FEDERAL NATIONAL MORTGAGE ASSOCIATION FANNIE MAE
Form 10-Q
May 08, 2014

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

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File No.: 0-50231
Federal National Mortgage Association
(Exact name of registrant as specified in its charter)
Fannie Mae

Federally chartered corporation	52-0883107
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3900 Wisconsin Avenue, NW Washington, DC	20016
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code:
(202) 752-7000
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
As of March 31, 2014, there were 1,158,080,657 shares of common stock of the registrant outstanding.

TABLE OF CONTENTS

MD&A TABLE REFERENCE

PART I—FINANCIAL INFORMATION

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

We have been under conservatorship, with the Federal Housing Finance Agency ("FHFA") acting as conservator, since September 6, 2008. As conservator, FHFA succeeded to all rights, titles, powers and privileges of the company, and of any shareholder, officer or director of the company with respect to the company and its assets. The conservator has since delegated specified authorities to our Board of Directors and has delegated to management the authority to conduct our day-to-day operations. Our directors do not have any fiduciary duties to any person or entity except to the conservator and, accordingly, are not obligated to consider the interests of the company, the holders of our equity or debt securities or the holders of Fannie Mae MBS unless specifically directed to do so by the conservator. We describe the rights and powers of the conservator, key provisions of our agreements with the U.S. Department of the Treasury ("Treasury"), and their impact on shareholders in our Annual Report on Form 10-K for the year ended December 31, 2013 ("2013 Form 10-K") in "Business—Conservatorship and Treasury Agreements."

You should read this Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") in conjunction with our unaudited condensed consolidated financial statements and related notes and the more detailed information in our 2013 Form 10-K.

This report contains forward-looking statements that are based on management's current expectations and are subject to significant uncertainties and changes in circumstances. Please review "Forward-Looking Statements" for more information on the forward-looking statements in this report. Our actual results may differ materially from those reflected in our forward-looking statements due to a variety of factors including, but not limited to, those discussed in "Risk Factors" and elsewhere in this report and in "Risk Factors" in our 2013 Form 10-K.

You can find a "Glossary of Terms Used in This Report" in the "MD&A" of our 2013 Form 10-K.

INTRODUCTION

Fannie Mae is a government-sponsored enterprise ("GSE") that was chartered by Congress in 1938. We serve an essential role in the functioning of the U.S. housing market and are investing in improvements to the U.S. housing finance system. Our public mission is to support liquidity and stability in the secondary mortgage market, where existing mortgage-related assets are purchased and sold, and to increase the supply of affordable housing. Our charter does not permit us to originate loans or lend money directly to consumers in the primary mortgage market.

Fannie Mae provides reliable, large-scale access to affordable mortgage credit and indirectly enables families to buy, refinance or rent homes. We securitize mortgage loans originated by lenders into Fannie Mae mortgage-backed securities that we guarantee, which we refer to as Fannie Mae MBS. One of our key functions is to evaluate, price and manage the credit risk on the loans and securities that we guarantee. We also purchase mortgage loans and mortgage-related securities for securitization and sale at a later date and, to a declining extent, for our retained mortgage portfolio. We use the term "acquire" in this report to refer to both our securitizations and our purchases of mortgage-related assets. We obtain funds to support our business activities by issuing a variety of debt securities in the domestic and international capital markets, which attracts global capital to the United States housing market.

Our conservatorship has no specified termination date, and we do not know when or how the conservatorship will terminate, whether we will continue to exist following conservatorship, what changes to our business structure will be made during or following the conservatorship, or what ownership interest, if any, our current common and preferred stockholders will hold in us after the conservatorship is terminated. In addition, our agreements with Treasury that provide for financial support include covenants that significantly restrict our business activities and provide for dividends to accrue at a rate equal to our net worth less a capital reserve amount, allowing us to retain only a limited and decreasing amount of our net worth. We provide additional information on the conservatorship, the provisions of our agreements with Treasury, and their impact on our business in our 2013 Form 10-K in "Business—Conservatorship and Treasury Agreements" and "Risk Factors." We discuss the uncertainty of our future in "Executive Summary—Outlook" and "Risk Factors." We discuss proposals for housing finance reform that could materially affect our business in "Legislative and Regulatory Developments—Housing Finance Reform" in this report and in "Business—Housing Finance Reform" in our 2013 Form 10-K.

Although Treasury owns our senior preferred stock and a warrant to purchase 79.9% of our common stock, and has made a commitment under a senior preferred stock purchase agreement to provide us with funds to maintain a positive net worth under specified conditions, the U.S. government does not guarantee our securities or other obligations.

1

Our common stock is traded in the over-the-counter market and quoted on the OTC Bulletin Board under the symbol "FNMA." Our debt securities are actively traded in the over-the-counter market.

EXECUTIVE SUMMARY

Our Strategy and Progress

We are focused on:

- achieving strong financial performance and strengthening our book of business;
- supporting the housing recovery by providing reliable, large-scale access to affordable mortgage credit and helping struggling homeowners; and
- helping to lay the foundation for a safer, transparent and sustainable housing finance system going forward.

Achieving strong financial performance and strengthening our book of business

Our actions to accomplish these goals have had a positive impact:

- Financial Performance. We reported net income of $5.3 billion and pre-tax income of $7.9 billion for the first quarter of 2014, compared with net income of $58.7 billion and pre-tax income of $8.1 billion for the first quarter of 2013. See "Summary of Our Financial Performance" below for an overview of our financial performance for the first quarter of 2014, as compared with the first quarter of 2013. As of March 31, 2014, we have been profitable for nine consecutive quarters, and we expect to remain profitable for the foreseeable future. For more information regarding our expectations for our future financial performance, see "Outlook—Financial Results" and "Outlook—Revenues" below.
- Dividend Payments to Treasury. With our expected June 2014 dividend payment to Treasury, we will have paid a total of $126.8 billion in dividends to Treasury on our senior preferred stock. The aggregate amount of draws we have received from Treasury to date under the senior preferred stock purchase agreement is $116.1 billion. Under the terms of the senior preferred stock purchase agreement, dividend payments do not offset prior Treasury draws. See "Outlook—Dividend Obligations to Treasury" below for more information regarding our dividend payments to Treasury.
- Book of Business. Changes we have made beginning in 2008 to strengthen our underwriting and eligibility standards have improved the credit quality of our single-family guaranty book of business. Single-family loans we have acquired since the beginning of 2009 (referred to as our "new single-family book of business") comprised 78% of our single-family guaranty book of business as of March 31, 2014, while the single-family loans we acquired prior to 2009 (referred to as our "legacy book of business") comprised 22% of our single-family guaranty book of business. As described below in "Strengthening Our Book of Business—New Book of Business," we expect that our new single-family book of business will be profitable over its lifetime.
- Credit Performance. As of March 31, 2014, our single-family serious delinquency rate had declined for sixteen consecutive quarters. Our single-family serious delinquency rate was 2.19% as of March 31, 2014, compared with 2.38% as of December 31, 2013. See "Improving the Credit Performance of our Book of Business" below for additional information on the credit performance of the mortgage loans in our single-family guaranty book of business for each of the last five quarters, and for a description of our strategies for reducing credit losses on our legacy book of business.

Although we have improved our financial performance and the quality of our book of business since entering into conservatorship in 2008, we remain under conservatorship and subject to the restrictions of the senior preferred stock purchase agreement with Treasury. As a result of the senior preferred stock purchase agreement and directives from our conservator, we are not permitted to retain our net worth (other than a limited amount that will decrease to zero by 2018), rebuild our capital position or pay dividends or other distributions to stockholders other than Treasury. See "Business—Conservatorship and Treasury Agreements" in our 2013 Form 10-K for more information regarding our conservatorship and our senior preferred stock purchase agreement with Treasury. In addition, the future of our company remains uncertain. Congress continues to consider options for reform of the housing finance system, including the GSEs, and we cannot predict the prospects for the enactment, timing or final content of housing finance reform legislation. See "Legislative and Regulatory Developments—Housing Finance Reform" in this report and "Business—Housing Finance Reform" in our 2013 Form 10-K for information on recent proposals for housing finance reform.

Supporting the housing recovery by providing reliable, large-scale access to affordable mortgage credit and helping struggling homeowners

We continued our efforts to support the housing recovery in the first quarter of 2014. We remained the largest single issuer of mortgage-related securities in the secondary market during the first quarter of 2014 and a continuous source of liquidity in the multifamily market. We also continued to help struggling homeowners. In the first quarter of 2014, we provided over 48,000 loan workouts to help homeowners stay in their homes or otherwise avoid foreclosure. We discuss our activities to support the housing and mortgage markets in "Contributions to the Housing and Mortgage Markets" below.

Helping to lay the foundation for a safer, transparent and sustainable housing finance system going forward

We also continued our efforts to help build a sustainable housing finance system, including pursuing the strategic goals identified by our conservator: build a new infrastructure for the secondary mortgage market; gradually contract our dominant presence in the marketplace while simplifying and shrinking our operations; and maintain foreclosure prevention activities and credit availability for new and refinanced mortgages. We discuss these goals in our 2013 Form 10-K in "Business—Executive Summary—Helping to Build a Sustainable Housing Finance System."

In addition to working on FHFA's goals, we are also working on additional related initiatives to help prepare our business and infrastructure for potential future changes in the structure of the U.S. housing finance system and to help ensure our safety and soundness during conservatorship. These projects will likely take several years to implement. We are devoting significant resources to and incurring significant expenses in implementing FHFA's objectives and these additional related initiatives.

Summary of Our Financial Performance

Comprehensive Income

We recognized comprehensive income of $5.7 billion in the first quarter of 2014, consisting of net income of $5.3 billion and other comprehensive income of $372 million. In comparison, we recognized comprehensive income of $59.3 billion in the first quarter of 2013, consisting of net income of $58.7 billion and other comprehensive income of $654 million.

Our comprehensive income for the first quarter of 2014 included a provision for federal income taxes of $2.6 billion resulting from our estimated federal income tax liability for the first quarter of 2014. Our comprehensive income for the first quarter of 2013 included a benefit for federal income taxes of $50.6 billion resulting from the release of the substantial majority of our valuation allowance against our deferred tax assets. We discuss the factors that led to our conclusion to release the valuation allowance against our deferred tax assets in "Critical Accounting Policies and Estimates—Deferred Tax Assets" and "Note 10, Income Taxes" in our 2013 Form 10-K.

Our pre-tax income was $7.9 billion in the first quarter of 2014 compared with $8.1 billion in the first quarter of 2013. The decrease in our pre-tax income was primarily due to fair value losses and a decline in net interest income in the first quarter of 2014. These decreases were offset by income from settlement agreements resolving certain lawsuits relating to private-label mortgage-related securities ("PLS") sold to us, resolutions we entered into relating to representation and warranty matters and compensatory fees related to servicing matters. In the first quarter of 2014, we recognized $4.7 billion in income related to these arrangements, compared with $820 million in the first quarter of 2013.

Fair value losses of $1.2 billion in the first quarter of 2014 were primarily driven by derivative fair value losses as longer-term swap rates declined in the first quarter of 2014 compared with fair value gains of $834 million in the first quarter of 2013 primarily driven by derivative fair value gains as swap rates increased in the first quarter of 2013.

Net interest income decreased to $4.7 billion in the first quarter of 2014 from $6.3 billion in the first quarter of 2013, primarily due to a decline in the average balance of our retained mortgage portfolio, partially offset by higher guaranty fee income. Also contributing to the decline in our net interest income in the first quarter of 2014 compared with the first quarter of 2013 was our recognition in the first quarter of 2013 of $518 million of income from unamortized cost basis adjustments on loans repurchased by Bank of America as part of the resolution agreement that was entered into in January 2013.

Credit-related income decreased to $1.0 billion in the first quarter of 2014 from $1.2 billion in the first quarter of 2013. Our credit results for the first quarter of 2014 were primarily driven by higher discounted cash flow projections on our individually impaired loans due to a decrease in mortgage interest rates in the first quarter of 2014. Lower mortgage interest rates shorten the expected lives of modified loans, which reduces the impairment on these loans and results in a decrease in the provision for credit losses. In the first quarter of 2013, our credit results were primarily driven by an increase in home prices, including the sales prices of our REO properties as a result of strong demand in the first quarter of 2013.