

**Supplement dated May 15, 2002 to  
Information Statement dated April 1, 2002**



This Supplement describes the financial condition of the Federal National Mortgage Association (“Fannie Mae”) as of March 31, 2002, and contains unaudited financial information with respect to Fannie Mae for the quarter ended March 31, 2002. This Supplement is a supplement to, and should be read in conjunction with, Fannie Mae’s Information Statement dated April 1, 2002 (the “Information Statement”). The Information Statement describes the business and operations of Fannie Mae and contains financial data as of December 31, 2001. Fannie Mae also periodically makes available statistical information on its mortgage purchase and mortgage-backed securities volumes as well as other relevant information about Fannie Mae. You may obtain copies of Fannie Mae’s current Information Statement, any supplements thereto, and other available information regarding Fannie Mae, including Fannie Mae’s Proxy Statement dated April 2, 2002, without charge from Fannie Mae’s Office of Investor Relations, 3900 Wisconsin Avenue, NW, Washington, D.C. 20016 (telephone: 202/752-7115) or by accessing Fannie Mae’s Web site at <http://www.fanniemae.com/ir>.

In connection with offerings of securities, Fannie Mae distributes offering circulars, prospectuses, or other offering documents that describe securities offered, their selling arrangements and other information. Fannie Mae may incorporate this Supplement by reference in one or more other offering documents. This Supplement does not offer any securities for sale.

Fannie Mae is a federally chartered corporation. Its principal office is located at 3900 Wisconsin Avenue, NW, Washington, DC 20016 (telephone: 202-752-7000). Fannie Mae’s Internal Revenue Service employer identification number is 52-0883107.

Fannie Mae’s securities are not required to be registered under the Securities Act of 1933. At the close of business on April 30, 2002, approximately 996 million shares of Fannie Mae’s common stock (without par value) were outstanding.

**The delivery of this Supplement at any time shall not under any circumstances create an implication that there has been no change in the affairs of Fannie Mae since the date hereof or that the information contained herein is correct as of any time subsequent to its date.**

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## SELECTED FINANCIAL DATA

The following selected financial data for the three months ended March 31, 2002 and 2001 are unaudited and include, in the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation. Operating results for the three months ended March 31, 2002 are not necessarily indicative of the results expected for the entire year.

(Dollars and shares in millions, except per common share amounts)

	At or for the three months ended March 31,	
	2002	2001
<b>Operating Data:</b>		
Operating net income(1) .....	\$ 1,519	\$ 1,238
Operating earnings per diluted common share .....	1.48	1.20
Total taxable-equivalent revenue(2) .....	2,840	2,276
Average net interest margin .....	1.15%	1.03%
Operating return on average realized common equity(3) .....	25.8	25.4
Average effective guaranty fee rate .....	.186	.191
Credit loss ratio(4) .....	.005	.009
<b>Income Statement Data:</b>		
Interest income .....	\$ 12,576	\$ 11,995
Interest expense .....	(10,146)	(10,288)
Net interest income .....	2,430	1,707
Guaranty fee income .....	407	343
Fee and other income .....	4	27
Credit-related expenses .....	(22)	(29)
Administrative expenses .....	(290)	(239)
Purchased options expense(5) .....	(787)	(238)
Income before federal income taxes, extraordinary item and cumulative effect of change in accounting principle .....	1,742	1,571
Provision for federal income taxes .....	(422)	(391)
Income before extraordinary item and cumulative effect of change in accounting principle .....	1,320	1,180
Extraordinary item, loss on early extinguishment of debt, net of tax effect .....	(111)	(55)
Cumulative effect of change in accounting principle, net of tax effect(6) .....	—	168
Net income .....	<u>\$ 1,209</u>	<u>\$ 1,293</u>
Preferred stock dividends .....	(33)	(33)
Net income available to common stockholders .....	<u>\$ 1,176</u>	<u>\$ 1,260</u>
Basic earnings per common share .....	\$ 1.18	\$ 1.26
Diluted earnings per common share .....	1.17	1.25
Cash dividends per common share .....	.33	.30
<b>Balance Sheet Data:</b>		
Mortgage portfolio, net .....	\$731,716	\$640,374
Liquid assets .....	57,290	44,911
Total assets .....	807,961	700,977
Borrowings:		
Due within one year .....	339,793	324,421
Due after one year .....	429,982	342,171
Total liabilities .....	787,208	684,891
Stockholders' equity .....	20,753	16,086
Core capital(7) .....	25,500	21,482
<b>Other Data:</b>		
Dividend payout ratio .....	28.0%	23.8%
Ratio of earnings to combined fixed charges and preferred stock dividends(8) .....	1.17:1	1.15:1
Mortgage purchases .....	\$ 90,946	\$ 58,727
MBS issues acquired by others .....	106,804	46,850
Outstanding MBS at period-end(9) .....	896,463	725,685
Weighted-average diluted common shares outstanding .....	1,002	1,006

(1) Operating net income excludes the cumulative after-tax gain of \$168 million from the change in accounting principle upon adoption of FAS 133 on January 1, 2001. Also excludes the after-tax charge of \$512 million recognized during the first quarter of 2002 and after-tax charge of \$154 million recognized during the first quarter of 2001 for the change in fair value of the time value of purchased options. Includes after-tax charges for the amortization expense of purchased option premiums of \$202 million for the first quarter of 2002 and \$41 million for the first quarter of 2001.

(2) Includes revenues net of operating losses and amortization expense of option premiums, plus taxable-equivalent adjustments for tax-exempt income and investment tax credits using the applicable federal income tax rate.

(3) Annualized operating net income less preferred stock dividends divided by average realized common stockholders' equity (common stockholders' equity excluding accumulated other comprehensive income).

(4) Charge-offs, net of recoveries, and foreclosed property expenses as a percentage of average net portfolio and average net outstanding MBS (annualized).

(5) Represents the change in the fair value of the time value of purchased options, which includes amortization expense related to purchased option premiums of \$310 million and \$64 million in the first quarter of 2002 and 2001, respectively.

(6) To record the after-tax effect of the adoption of FAS 133, *Accounting for Derivative Instruments and Hedging Activities*, on January 1, 2001.

(7) The sum of (a) the stated value of outstanding common stock, (b) the stated value of non-cumulative preferred stock, (c) paid in capital, and (d) retained earnings.

(8) "Earnings" consists of (a) income before federal income taxes, extraordinary items and cumulative effect of accounting changes and (b) fixed charges. "Fixed charges" represents interest expense.

(9) MBS held by investors other than Fannie Mae.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND  
RESULTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED MARCH 31, 2002**

**Results of Operations**

Fannie Mae recorded net income and earnings per diluted share (EPS) for the first quarter of 2002 of \$1.209 billion and \$1.17, respectively, under generally accepted accounting principles (GAAP), which include the effects of Financial Accounting Standard No. 133 (FAS 133), *Accounting for Derivative Instruments and Hedging Activities*. Fannie Mae's net income and EPS in the first quarter of 2001 totaled \$1.293 billion and \$1.25, respectively. Fannie Mae recorded a decrease in GAAP net income in the first quarter of 2002 primarily because of increased expense related to unrealized market value losses on purchased options that are included in GAAP earnings under FAS 133. FAS 133 may result in earnings volatility because it requires that Fannie Mae record the change in the fair value of the time value of purchased options in the income statement, but not the options in callable debt or mortgages.

Because of the earnings volatility that results from the accounting for purchased options under FAS 133, Fannie Mae's management believes operating net income is a more meaningful measure of operating performance of the Company. The change in the fair value of the time value of purchased options that is recorded under FAS 133 will vary from period to period with changes in interest rates and market views on interest rate volatility. However, the total expense included in earnings from the purchase date until the exercise or expiration date will equal the up-front option premium paid because Fannie Mae generally holds such options to the exercise or expiration date. Operating net income and operating EPS primarily adjust for this element of earnings volatility related to FAS 133 and are comparable with income results reported in periods prior to the adoption of FAS 133. Prior to the adoption of FAS 133, Fannie Mae amortized premiums on purchased options into interest expense on a straight-line basis over the life of the option.

Operating net income and operating EPS in the first quarter of 2002 grew 23 percent over first quarter 2001 to \$1.519 billion and \$1.48, respectively. The chart below reconciles net income to operating net income.

	<b>For the three months ended March 31,</b>	
	<b>2002</b>	<b>2001</b>
Net income . . . . .	\$1,209	\$1,293
Cumulative after-tax gain upon adoption of FAS 133 . . . . .	—	(168)
After-tax expense from the change in the fair value of the time value of purchased options . . . . .	512	154
After-tax amortization expense of purchased options premiums . . . . .	(202)	(41)
Operating net income . . . . .	<b>\$1,519</b>	<b>\$1,238</b>

Fannie Mae's operating net income growth in first quarter 2002 resulted from strong portfolio and net interest margin growth. Highlights of Fannie Mae's first quarter 2002 performance include:

- *25 percent growth in taxable-equivalent revenues*
- *19 percent increase in the total book of business*
- *12 basis point increase in the average net interest margin to 1.15 percent*
- *29 percent increase in adjusted net interest income*
- *19 percent growth in guaranty fee income*
- *decrease in credit-related losses to \$22 million from \$29 million*
- *losses of \$172 million from the call and repurchase of debt compared with \$83 million in first quarter 2001*
- *repurchase of 7.5 million shares of Fannie Mae common stock compared with 1.0 million shares in first quarter 2001*

Taxable-equivalent revenue increased 25 percent over first quarter 2001 to \$2.840 billion largely due to growth in adjusted net interest income. Taxable-equivalent revenue represents total revenue adjusted to reflect the benefits of tax-exempt income and investment tax credits based on applicable federal income tax rates.

Fannie Mae's GAAP net interest income in the first quarter of 2002 totaled \$2.430 billion, compared with \$1.707 billion in the prior year. Following the adoption of FAS 133, Fannie Mae also began measuring net interest income and net interest margin on an adjusted basis. Management believes Fannie Mae's adjusted net interest income and net interest margin, which is comparable with GAAP net interest income and net interest margin in periods prior to the adoption of FAS 133, is a more meaningful measure of performance. Adjusted net interest income includes GAAP net interest income less amortization expense related to purchased options premiums. Prior to the adoption of FAS 133, reported net interest income included the amortization expense of purchased options premiums on a straight-line basis over the life of the option. With the adoption of FAS 133, this expense is now included in the change in the fair value of the time value of purchased options that is reported in the income statement in the category "purchased options expense."

Adjusted net interest income for the first quarter of 2002 increased 29 percent to \$2.120 billion, as Fannie Mae grew the average net mortgage portfolio 15 percent and the average net interest margin by 12 basis points. Fannie Mae's net interest margin continued to benefit from the sharp declines in interest rates in 2001, which gave the company an opportunity to call debt early in 2001 in amounts that substantially exceeded the timing and volume of liquidations. Portfolio growth fell in March as mortgage commitments slowed due to tighter mortgage-to-debt spreads, portfolio sales increased, and liquidation rates remained high. The results of Fannie Mae's *portfolio investment business*, which manages the interest rate risk of the company's mortgage portfolio and other investments, is largely reflected in adjusted net interest income.

The following table presents an analysis of GAAP net interest income, adjusted net interest income, net interest margin, and average balances for the three months ended March 31, 2002 and 2001.

**Net Interest Income and Average Balances**  
(Dollars in millions)

	Three Months Ended March 31,	
	2002	2001
Interest income:		
Mortgage portfolio .....	\$ 12,171	\$ 11,131
Investments and cash equivalents .....	405	864
Total interest income .....	<u>12,576</u>	<u>11,995</u>
Interest expense (1):		
Short-term debt .....	743	1,815
Long-term debt .....	9,403	8,473
Total interest expense .....	<u>10,146</u>	<u>10,288</u>
Net interest income .....	2,430	1,707
Taxable-equivalent adjustment (2) .....	123	111
Amortization of purchased options .....	(310)	(64)
Adjusted net interest income taxable-equivalent basis .....	<u>\$ 2,243</u>	<u>\$ 1,754</u>
Average balances:		
Interest-earning assets (3):		
Mortgage portfolio, net .....	\$715,604	\$622,764
Investments and cash equivalents .....	65,165	55,721
Total interest-earning assets .....	<u>\$780,769</u>	<u>\$678,485</u>
Interest-bearing liabilities (4):		
Short-term debt .....	\$131,421	\$129,957
Long-term debt .....	625,378	524,433
Total interest-bearing liabilities .....	<u>756,799</u>	<u>654,390</u>
Interest-free funds .....	23,970	24,095
Total interest-bearing liabilities and interest-free funds .....	<u>\$780,769</u>	<u>\$678,485</u>
Average interest rates (2):		
Interest-earning assets:		
Mortgage portfolio, net .....	6.85%	7.21%
Investments and cash equivalents .....	2.52	6.27
Total interest-earning assets .....	<u>6.49</u>	<u>7.13</u>
Interest-bearing liabilities (5):		
Short-term debt .....	2.56	5.55
Long-term debt .....	6.15	6.52
Total interest-bearing liabilities .....	<u>5.52</u>	<u>6.32</u>
Investment spread (6) .....	.97	.81
Interest-free return (7) .....	.18	.22
Net interest margin (8) .....	<u>1.15%</u>	<u>1.03%</u>

(1) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on effective maturity or repricing date, taking into consideration the effect of derivative financial instruments. The cost of debt includes expense for the amortization of purchased options.

(2) Reflects pro forma adjustments to permit comparison of yields on tax-advantaged and taxable assets.

(3) Includes average balance of nonperforming loans of \$4.2 billion and \$2.2 billion for the three months ended March 31, 2002 and 2001, respectively.

(4) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on effective maturity or repricing date, taking into consideration the effect of derivative financial instruments.

(5) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on effective maturity or repricing date, taking into consideration the effect of derivative financial instruments. The cost of debt includes expense for the amortization of purchased options.

(6) Consists primarily of the difference between the yield on interest-earning assets, adjusted for tax benefits of nontaxable income, and the effective cost of funds on interest-bearing liabilities.

(7) Consists primarily of the return on that portion of the investment portfolio funded by equity and non-interest-bearing liabilities.

(8) Based on adjusted net interest income, on a taxable-equivalent basis, as a percentage of the average investment portfolios.

The following rate/volume analysis shows the relative contribution of asset and debt growth and interest rate changes to changes in GAAP net interest income for the three months ended March 31, 2002 and 2001.

**Rate / Volume Analysis**  
(Dollars in millions)

<u>First Quarter 2002 vs. First Quarter 2001</u>	<u>Increase (Decrease)</u>	<u>Attributable to Changes in (1)</u>	
		<u>Volume</u>	<u>Rate</u>
Interest income:			
Mortgage portfolio .....	\$ 1,040	\$1,599	\$ (559)
Investments and cash equivalents.....	<u>(459)</u>	<u>127</u>	<u>(586)</u>
Total interest income.....	<u>581</u>	<u>1,726</u>	<u>(1,145)</u>
Interest expense(2):			
Short-term debt .....	(1,072)	20	(1,092)
Long-term debt .....	<u>930</u>	<u>1,548</u>	<u>(618)</u>
Total interest expense .....	<u>(142)</u>	<u>1,568</u>	<u>(1,710)</u>
Net interest income .....	<u>\$ 723</u>	<u>\$ 158</u>	<u>\$ 565</u>

- (1) Combined rate/volume variances, a third element of the calculation, are allocated to the rate and volume variances based on their relative size.
- (2) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on the effective maturity or repricing date, taking into consideration the effect of derivative financial instruments.

Guaranty fee income increased by \$64 million, or 19 percent, to \$407 million, compared with \$343 million in the first quarter of 2001. This increase resulted from 22 percent growth in average outstanding Mortgage-Backed Securities (“MBS”), which more than offset a decline in the effective guaranty fee rate to 18.6 basis points in the first quarter of 2002 from 19.1 basis points in the first quarter of 2001. Fannie Mae’s *credit guaranty business* manages the company’s credit risk. Results of this business segment are primarily reflected in guaranty fee income and credit-related expenses.

Fee and other income decreased \$23 million to \$4 million in the first quarter of 2002 compared with the first quarter of 2001. The decline from the first quarter of 2001 was primarily due to losses on sales of mortgages and an increase in credit enhancement expenses — principally for new products with higher-than-average risk characteristics — both of which are included in the other miscellaneous items category of fee and other income. Fee and other income includes technology fees, transaction fees, multifamily fees, and other miscellaneous items, and is net of operating losses from certain tax-advantaged investments in affordable housing projects.

Administrative expenses in the first quarter of 2002 increased \$51 million, or 21 percent, over the first quarter of 2001 to \$290 million primarily due to increased compensation costs and expenses related to Fannie Mae’s core infrastructure reengineering project. Fannie Mae’s efficiency ratio (ratio of administrative expenses to taxable-equivalent revenue) improved to 10.2 percent for the first quarter of 2002 from 10.5 percent for the first quarter of 2001. Fannie Mae’s ratio of annualized administrative expenses to the average mortgage portfolio plus average MBS outstanding (combined book of business) was .073 percent in the first quarter of 2002 versus .072 percent in the first quarter of 2001.

During the first quarter of 2002, Fannie Mae recorded \$787 million in purchased options expense under FAS 133 compared with expense of \$238 million in the first quarter of 2001. Purchased options expense represents the change in the fair value of the time value of purchased options. Purchased



options expense for the first quarter of 2002 and 2001 includes \$310 million and \$64 million, respectively, in amortization expense of purchased option premiums that would have been reported in net interest income prior to the adoption of FAS 133. The change in the fair value of the time value of purchased options will vary from period to period with changes in interest rates and market views on interest rate volatility. However, the total expense included in earnings from the purchase date until the exercise or expiration date will equal the option premium paid.

Federal income tax expense, including the tax impact from extraordinary items and the cumulative effect of the change in accounting principle from the adoption of FAS 133, decreased \$92 million to \$361 million in the first quarter of 2002 from \$453 million in the first quarter of 2001. The effective federal income tax rate for the first three months of 2002 decreased to 23 percent from 26 percent for the first three months of 2001 primarily due to the marginal increase in tax benefits from low-income housing tax credits, coupled with higher purchased options expense recorded in the first quarter of 2002. Fannie Mae's effective federal income tax rate on operating net income increased to 26 percent during the first quarter of 2002 from 25 percent in the first quarter of 2001.

Fannie Mae incurred extraordinary losses of \$172 million (\$111 million after-tax) from the call or repurchase of debt in the first quarter of 2002 compared with \$83 million (\$55 million after-tax) in the first quarter of 2001. Debt called or repurchased in the first quarter of 2002 totaled \$30 billion, compared with \$79 billion in the first quarter of 2001.

Fannie Mae's GAAP results for the first quarter of 2001 include cumulative pre-tax income of \$258 million (\$168 million after-tax) from the change in accounting principle recorded upon adoption of FAS 133. The cumulative effect on earnings from the change in accounting principle is attributable to recording the fair value of the time value of purchased options that the company used as a substitute for callable debt at adoption of FAS 133 on January 1, 2001.

## Risk Management

Fannie Mae is subject to several major areas of risk, including interest rate risk and credit risk, that are described and discussed in the Information Statement under "MD&A — Risk Management."

### *Interest Rate Risk Management*

Two primary measures of interest rate risk used by Fannie Mae in managing its mortgage portfolio business are net interest income at risk and effective asset/liability portfolio duration gap.

Fannie Mae's net interest income at risk measures the sensitivity of Fannie Mae's projected net interest income to an immediate 50 basis point increase or decrease in interest rates and an immediate 25 basis point increase or decrease in the slope of the yield curve. Yield curve slope sensitivity is calculated assuming a 25 basis point flattening or steepening between one and ten-year maturities, with the five-year yield/rate held constant. Over the company's monthly reporting period, a 50 basis point change in interest rates and a 25 basis point change in the slope of the yield curve encompass approximately 95 percent of the actual changes that are likely to occur.

Net interest income at risk expresses the percentage change in projected net interest income under the more adverse of the interest rate and yield curve scenarios. Fannie Mae's net interest income at risk over a one-year and four-year period under each of the interest rate scenarios were as follows at March 31, 2002:

	Assuming a 50 basis point change in interest rates		Assuming a 25 basis point change in slope of yield curve	
	One-year	Four-year	One-year	Four-year
March 2002 .....	3.8%	6.1%	1.0%	3.1%



Fannie Mae's expected range of net interest income at risk is between 1 percent to 5 percent. A positive number indicates the percent by which projected net interest income could be reduced by the increased rate shock. Actual portfolio net interest income may differ from these estimates because of specific interest rate movements, changing business conditions, changing prepayments, and management actions.

The portfolio duration gap—the difference between the durations of portfolio assets and liabilities—summarizes for management the extent to which estimated cash flows for assets and liabilities are matched, on average, through time and across interest rate scenarios. A positive duration gap indicates more of an exposure to rising interest rates, and a negative duration gap indicates more of an exposure to declining interest rates. In computing duration gap, Fannie Mae uses a modified option-adjusted duration calculation. Fannie Mae's effective duration gap was positive five months at March 31, 2002 and December 31, 2001 and positive one month at March 31, 2001. Fannie Mae's duration gap has historically fallen inside the target range of plus or minus six months approximately two-thirds of the time.

### *Credit Risk Management*

The following table shows Fannie Mae's serious delinquencies for conventional loans in portfolio and underlying outstanding MBS, the number of conventional properties acquired, and total net charge-offs (recoveries) for the three months ended March 31, 2002 and 2001.

	Delinquency Rate(1)		Number of Properties Acquired		Net Charge-offs/ (Recoveries)	
	March 31, 2002	March 31, 2001	March 31, 2002	March 31, 2001	March 31, 2002	March 31, 2001
	(Dollars in millions)					
Single-family ...	.46%	.44%	4,337	3,593	\$(31)	\$(26)
Multifamily ....	.31	.05	—	1	1	—
Total .....					<u>\$(30)</u>	<u>\$(26)</u>

(1) Single-family serious delinquencies consist of those loans in the portfolio or underlying outstanding MBS for which Fannie Mae has the primary risk of loss that are 90 or more days delinquent or in foreclosure. Multifamily serious delinquencies are those loans in the portfolio or underlying outstanding MBS that are 60 days or more delinquent for which Fannie Mae has primary risk of loss. The single-family percentages are based on the number of such single-family loans and the multifamily percentages are based on the dollar amount of such multifamily loans in the portfolio and underlying outstanding MBS.

Total credit-related losses, which include loan charge-offs, net of recoveries, and foreclosed property expenses, decreased \$6 million in the first quarter of 2002 to \$22 million compared to the first quarter of 2001 because of a \$4 million increase in loan charge-off recoveries and a \$2 million decrease in foreclosed property expenses. Fannie Mae's credit loss ratio—credit-related losses as a percentage of the average combined book of business—declined to .5 basis points in the first quarter of 2002 from .9 basis points in the first quarter of 2001.

The inventory of single-family properties held by Fannie Mae increased to 7,634 as of March 31, 2002 from 6,517 as of March 31, 2001, resulting primarily from the economic slowdown. Fannie Mae held no multifamily properties in its inventory at March 31, 2002, compared with 5 properties at March 31, 2001.

Fannie Mae's multifamily serious delinquency rate increased to .31 percent at March 31, 2002 because of two loans totaling \$118 million on properties in New York City that were affected by the World Trade Center disaster. These loans were under forbearance agreements at March 31, 2002.

The multifamily delinquency rate excluding these two loans was .11 percent at March 31, 2002, compared with .05 percent at March 31, 2001.

Total credit-related expenses, which include foreclosed property expenses and the provision for losses, decreased \$7 million to \$22 million in the first quarter of 2002 from the first quarter of 2001 resulting from a \$5 million increase in the negative loss provision in the first quarter of 2002 and a \$2 million decrease in foreclosed property expenses.

The allowance for losses was \$806 million at March 31, 2002 unchanged from December 31, 2001. The allowance for losses declined as a percentage of Fannie Mae's total book of business to .049 percent at March 31, 2002 from .052 percent at December 31, 2001. Nonperforming loans outstanding totaled \$4.2 billion at March 31, 2002, compared with \$3.7 billion at December 31, 2001.

Fannie Mae discloses on a quarterly basis the sensitivity of its future credit losses to an immediate 5 percent decline in home prices as part of its voluntary safety and soundness initiatives. At December 31, 2001, the present value of Fannie Mae's sensitivity of net future credit losses to an immediate 5 percent decline in home prices was \$487 million, taking into account the beneficial effect of third-party credit enhancements. This amount reflects a gross credit loss sensitivity of \$1.332 billion before the effect of credit enhancements, and is net of projected credit risk-sharing proceeds of \$845 million. The sensitivity of future credit losses is calculated based on the present value of the difference between credit losses in a baseline scenario and credit losses assuming an immediate 5 percent decline in home prices, followed by an increase in home prices at the rate projected by Fannie Mae's credit pricing models.

The use of credit enhancement contracts is an important tool to provide protection against credit losses. Credit enhancements include primary loan-level mortgage insurance, pool mortgage insurance, recourse arrangements with lenders, and other customized contracts, which together absorbed \$136 million, or 87 percent, of \$157 million in gross single-family losses on loans in portfolio and underlying outstanding MBS in the first quarter of 2002. In comparison, credit enhancements absorbed \$103 million, or 78 percent, of \$132 million in gross single-family credit losses during the first quarter of 2001.

Fannie Mae's primary credit risk on these contracts is that counterparties will not fulfill their contractual obligations to make payments due to Fannie Mae. At March 31, 2002, Fannie Mae was the beneficiary of primary mortgage insurance coverage on \$319 billion of single-family loans in portfolio or underlying MBS. Seven mortgage insurance companies, all rated AA or higher by Standard & Poor's, provided 96 percent of this coverage. At March 31, 2002, the unpaid balance of single-family loans where Fannie Mae has recourse to lenders for losses totaled an estimated \$41 billion. Fifty-four percent of the \$41 billion is covered by recourse agreements with investment grade counterparties. Fannie Mae held \$241 million in collateral directly or through custodians on single-family recourse transactions at March 31, 2002. Fannie Mae also retains the right to terminate a lender's contractual status as a Fannie Mae seller/servicer as a result of a lender's nonperformance, to sell the rights to service Fannie Mae loans, and to retain sale proceeds. Lenders with recourse obligations had servicing rights on \$1.356 trillion of mortgages.

Fannie Mae also has counterparty performance risk in its derivatives and liquidity investments. Credit risk information related to derivatives and liquidity investments is provided under "Balance Sheet Analysis—Derivative Instruments" and "Balance Sheet Analysis—Investments," respectively.

## **Balance Sheet Analysis**

### *Mortgage Portfolio*

As of March 31, 2002, the net mortgage portfolio totaled \$732 billion with an average yield (before deducting the allowance for losses) of 6.80 percent, compared with \$705 billion at 6.95 percent as of December 31, 2001 and \$641 billion at 7.19 percent as of March 31, 2001.

Fannie Mae purchased \$91 billion of mortgages at an average yield of 6.31 percent in the first quarter of 2002, compared with \$59 billion of mortgage purchases at an average yield of 6.86 percent in the first quarter of 2001. The increase in mortgage purchases was primarily due to a lower interest rate environment and the increased availability of mortgages offered for sale in the secondary market. The decline in the net mortgage portfolio yield from December 31, 2001 to March 31, 2002 was primarily due to the decline in mortgage interest rates and accelerated prepayments. Mortgage loan repayments accelerated during the first quarter of 2002 and totaled \$61 billion, compared with \$23 billion in the first quarter of 2001. The increase in loan repayments was primarily due to an increased level of refinance activity in a lower interest rate environment.

Mandatory commitments issued to purchase mortgages from lenders, net of commitments to sell mortgages, totaled \$51 billion during the first quarter of 2002, compared with \$76 billion during the first quarter of 2001. The decline in commitments resulted from less attractive mortgage purchase opportunities in first quarter 2002 because of tighter mortgage-to-debt spreads.

### Investments

Presented below are the amortized cost and fair value of the Liquid Investment Portfolio and other investments classified as held-to-maturity at March 31, 2002 and December 31, 2001.

Dollars in millions	March 31, 2002						December 31, 2001					
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Average Maturity in Months	% Rated A or Better	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Average Maturity in Months	% Rated A or Better
Held-to-maturity investments:												
Eurodollar time deposits . . . . .	\$ 4,410	\$—	\$—	\$ 4,410	1.2	100.0%	\$11,185	\$—	\$—	\$11,185	.3	100.0%
Repurchase agreements . . . . .	6,234	—	—	6,234	.5	100.0	9,380	—	—	9,380	.5	100.0
Asset-backed securities(1) . . . . .	5,905	49	—	5,954	12.0	100.0	6,065	88	—	6,153	10.6	100.0
Federal funds . . . . .	871	—	—	871	.7	100.0	4,904	—	—	4,904	.4	100.0
Commercial paper . . . . .	3,265	—	—	3,265	.9	100.0	2,844	1	—	2,845	.6	100.0
Auction rate preferred stock . . . . .	2,149	—	—	2,149	1.5	100.0	2,127	—	—	2,127	1.7	100.0
Other . . . . .	2,192	40	—	2,232	13.9	59.4	2,166	73	—	2,239	16.7	56.4
Total . . . . .	<u>\$25,026</u>	<u>\$89</u>	<u>\$—</u>	<u>\$25,115</u>	<u>4.7</u>	<u>96.4%</u>	<u>\$38,671</u>	<u>\$162</u>	<u>\$—</u>	<u>\$38,833</u>	<u>3.0</u>	<u>97.5%</u>

(1) Contractual maturity of asset-backed securities is not a reliable indicator of their expected life because borrowers generally have the right to repay their obligations at any time.

Presented below are the amortized cost and fair value of the Liquid Investment Portfolio and other investments classified as available-for-sale at March 31, 2002 and December 31, 2001.

Dollars in millions	March 31, 2002						December 31, 2001					
	Amortized Cost	Unrealized Gains (2)	Unrealized Losses (3)	Fair Value	Average Maturity in Months	% Rated A or Better	Amortized Cost	Unrealized Gains (2)	Unrealized Losses (3)	Fair Value	Average Maturity in Months	% Rated A or Better
Available-for-sale investments:												
Asset-backed securities(1) . . . . .	\$16,016	\$—	\$—	\$16,016	27.3	100.0%	\$14,876	\$—	\$ 4	\$14,872	26.2	99.9%
Floating rate notes(1) . . . . .	12,214	—	26	12,188	17.3	85.2	12,114	—	33	12,081	18.2	84.3
Commercial paper . . . . .	2,871	—	—	2,871	1.6	100.0	8,879	1	—	8,880	.9	100.0
Other . . . . .	250	—	—	250	9.1	100.0	50	—	—	50	9.5	100.0
Total . . . . .	<u>\$31,351</u>	<u>\$—</u>	<u>\$26</u>	<u>\$31,325</u>	<u>20.9</u>	<u>94.2%</u>	<u>\$35,919</u>	<u>\$ 1</u>	<u>\$37</u>	<u>\$35,883</u>	<u>17.2</u>	<u>94.7%</u>

- (1) As of March 31, 2002, 100 percent of asset-backed securities and floating rate notes reprice at intervals of 90 days or less.
- (2) Gross realized gains of \$1.0 million were recorded in the first quarter of 2002 and \$3.3 million in the first quarter of 2001.
- (3) Gross realized losses of \$1.5 million were recorded in the first quarter of 2002 and \$1.8 million in the first quarter of 2001.

The following table shows the amortized cost, fair value, and yield of the Liquid Investment Portfolio and other investments at March 31, 2002 and December 31, 2001 by remaining maturity.

<u>Dollars in millions</u>	<u>March 31, 2002</u>			<u>December 31, 2001</u>		
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Yield</u>	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Yield</u>
Due within one year .....	\$24,081	\$24,086	2.36%	\$42,190	\$42,210	2.41%
Due after one year through five years .....	10,374	10,384	2.84	11,459	11,481	3.01
	34,455	34,470	2.50	53,649	53,691	2.54
Asset-backed securities(1) .....	21,922	21,970	2.79	20,941	21,025	3.07
Total.....	<u>\$56,377</u>	<u>\$56,440</u>	<u>2.62%</u>	<u>\$74,590</u>	<u>\$74,716</u>	<u>2.69%</u>

(1) Contractual maturity of asset-backed securities is not a reliable indicator of their expected life because borrowers generally have the right to repay their obligations at any time.

The primary credit risk associated with the Liquid Investment Portfolio is that issuers will not repay Fannie Mae in accordance with contractual terms. The level of credit risk in the portfolio is low because these investments are primarily high-quality, short-term investments. The majority of asset-backed securities in the Liquid Investment Portfolio are rated AAA by Standard & Poor's. Unsecured investments in the portfolio are generally rated A or higher by Standard & Poor's. At March 31, 2002, 95 percent of the Liquid Investment Portfolio had a credit rating of A or higher, compared with 96 percent at December 31, 2001.

#### *Financing and Other Activities*

Fannie Mae's total debt outstanding increased 15 percent to \$770 billion at March 31, 2002 from \$667 billion at March 31, 2001. The cost of debt outstanding at March 31, 2002 decreased to 5.44 percent from 5.49 percent at December 31, 2001 and 6.19 percent at March 31, 2001. Fannie Mae's financing activities for the first three months of 2002 and 2001 are summarized below.

<u>(Dollars in billions)</u>	<u>Three Months Ended March 31,</u>	
	<u>2002</u>	<u>2001</u>
Debt issued .....	\$ 524	\$ 442
Average cost .....	2.12%	5.44%
Debt redeemed .....	\$ 517	\$ 418
Average cost .....	2.25%	6.08%

Option-embedded debt instruments as a percentage of the total net mortgage portfolio increased to 55 percent in the first quarter of 2002 from 39 percent at the end of the first quarter of 2001. The following table presents the amount of option-embedded debt instruments as a percentage of mortgage purchases and the net mortgage portfolio at March 31, 2002 and March 31, 2001. Option-embedded debt instruments include the effect of derivative financial instruments.

<u>(Dollars in billions)</u>	<u>Three Months Ended March 31,</u>	
	<u>2002</u>	<u>2001</u>
Issued during the period .....	\$ 65	\$ 57
Percentage of total mortgage purchases .....	71%	97%
Outstanding at end of period .....	\$406	\$252
Percentage of total net mortgage portfolio .....	55%	39%

The following table summarizes the amounts and call periods of callable debt, callable swaps, and receive-fixed swaptions, excluding \$9 billion of callable debt that was swapped to variable-rate debt and the notional amount of pay-fixed swaptions and caps. Universal debt that is redeemable at Fannie Mae's option is also included in the table.

<u>Dollars in millions</u>	<u>Call Date</u>	<u>Year of Maturity</u>	<u>Amount Outstanding</u>	<u>Average Cost</u>
Callable debt, callable swaps and receive-fixed swaptions:	Currently callable	2003-2016	\$ 3,400	6.00%
	2002	2002-2027	79,295	5.32
	2003	2003-2031	58,924	5.59
	2004	2004-2022	57,793	6.18
	2005	2007-2030	15,909	6.38
	2006	2010-2031	20,775	6.30
	2007	2012-2032	4,485	6.80
	2008 and later	2014-2030	<u>7,975</u>	<u>7.20</u>
			248,556	5.83%
Pay-fixed swaptions .....			72,800	
Interest-rate caps .....			<u>84,543</u>	
Total option-embedded financial instruments .....			<u>\$ 405,899</u>	

#### *Derivative Instruments*

Derivative instruments are important tools that Fannie Mae uses to manage interest rate risk. Fannie Mae primarily uses derivatives as a substitute for notes and bonds it issues in the cash debt markets. The ability to either issue debt in the cash market or modify debt through the derivatives markets increases the funding flexibility of the company and reduces overall funding costs. The funding flexibility created by derivatives helps Fannie Mae match the duration of its debt with the duration of its mortgage assets. This duration matching helps reduce the interest rate risk of prepayments in the mortgage portfolio. Fannie Mae acts only as an end user of derivatives and does not broker or speculate in them. Fannie Mae uses only the most straightforward types of derivative instruments such as interest-rate swaps, basis swaps, swaptions, and caps, whose values are relatively easy to model and predict.

The following table summarizes Fannie Mae's derivatives activity for the quarter ended March 31, 2002 and year ended December 31, 2001 by derivative category, the fair values of its

derivatives at March 31, 2002, and the expected maturities of the derivative instruments outstanding as of March 31, 2002 by derivative type.

### Derivative Activity and Maturity Data

(Dollars in millions)

	Pay-Fixed / Receive Variable Swaps (2)		Pay Variable / Receive-Fixed Swaps	Basis Swaps	Caps and Swaptions	Other (4)	Total	
	Amount	Pay Rate (3)						Receive Rate (3)
Notional Amounts:(1)								
Notional balance at January 1, 2001 . . . .	\$153,737	6.74%	6.79%	\$59,174	\$14,559	\$ 82,528	\$14,742	\$324,740
Additions . . . . .	90,787	5.39	3.95	33,230	46,150	168,350	100	338,617
Maturities . . . . .	30,844	6.41	4.20	53,335	13,655	30,935	1,449	130,218
Notional balance at December 31, 2001	213,680	6.21	2.47	39,069	47,054	219,943	13,393	533,139
Additions . . . . .	9,807	5.50	1.90	12,694	5,640	30,400	95	58,636
Maturities . . . . .	1,200	5.97	2.83	9,017	2,834	12,250	213	25,514
Notional balance at March 31, 2002 . . . .	<u>\$222,287</u>	<u>6.18%</u>	<u>1.96%</u>	<u>\$42,746</u>	<u>\$49,860</u>	<u>\$238,093</u>	<u>\$13,275</u>	<u>\$566,261</u>
Fair value at March 31, 2002(5) . . . . .	<u>\$ (6,317)</u>			<u>\$ 968</u>	<u>\$ 9</u>	<u>\$ 6,026</u>	<u>\$(1,456)</u>	<u>\$ (770)</u>
Future Maturities of Notional Amounts:(6)								
2002 . . . . .	\$ 25,895	5.53%	1.96%	\$12,337	\$31,020	\$ 42,500	\$ 4,596	\$116,348
2003 . . . . .	26,230	5.03	1.96	8,314	16,590	54,643	497	106,274
2004 . . . . .	19,895	5.97	1.92	2,430	2,100	9,450	1,200	35,075
2005 . . . . .	16,050	6.47	1.95	3,425	—	2,900	590	22,965
2006 . . . . .	21,975	6.21	1.92	3,080	100	4,750	—	29,905
Thereafter . . . . .	112,242	6.60	1.98	13,160	50	123,850	6,392	255,694
Total . . . . .	<u>\$222,287</u>	<u>6.18%</u>	<u>1.96%</u>	<u>\$42,746</u>	<u>\$49,860</u>	<u>\$238,093</u>	<u>\$13,275</u>	<u>\$566,261</u>

- (1) Dollars represent notional amounts that indicate only the amount on which payments are being calculated and do not represent the amount at risk of loss.
- (2) Included in the notional amounts are callable swaps of \$33 billion and \$32 billion with weighted-average pay rates of 6.73 percent and 6.72 percent and weighted-average receive rates of 1.96 percent and 2.54 percent at March 31, 2002 and December 31, 2001, respectively.
- (3) The weighted-average interest rate payable and receivable is as of the date indicated. The interest rates of the swaps may be variable-rate, so these rates may change as prevailing interest rates change.
- (4) Includes foreign currency swaps, futures contracts and derivative instruments that provide a hedge against interest rate fluctuations.
- (5) Based on fair value at March 31, 2002, estimated by calculating the cost, on a net present value basis, to settle at current market rates all outstanding derivative contracts.
- (6) Based on stated maturities. Assumes that variable interest rates remain constant at March 31, 2002 levels.

Over 99 percent of the notional amount of Fannie Mae's outstanding derivative transactions were with counterparties rated A or better by Standard & Poor's at March 31, 2002 (one counterparty was downgraded below an A rating after the contract was entered into). Fannie Mae's derivative instruments were diversified among 23 counterparties at March 31, 2002. At March 31, 2002, 8 counterparties represented approximately 77 percent of the total notional amount of outstanding derivatives transactions, and each had a credit rating of A or better.

Although notional principal is a commonly used measure of volume in the derivatives market, it is not a meaningful measure of market or credit risk since the notional amount typically does not change hands. The notional amounts of derivative instruments are used to calculate contractual cash flows to be exchanged and are significantly greater than the potential market or credit loss that could result from such transactions. Fannie Mae's primary credit exposure on a derivative transaction is that a counterparty might default on payments due, which could result in Fannie Mae having to replace the derivative with a different counterparty at a higher cost. The fair value of derivatives in a gain position after offsetting arrangements, such as master netting agreements and the value of related collateral, is



the appropriate measure of Fannie Mae's exposure to counterparty default and the actual credit risk of derivative contracts.

Fannie Mae's derivative credit loss exposure, net of collateral held, was \$200 million at March 31, 2002, compared with \$110 million at December 31, 2001. The exposure to credit loss on derivative instruments can be estimated by calculating the cost, on a present value basis, to replace at current market rates all outstanding derivative contracts in a gain position. Fannie Mae's exposure on derivative contracts (after taking into account master settlement agreements that allow for netting of payments, but before consideration of collateral held) was \$1.033 billion at March 31, 2002, compared with \$766 million at December 31, 2001. Fannie Mae expects the credit exposure on derivative contracts to fluctuate as interest rates change. Fannie Mae held \$833 million of collateral through custodians for derivative instruments at March 31, 2002 and \$656 million of collateral at December 31, 2001.

The following table provides a summary of counterparty credit ratings for the exposure on derivatives in a gain position at March 31, 2002.

### Derivative Credit Loss Exposure<sup>(1)</sup>

(Dollars in millions)

Credit Rating	Years to Maturity			Maturity Distribution Netting <sup>(2)</sup>	Exposure	Collateral Held	Exposure Net of Collateral
	Less than 1 year	1 to 5 years	Over 5 years				
AAA.....	\$ —	\$ —	\$ 281	\$ (281)	\$ —	\$ —	\$ —
AA.....	3	74	1,132	(943)	266	110	156
A.....	—	50	934	(217)	767	723	44
Total.....	<u>\$ 3</u>	<u>\$124</u>	<u>\$2,347</u>	<u>\$(1,441)</u>	<u>\$1,033</u>	<u>\$833</u>	<u>\$200</u>

(1) Represents the exposure to credit loss on derivative instruments, which is estimated by calculating the cost, on a present value basis, to replace all outstanding derivative contracts in a gain position. Reported on a net-by-counterparty basis where a legal right of offset exists under an enforceable master settlement agreement. Derivative gains and losses with the same counterparty in the same maturity category are presented net within the maturity category.

(2) Represents impact of netting of derivatives in a gain position and derivatives in a loss position for the same counterparty across maturity categories.

The majority of Fannie Mae's credit exposure of \$2.474 billion based on these maturity categories was offset by \$1.441 billion of exposure that counterparties had to Fannie Mae, resulting in net exposure, before consideration of collateral held, of \$1.033 billion to counterparties. At March 31, 2002, 100 percent of Fannie Mae's exposure on derivatives before consideration of collateral held was with counterparties rated A or better by Standard & Poor's, and 78 percent of Fannie Mae's exposure net of collateral held was with counterparties rated AA by Standard & Poor's. Three counterparties accounted for approximately 90 percent of exposure on derivatives (before consideration of collateral held) to counterparties at March 31, 2002, and each had a credit rating of A or better.

Fannie Mae minimizes derivative credit risk by dealing only with very high credit quality and experienced counterparties, maintaining a conservative collateral management policy, and regular monitoring of counterparties. Fannie Mae's counterparties consist of large banks, broker-dealers, and other financial institutions that have a significant presence in the derivatives market, most of whom are based in the United States. Fannie Mae has never experienced a loss on a derivative transaction due to credit default by a counterparty. Derivative counterparties are obligated to post specific types of collateral when Fannie Mae is exposed to credit losses exceeding agreed-upon thresholds that are based on counterparty credit ratings. Fannie Mae further reduces its net exposure on derivatives by generally requiring overcollateralization from counterparties whose credit ratings have dropped below predetermined credit rating levels. Each type of collateral is valued based on its relative risk. All of the



collateral posted by Fannie Mae counterparties at March 31, 2002 was in the form of cash or U.S. Treasury securities and held by a New York based third-party custodian, which monitors the value of posted collateral on a daily basis.

Additional information on derivative instruments is presented in the Notes to Financial Statements.

### **Capital Resources & Liquidity**

Fannie Mae's core capital (defined as the stated value of outstanding common stock, the stated value of outstanding noncumulative perpetual preferred stock, paid-in capital, and retained earnings) increased to \$25.5 billion at March 31, 2002 from \$25.2 billion at December 31, 2001 and \$21.5 billion at March 31, 2001. Fannie Mae's core capital, which excludes accumulated other comprehensive income (AOCI), is a more accurate reflection of its capital resources than total stockholders' equity. AOCI is excluded from core capital because AOCI includes unrealized gains (losses) on derivatives and investment securities but does not include the related unrealized losses (gains) on items hedged by these derivatives nor the liabilities that fund the acquisition of investment securities.

Upon adoption of FAS 133 on January 1, 2001, Fannie Mae recorded a \$3.9 billion reduction in AOCI. The \$3.9 billion reduction in AOCI was attributable primarily to recording derivatives, mostly interest rate swaps used as substitutes for non-callable debt, that qualify as cash flow hedges on the balance sheet at their fair values. FAS 133 requires that entities mark-to-market derivatives that qualify as cash flow hedges through AOCI, to the extent they are effective hedges, but not the hedged items. Fannie Mae recorded a \$2.5 billion increase to AOCI during the first quarter of 2002 primarily related to an increase in the fair value of derivatives used as cash flow hedges. During the first quarter of 2001, Fannie Mae recorded a \$1.7 billion reduction to AOCI primarily related to the decline in the fair value of derivatives used as cash flow hedges.

Fannie Mae had approximately 995 million common shares outstanding as of March 31, 2002, compared with 997 million common shares outstanding as of December 31, 2001. Pursuant, in part, to the capital restructuring program described in the Information Statement under "MD&A—Balance Sheet Analysis—Liquidity and Capital Resources," Fannie Mae repurchased 7.5 million common shares at a weighted-average cost of \$78.26. Fannie Mae issued 1.9 million common shares for employee and other stock compensation plans and 3.8 million common shares to fund its 2001 commitment of \$300 million to the Fannie Mae Foundation during the first quarter of 2002.

On February 28, 2002, Fannie Mae redeemed all of the outstanding shares of its 6.50 percent Series B preferred stock at \$50.51 per share. The redemption price includes dividends of .51458 per share. At March 31, 2002, preferred stock made up 7.6 percent of Fannie Mae's core capital.

On April 16, 2002, the Board of Directors approved a dividend for the quarter ended March 31, 2002 of \$.33 per common share; and dividends of \$.80625 per Series C preferred share, \$.65625 per Series D preferred share, \$.63750 per Series E preferred share, \$.4425 per Series F preferred share, \$.7529 per Series G preferred share, and \$.7263 per Series H preferred share for the period from and including March 31, 2002, to but excluding June 30, 2002.

On March 1, 2002, Fannie Mae issued \$1.0 billion of subordinated debt that received ratings of Aa2 from Moody's Investors Service, AA- from Standard & Poor's, and AA by Fitch Ratings. Fannie Mae's subordinated debt serves as an important supplement to Fannie Mae's equity capital, although it is not a component of core capital. By the end of 2003, Fannie Mae intends to issue sufficient subordinated debt to bring the sum of total capital and outstanding subordinated debt to at least 4 percent of on-balance-sheet assets, after providing adequate capital to support off-balance-sheet MBS. Subordinated debt totaled \$6.0 billion at March 31, 2002. Total capital and subordinated debt represented 3.5 percent of on-balance sheet assets at March 31, 2002 versus 3.4 percent at year-end 2001.

As discussed in the Information Statement under “Government Regulation and Charter Act” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Environment,” Fannie Mae is subject to capital standards. Fannie Mae met the applicable capital standards as of March 31, 2002, and management expects to continue to comply with the applicable standards.

As part of its voluntary adoption of measures to enhance disclosure, capital, and market discipline, Fannie Mae agreed to maintain more than three months worth of liquidity, assuming no access to the new issue debt markets, to reduce the possibility that the company’s operations could be disrupted during a significant financial crisis. Fannie Mae has a contingency plan in place to ensure funding needs are met for three months without access to the agency debt markets. Fannie Mae also committed to maintain at least five percent of on-balance-sheet assets in a liquid, marketable portfolio of nonmortgage securities and to maintain additional highly liquid securities in unencumbered form to facilitate liquidity. Fannie Mae’s liquid investments were 7.1 percent of Fannie Mae’s on-balance-sheet assets at March 31, 2002.

### **Mortgage-Backed Securities**

Total MBS outstanding increased 23 percent to \$1.355 trillion at March 31, 2002 from \$1.099 trillion at March 31, 2001. Total MBS issues increased to \$241 billion during the first three months of 2002 from \$119 billion in the first three months of 2001 due to a decrease in interest rates and growth in mortgage originations. REMIC issuances were \$37 billion in the first quarter of 2002, compared with \$9 billion in the first quarter of 2001.

The following table summarizes MBS activity for the three months ended March 31, 2002 and 2001.

#### **Summary of MBS Activity (Dollars in millions)**

Three Months Ended March 31,	MBS Issued			Outstanding (1)			Outstanding MBS Held by Other Investors
	Lender Originated Issues	MBS Purchased for Fannie Mae’s Portfolio	MBS Issues Acquired by Others	Fannie Mae Risk	Lender or Shared Risk (2)	Total (3)	
2002	\$173,916	\$67,112	\$106,804	\$1,135,096	\$220,308	\$1,355,404	\$896,463
2001	83,058	36,208	46,850	881,267	217,782	1,099,049	725,685

(1) Based on primary default risk category. Includes MBS held by Fannie Mae and investors other than Fannie Mae. This table classifies lender originated issues and total MBS outstanding based on primary default risk category; however, Fannie Mae bears the ultimate risk of default on all MBS. Total MBS outstanding includes MBS that have been pooled to back Megas, SMBS, or REMICs.

(2) Included in lender or shared risk are \$175 billion and \$169 billion at March 31, 2002 and 2001, respectively, on which the lender or a third party agreed to bear default risk limited to a certain portion or percentage of the loans delivered and, in some cases, the lender has pledged collateral to secure that obligation.

(3) Included are \$459 billion and \$373 billion at March 31, 2002 and 2001, respectively, of Fannie Mae MBS held in portfolio.

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## INDEPENDENT ACCOUNTANTS' REVIEW REPORT

To the Board of Directors and Stockholders of Fannie Mae:

We have reviewed the accompanying condensed balance sheet of Fannie Mae as of March 31, 2002 and the related condensed statements of income, changes in stockholders' equity, and cash flows for the three-months ended March 31, 2002 and 2001. These condensed financial statements are the responsibility of Fannie Mae's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheet of Fannie Mae as of December 31, 2001 (presented herein in condensed form) and the related statements of income, changes in stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated January 10, 2002, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed balance sheet as of December 31, 2001, is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.

KPMG LLP

Washington, D.C.  
April 11, 2002

**FANNIE MAE**  
**INTERIM FINANCIAL STATEMENTS**  
**CONDENSED STATEMENTS OF INCOME**  
**(Unaudited)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2002</b>	<b>2001</b>
	<b>(Dollars in millions,</b>	
	<b>except per common share</b>	
	<b>amounts)</b>	
Interest income .....	\$ 12,576	\$11,995
Interest expense .....	<u>(10,146)</u>	<u>(10,288)</u>
Net interest income .....	2,430	1,707
Guaranty fee income .....	407	343
Fee and other income .....	4	27
Credit-related expenses .....	(22)	(29)
Administrative expenses .....	(290)	(239)
Purchased options expense .....	<u>(787)</u>	<u>(238)</u>
Income before federal income taxes, extraordinary item and cumulative effect of change in accounting principle .....	1,742	1,571
Provision for federal income taxes .....	<u>(422)</u>	<u>(391)</u>
Income before extraordinary item and cumulative effect of accounting change .....	1,320	1,180
Extraordinary item—loss on early extinguishment of debt, net of tax effect .....	(111)	(55)
Cumulative effect of change in accounting principle, net of tax effect .....	—	168
Net income .....	<u>\$ 1,209</u>	<u>\$ 1,293</u>
Preferred stock dividends .....	<u>(33)</u>	<u>(33)</u>
Net income available to common stockholders .....	<u>\$ 1,176</u>	<u>\$ 1,260</u>
Basic earnings per common share:		
Earnings before extraordinary item and cumulative effect of change in accounting principle ..	\$ 1.29	\$ 1.15
Extraordinary loss .....	(.11)	(.06)
Cumulative effect of change in accounting principle .....	—	.17
Net earnings .....	<u>\$ 1.18</u>	<u>\$ 1.26</u>
Diluted earnings per common share:		
Earnings before extraordinary item and cumulative effect of change in accounting principle ..	\$ 1.29	\$ 1.14
Extraordinary loss .....	(.12)	(.06)
Cumulative effect of change in accounting principle .....	—	.17
Net earnings .....	<u>\$ 1.17</u>	<u>\$ 1.25</u>

**CONDENSED BALANCE SHEETS**  
**(Unaudited)**

	<b>March 31,</b>	<b>December 31,</b>
	<b>2002</b>	<b>2001</b>
	<b>(Dollars in millions)</b>	
Assets		
Mortgage portfolio, net .....	\$731,716	\$705,167
Investments .....	56,351	74,554
Derivatives in gain positions .....	1,873	954
Other assets .....	<u>18,021</u>	<u>19,116</u>
Total assets .....	<u>\$807,961</u>	<u>\$799,791</u>
Liabilities		
Debentures, notes, and bonds, net:		
Due within one year .....	\$339,793	\$343,492
Due after one year .....	429,982	419,975
Derivatives in loss positions .....	2,643	5,069
Other liabilities .....	<u>14,790</u>	<u>13,137</u>
Total liabilities .....	<u>787,208</u>	<u>781,673</u>
Stockholders' equity		
Accumulated other comprehensive income (loss) .....	(4,747)	(7,065)
Core capital .....	<u>25,500</u>	<u>25,183</u>
Total stockholders' equity .....	<u>20,753</u>	<u>18,118</u>
Total liabilities and stockholders' equity .....	<u>\$807,961</u>	<u>\$799,791</u>

See Notes to Interim Financial Statements

**FANNIE MAE**  
**INTERIM FINANCIAL STATEMENTS**  
**CONDENSED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2002</b>	<b>2001</b>
	<b>(Dollars in millions)</b>	
<b>Balance, beginning of period</b> .....	\$18,118	\$20,838
Comprehensive income:		
Net income .....	1,209	1,293
Other comprehensive income, net of tax effect:		
Transition adjustment from the adoption of FAS 133 .....	—	(3,973)
Unrealized gain on securities transferred to available-for-sale upon adoption of FAS 133 .....	—	86
Cash flow hedging gains (losses) .....	2,526	(1,726)
Unrealized (losses) gains on securities .....	(208)	207
<b>Total comprehensive income (loss)</b> .....	<b>3,527</b>	<b>(4,113)</b>
Dividends .....	(362)	(333)
Shares repurchased .....	(585)	(77)
Preferred stock redeemed .....	(375)	(375)
Treasury stock issued for stock options, benefit plans, and special contribution .....	430	146
<b>Balance, end of period</b> .....	<b>\$20,753</b>	<b>\$16,086</b>

**CONDENSED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2002</b>	<b>2001</b>
	<b>(Dollars in millions)</b>	
Net cash provided by operating activities .....	\$ 4,273	\$ 2,941
Cash flows from investing activities:		
Purchases of mortgages .....	(90,861)	(58,705)
Proceeds from sales of mortgages .....	3,060	2,573
Mortgage principal repayments .....	61,367	24,034
Net decrease in investments .....	18,214	10,880
Net cash used in investing activities .....	(8,220)	(21,218)
Cash flows from financing activities:		
Proceeds from issuance of debt .....	522,470	438,420
Payments to redeem debt .....	(517,525)	(418,694)
Other .....	(1,577)	(1,257)
Net cash provided by financing activities .....	3,368	18,469
Net (decrease) increase in cash and cash equivalents .....	(579)	192
Cash and cash equivalents at beginning of period .....	1,518	617
Cash and cash equivalents at end of period .....	\$ 939	\$ 809

See Notes to Interim Financial Statements

**NOTES TO INTERIM FINANCIAL STATEMENTS**  
**(Unaudited)**

**Basis of Presentation**

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain amounts in 2001 have been reclassified to conform with the current presentation. Operating results for the three months ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. The unaudited interim financial statements should be read in conjunction with the audited financial statements and notes to financial statements that are presented in the Information Statement dated April 1, 2002.

**Derivative Instruments and Hedging Activities**

Fannie Mae issues various types of debt to finance the acquisition of mortgages. Fannie Mae typically uses derivative instruments, such as interest rate swaps, swaptions, interest rate caps, deferred rate-setting agreements, and foreign currency swaps, to hedge against the impact of interest rate movements on its debt costs to preserve its mortgage-to-debt interest spreads. Fannie Mae does not engage in trading or other speculative use of derivative instruments.

On January 1, 2001, Fannie Mae adopted Financial Accounting Standard No. 133 (FAS 133), *Accounting for Derivative Instruments and Hedging Activities*, as amended by Financial Accounting Standard No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. The adoption of FAS 133 resulted in a cumulative after-tax increase to income of \$168 million and an after-tax reduction in AOCI of \$3.9 billion. FAS 133 requires that all derivatives be recognized as either assets or liabilities on the balance sheet at their fair value. Subject to certain qualifying conditions, a derivative may be designated as either a hedge of the cash flows of a variable-rate instrument or anticipated transaction (cash flow hedge) or a hedge of the fair value of a fixed-rate instrument (fair value hedge). For a derivative qualifying as a cash flow hedge, fair value gains or losses are reported in a separate component of AOCI, net of deferred taxes, in stockholders' equity to the extent the hedge is perfectly effective and then recognized in earnings during the period(s) in which the hedged item affects earnings. For a derivative qualifying as a fair value hedge, fair value gains or losses on the derivative are reported in earnings along with fair value gains or losses on the hedged item attributable to the risk being hedged. For a derivative not qualifying as a hedge, or components of a derivative that are excluded from any hedge effectiveness assessment, fair value gains and losses are reported in earnings.



The following table reflects the hedge classification of the notional balances of derivatives by type that were held by Fannie Mae at March 31, 2002 and December 31, 2001.

	March 31, 2002			December 31, 2001		
	Cash Flow Hedges	Fair Value Hedges	Total	Cash Flow Hedges	Fair Value Hedges	Total
Interest rate swaps:						
Pay-fixed . . . . .	\$211,047	\$ 11,240	\$222,287	\$206,617	\$ 7,063	\$213,680
Receive-fixed and basis . . . . .	79,343	13,263	92,606	75,134	10,989	86,123
Interest rate caps . . . . .	84,543	—	84,543	75,893	—	75,893
Swaptions:						
Pay-fixed . . . . .	72,800	—	72,800	69,650	—	69,650
Receive-fixed . . . . .	—	80,750	80,750	—	74,400	74,400
Other (1) . . . . .	4,550	8,725	13,275	4,550	8,843	13,393
Total . . . . .	<u>\$452,283</u>	<u>\$113,978</u>	<u>\$566,261</u>	<u>\$431,844</u>	<u>\$101,295</u>	<u>\$533,139</u>

(1) Includes foreign currency swaps, forward starting swaps, and asset swaps.

The reconciliation below reflects the change in AOCI, net of taxes, associated with FAS 133 during the three months ended March 31, 2002:

Dollars in millions	Three Months Ended March 31, 2002
Balance at December 31, 2001 . . . . .	\$(7,359)
Gains on cash flow hedges, net . . . . .	1,193
Reclassifications to earnings, net . . . . .	<u>1,333</u>
Balance at March 31, 2002 . . . . .	<u>\$(4,833)</u>

### Line of Business Reporting

The following table sets forth Fannie Mae's operating net income, which excludes the effect of FAS 133 items, by line of business for the three months ended March 31, 2002 and 2001. Significant changes from period to period were due to the same factors discussed under "Results of Operations."

Three Months Ended March 31,	2002			2001		
	Portfolio Investment	Credit Guaranty	Total	Portfolio Investment	Credit Guaranty	Total
	(Dollars in millions)					
Net interest income . . . . .	\$2,269	\$ 161	\$2,430	\$1,534	\$ 173	\$1,707
Guaranty fee income . . . . .	(319)	726	407	(264)	607	343
Fee and other income (expense) . . . . .	61	(57)	4	35	(8)	27
Credit-related expenses . . . . .	—	(22)	(22)	—	(29)	(29)
Administrative expenses . . . . .	(85)	(205)	(290)	(72)	(167)	(239)
Purchased options expense . . . . .	(310)	—	(310)	(64)	—	(64)
Federal income taxes . . . . .	(487)	(102)	(589)	(335)	(117)	(452)
Extraordinary item—loss on early extinguishment of debt (net of tax effect) . . . . .	(111)	—	(111)	(55)	—	(55)
Operating net income (1) . . . . .	<u>\$1,018</u>	<u>\$ 501</u>	<u>\$1,519</u>	<u>\$ 779</u>	<u>\$ 459</u>	<u>\$1,238</u>

(1) Operating net income excludes the cumulative after-tax gain of \$168 million from the change in accounting principle upon adoption of FAS 133 on January 1, 2001. Also excludes the after-tax charge of \$512 million recognized during the first quarter of 2002 and after-tax charge of \$154 million recognized during the first quarter of 2001 for the change in fair value of the time value of purchased options. Includes after-tax charges for the amortization expense of purchased option premiums of \$202 million for the first quarter of 2002 and \$41 million for the first quarter of 2001.

The Portfolio Investment line of business represented \$792 billion, or 98 percent of total assets, at March 31, 2002 and \$689 billion, or 98 percent of total assets, at March 31, 2001.

### Commitments and Contingencies

Fannie Mae had outstanding commitments to purchase mortgages, to issue MBS, and to make other investments as shown below:

	<u>March 31, 2002</u> (Dollars in billions)
Commitments to purchase mortgages:	
Mandatory delivery .....	\$ 20
Lender option(1) .....	2
Average net yield on mandatory delivery .....	6.33%
Master commitments:	
Mandatory delivery(2) .....	\$ 27
Lender option .....	33
Other investments .....	2

(1) Excludes commitments attached to master commitments, which are included in the total for master commitments.

(2) Under a mandatory master commitment, a lender must either deliver under an MBS contract at a specified guaranty fee or enter into a mandatory portfolio commitment with the yield established upon executing the portfolio commitment.

Fannie Mae also guarantees timely payment of principal and interest on outstanding MBS and provides credit enhancements or other guarantees as summarized below:

	<u>March 31, 2002</u> (Dollars in billions)
Total MBS outstanding(1) .....	\$1,355
Amount for which Fannie Mae has primary foreclosure loss risk(2) .....	1,135
Credit enhancements .....	11
Other guarantees .....	6

(1) Includes \$459 billion of MBS held in portfolio and is net of \$595 million in allowance for losses.

(2) Fannie Mae, however, assumes the ultimate risk of loss on all MBS.

## Computation of Earnings per Common Share

The following table sets forth the computation of basic and diluted earnings per common share:

	Three Months Ended March 31,			
	2002		2001	
	Basic	Diluted	Basic	Diluted
	(Dollars and shares in millions, except per common share amounts)			
Net income before extraordinary loss and cumulative effect of change in accounting principle .....	\$1,320	\$1,320	\$1,180	\$1,180
Less: Extraordinary loss .....	(111)	(111)	(55)	(55)
Cumulative effect of change in accounting principle .....	—	—	168	168
Preferred stock dividends .....	(33)	(33)	(33)	(33)
Net income available to common stockholders .....	<u>\$1,176</u>	<u>\$1,176</u>	<u>\$1,260</u>	<u>\$1,260</u>
Weighted average common shares .....	996	996	1,000	1,000
Dilutive potential common shares(1) .....	—	6	—	6
Average number of common shares outstanding used to calculate earnings per common share .....	<u>996</u>	<u>1,002</u>	<u>1,000</u>	<u>1,006</u>
Earnings per common share before extraordinary item and cumulative effect of change in accounting principle	\$ 1.29	\$ 1.29	\$ 1.15	\$ 1.14
Net earnings per common share .....	1.18	1.17	1.26	1.25

(1) Dilutive potential common shares consist primarily of the dilutive effect from employee stock options and other stock compensation plans.

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