricing Date and Spread	Geographic Distribution	Investor Type Distribution
3 year 1.125% 6/27/2014	\$4 billion 3135G0BJ1	Barclays Capital Inc.; Goldman Sachs & Co.; J.P. Morgan Securities Inc.	BNP Paribas; CastleOak Securities, LP.; Citigroup Global Markets Inc.; Credit Suisse (USA) LLC; FTN Financial Capital Markets; Loop Capital Markets	May 12, 2011 +20.5 basis points 1.000% 5/15/2014 U.S. Treasury	U.S. 57.8% Asia 16.7% Europe 4.2% Other 21.3%	Fund Manager 46.3% Comm. Banks 2.8% Insurance Companies 4.7% Central Banks 40.1% State & Local Gov't 5.6% Corporate/Pensions 0.4% Retail 0.1%