

2014 Annual Stress Testing Disclosure

Results of the FHFA Supervisory Severely Adverse Scenario

**As Required by the Dodd-Frank
Wall Street Reform and Consumer Protection Act**

Overview

- On November 26, 2013, FHFA implemented stress testing rules for its regulated entities, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. In accordance with the FHFA Orders issued to Fannie Mae for stress testing, Fannie Mae is providing public disclosure of the results for the Severely Adverse scenario using data as of September 30, 2013, on the nine quarters ending December 31, 2015.
- Fannie Mae's projections under the Severely Adverse scenario comply with the methodology and instructions provided by FHFA using Fannie Mae's internal stress testing process.
- The 2014 Dodd-Frank Stress Test Results disclosure included within this document has not been prepared under generally accepted accounting principles ("GAAP"). The stress test results under the FHFA Severely Adverse scenario, as disclosed in this document or otherwise, should not be viewed as forecasts of expected or likely outcomes for Fannie Mae. Rather, these projections are based solely on FHFA's hypothetical Severely Adverse scenario and other specific conditions required to be assumed by Fannie Mae. These assumptions include model assumptions necessary to project and assess the impact of the Severely Adverse scenario on the results of operations and capital position of Fannie Mae.
- Fannie Mae's financial information, prepared under GAAP, is available in reports filed with the Securities and Exchange Commission and on Fannie Mae's website, which include the Annual Report on Form 10-K for the year ended December 31, 2013.

Severely Adverse Scenario – Key Assumptions

- The Severely Adverse scenario features a severe recession in which:
 - the unemployment rate peaks to over 11% in the middle of 2015,
 - real GDP declines nearly 4.75% by the end of 2014,
 - house prices decline 25% by the end of 2015, and
 - commercial real estate prices decline nearly 35% at their trough.
- The large decline in U.S. house prices in the Severely Adverse scenario assumes some reversal of recent growth in house prices nationwide.
- Interest rates reflect both severe economic weakness and a substantial decline in inflation:
 - short-term rates remain near zero through 2015,
 - the 10-year Treasury rate falls 170 basis points and remains around 1% in 2014,
 - core inflation declines from 2.3% to below 1% in 2014, and
 - mortgage rates remain largely flat through 2015.

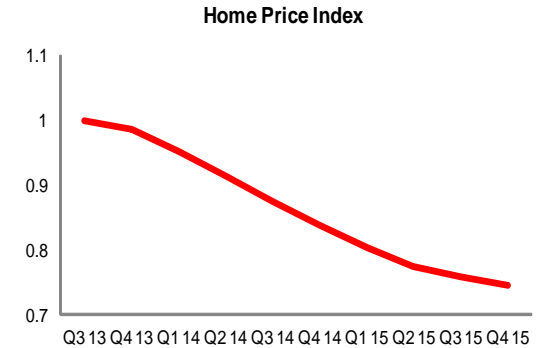
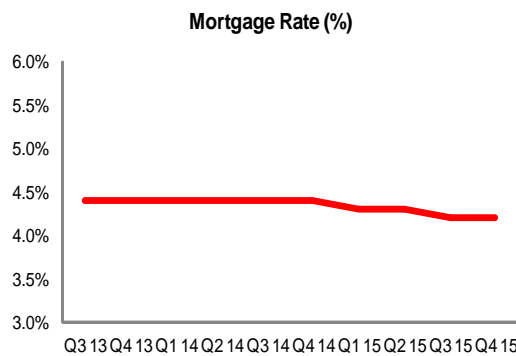
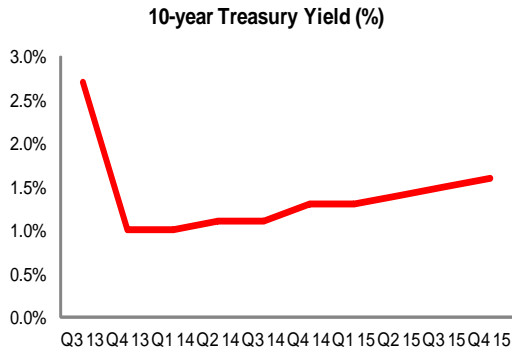
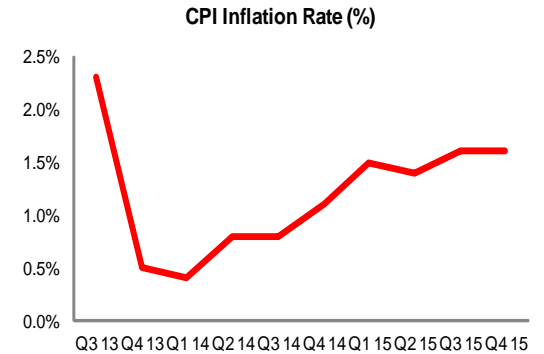
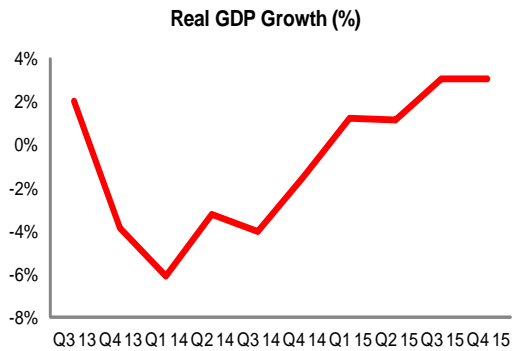
Note: Fannie Mae's Severely Adverse scenario is not an expected forecast, but a hypothetical stress scenario using Fannie Mae's internal projections by applying the rules and conditions set forth by FHFA.

Severely Adverse Scenario – Global Market Shock

- The Severely Adverse scenario also assumes a global shock to the economic drivers of asset prices. This Global Market Shock further assumes a counterparty default component. These two assumptions should be viewed as add-ons that are exogenous to the macroeconomic and financial market environment specified in the Severely Adverse scenario. The results of both assumptions are to be taken as an instantaneous loss and reduction of capital in the first quarter of the testing horizon without any future recoveries.
 - Characterized by large rate moves, sharply widening spreads, and heightened volatilities, the Global Market Shock is applied to the trading securities, available-for-sale (“AFS”) securities, and other fair value assets in Fannie Mae’s book as of September 30, 2013.
 - The Counterparty Default Component assumes the default of the counterparty that would generate the largest net loss after applying the market shock to Fannie Mae’s Securities Financing Transactions and derivative books.

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Severely Adverse Scenario – Macroeconomic Variables



Additional variables provided:

- Market volatility index
- Yields on 3-month and 5-year Treasuries
- Market shocks to securitized products and municipal & agency bonds
- 10-year BBB corporate bond yield
- Prime rate
- Commercial real estate price index

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Severely Adverse Scenario – Credit Risk Methodologies

- Credit risk is the potential for loss arising from a borrower’s failure to honor its financial obligations. Mortgage credit risk impacts Fannie Mae’s financial results through:
 - loss provisions to cover recently recognized losses on loans that Fannie Mae guarantees or owns,
 - loss provisions to build or release loss allowance, and
 - credit-related impairment for investment securities.
- Fannie Mae assesses mortgage credit risk through the use of behavioral models. These models project the likelihood of different borrower behaviors for prepayment, default, or modification at the loan level. These projected behaviors will vary according to the contractual terms of the mortgage, the borrower’s characteristics, property types, and the projected market environment.
- While forecasted losses are generally calibrated using a broad set of historical data, for Dodd-Frank Act Stress Testing (“DFAST”), Fannie Mae calibrated the model results to our actual loan performance during the recent housing crisis to ensure that the losses are more similar to what we have seen in a stress environment. This calibration to stress experience is a common practice in the Dodd-Frank stress testing processes of large banks.

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Severely Adverse Scenario – Market Risk Methodologies

- Market risk arises from fluctuations in the market value of positions, as a result of changes in market factors such as interest rates, volatility, and spreads. Fannie Mae's retained mortgage portfolio and derivative and non-mortgage asset portfolio contain market risk that impacts Fannie Mae's financials through:
 - market value changes of trading securities and derivatives recognized through net income and
 - market value changes of AFS securities recognized through other comprehensive income.
- Fannie Mae assesses market risk through the use of valuation models which incorporate behavioral models of mortgage performance (as described under Credit Risk Methodologies) and term structure models of the behavior of rates.
- For DFAST, we incorporated the market movements prescribed for the Global Market Shock into our valuation models to produce market value changes for our AFS and trading account holdings of securities.
- In addition to the Global Market Shock, Fannie Mae's projected fair value loss calculation includes applied price changes to the original securities value based upon the movement in rates and spreads.

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Severely Adverse Scenario – Counterparty Risk Methodologies

- Counterparty risk is the risk that the parties with which we do business will fail to meet their contractual obligations. Fannie Mae faces counterparty risk from our lender customers, mortgage insurers, derivative counterparties, and other financial institutions. Counterparty risk primarily impacts Fannie Mae's financials through:
 - failures of lenders to settle their representation and warranties liabilities,
 - failures of mortgage insurers to satisfy their contractual obligation on insurance claims, and
 - failures of derivative counterparties to pay or post collateral.
- For the DFAST Counterparty Default Component, we are required to assess counterparty risk on Fannie Mae's Securities Financing Transactions and derivative books. The values of these two books are shocked using the prescribed interest rates, implied volatility, and spread changes. The resulting losses in these two books are aggregated for each counterparty to determine the counterparty with the largest exposure by total net stress loss.
- The counterparty with the largest exposure to Fannie Mae after applying the Global Market Shock is presumed to default. The loss from that default is recorded as fair value loss in Q4 2013, without future recoveries.

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Severely Adverse Scenario – Operational Risk Methodologies

- Operational risk is the risk of loss resulting from inadequate or failed internal processes, systems, human factors, or external events.
- Operational risk can impact Fannie Mae's financial results in a variety of ways including:
 - errors,
 - fraudulent acts,
 - business interruptions,
 - inappropriate behavior of employees, and
 - business partners that do not perform in accordance with their arrangements.
- Operational risk is currently assessed across Fannie Mae's business lines using methods drawn from the Basel II standardized approach by applying a factor to average annual gross income.
- For DFAST, the sum of the operational risk assessments described above is applied across the nine quarters of the Severely Adverse scenario as an additional expense.

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Severely Adverse Scenario – Other Methodologies

- Pre-provision net revenue
 - Fannie Mae determines net interest income by projecting portfolio balances, income, and expense over the nine quarters using the macroeconomic variables provided, such as house price and mortgage rates.
 - Non-interest income and expense are determined at the business level using relevant macroeconomic variables and conservative management assumptions.
- (Provision) benefit for credit losses
 - Multifamily and mortgage loan charge-off projections were developed using the probability of default and loss given default models that are calibrated to the recent 2008 recession to reflect historical performance for stress.
 - FHFA has issued an advisory bulletin (AB 2012-02) requiring Fannie Mae to change the company's practice for determining when a loan is deemed uncollectible to the date when a loan is classified as a "loss." As a result, during this exercise, Fannie Mae reflects the charge-off when a loan becomes 180 days delinquent, beginning in 2015.
 - Fannie Mae estimates the allowance for loan losses and related build or release by assessing the adequacy of the reserve based on the profile and performance of the loan portfolio under the macroeconomic conditions specified in the Severely Adverse scenario.
- Mark-to-market gains (losses)
 - Fannie Mae estimates fair value gains / (losses) using the approaches described under Market Risk Methodologies.

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Severely Adverse Scenario – Other Methodologies (Cont'd)

- Outside of the Global Market Shock (see below), trading losses are based on portfolio risk positions, rate changes specified in the scenario, and historical stress spread levels.
- Global market shock impact on trading securities and counterparty
 - Instantaneous global market shocks were applied to Fannie Mae's positions as of September 30, 2013. The impact of the shocks is reflected during the first quarter of the forecast period, without subsequent recoveries.
 - Fannie Mae's estimate of the global market shock includes the counterparty default losses using the approaches as described under Counterparty Risk Methodologies and using the assumptions required by the Counterparty Default Component.
- Other comprehensive income ("OCI")
 - The impact of the instantaneous global market shocks applied to Fannie Mae's AFS positions are reflected in OCI during the first quarter of the forecast period, without subsequent recoveries. AFS losses outside of the Global Market Shock are based on portfolio risk positions, rate changes specified in the scenario, and historical stress spread levels.
- Deferred Tax Assets
 - As directed by FHFA, the results reflect a range with and without the re-establishment of the valuation allowance against deferred tax assets in Q4 2013. This impacts the incremental Treasury draws and remaining funding commitment under the Senior Preferred Stock Purchase Agreement ("SPSPA").

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Use of Stress Test Results in Capital Planning and Funding Commitment

- Fannie Mae management does not expect to engage in significant capital management actions while Fannie Mae is under conservatorship.
- Fannie Mae's capital is governed by the SPSPA. Under this agreement, Treasury provides Fannie Mae with a funding commitment, of which \$117.6B remained available as of September 30, 2013. The stress test results reflect a range in remaining funding commitment contingent upon the treatment of the deferred tax assets.
- The SPSPA restricts the recapitalization of Fannie Mae through its quarterly dividend obligations, which are equal to our net worth as of the prior quarter-end minus a capital reserve amount. Under the SPSPA, the capital reserve amount was \$3.0B in 2013 and is reduced by \$0.6B each year until it reaches \$0 on January 1, 2018.
- The SPSPA also restricts Fannie Mae from the following types of distributions of capital:
 - issuing additional equity,
 - repurchasing or redeeming common stock or preferred stock, and
 - paying dividends on common stock or preferred stock other than the senior preferred stock.

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Pro Forma Results – Financial Highlights in FHFA Required Format

Dodd Frank Severely Adverse Stress Test (\$ in billions)	Cumulative Projected Financial Metrics (Q4 2013 - Q4 2015)		
	Results without re-establishing valuation allowance on deferred tax assets	Impact of re-establishing valuation allowance on deferred tax assets	Results with re-establishing valuation allowance on deferred tax assets
1 Pre-provision net revenue ¹	\$ 31.0	-	\$ 31.0
2 (Provision) benefit for credit losses	(53.3)	-	(53.3)
3 Mark-to-market gains (losses) ²	(11.1)	-	(11.1)
4 Global market shock impact on trading securities and counterparty	(6.8)	-	(6.8)
5 Net income before taxes	(40.2)	-	(40.2)
6 (Provision) benefit for taxes	16.4	(62.7)	(46.3)
7 Other comprehensive income ³	(13.6)	-	(13.6)
8 Total comprehensive income	(37.4)	(62.7)	(100.2)
9 PSPA funding commitment as of September 30, 2013 ⁴	117.6		117.6
10 Treasury draws required	34.4	62.7	97.2
11 Remaining PSPA funding commitment ⁴	83.1	(62.7)	20.4
12 Credit losses (\$s) ⁵	55.9	-	55.9
13 Credit losses (% of average portfolio balance)	1.93%	-	1.93%

¹ amount includes net interest income, security impairments, operational risk losses, foreclosed property income (expense), and other non-interest income/expenses.

² amount includes fair value gains (losses) on derivative and trading securities, and other gains (losses) on investment securities.

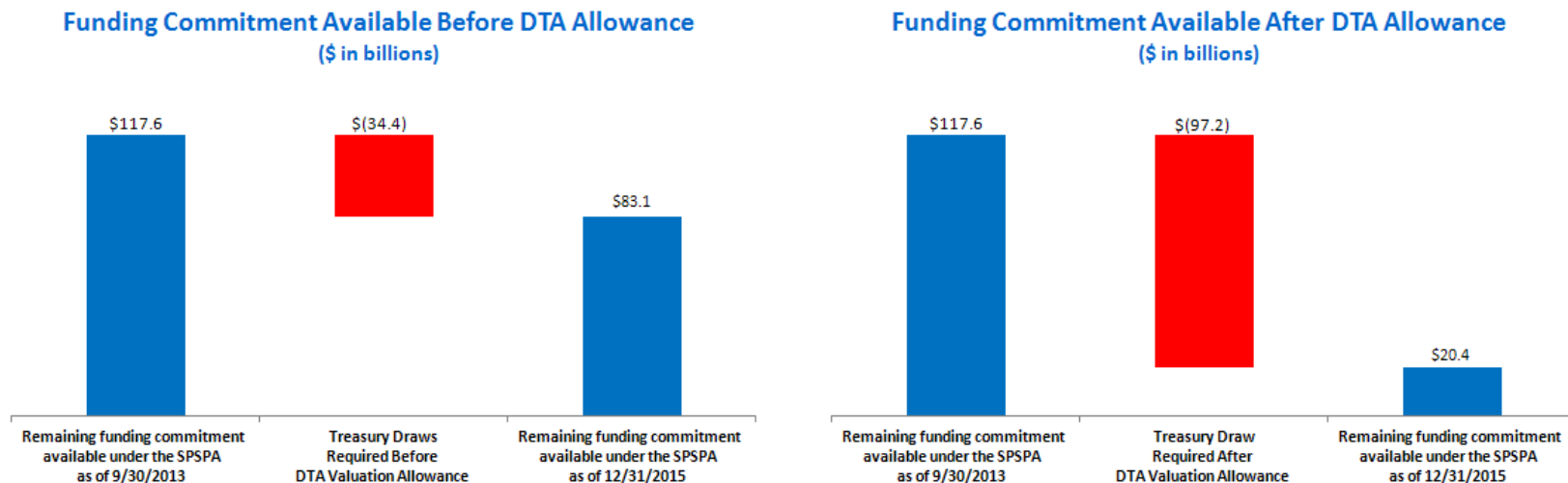
³ amount includes the global market shock impact on available-for-sale securities.

⁴ PSPA is the Senior Preferred Stock Purchase Agreement (SPSPA) between U.S. Treasury and Fannie Mae.

⁵ credit losses are defined as charge-offs, net plus foreclosed property expenses.

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Pro Forma Results – Funding Commitment



- The remaining funding commitment available under the SPSPA as of September 30, 2013, was \$117.6B, and the range of Treasury draws, depending on the treatment of deferred tax assets, is between \$34.4B and \$97.2B.
- The remaining funding commitment available under the SPSPA is \$83.1B without establishing the valuation allowance against deferred tax assets. Assuming there was a re-establishment of the valuation allowance, the remaining funding commitment available would be \$20.4B.

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