FannieMae

Subject:	4th Quarter 2012 Valuation Allowance Conclusion
Date:	March 25, 2013
Prepared by:	Vicki Lyons, VP for Tax
Approved by:	Chryssa Halley – VP & Asst Controller for Capital Markets & Operations Greg Fink – SVP & Controller, Finance
Primary Interpretive Guidance:	• Accounting Standards Codification 740, *Income Taxes* ("ASC 740")
Attachments:	Appendix A – 4Q12 Valuation Allowance Memo sent to SEC Appendix B-Accounting Policy Framework sent to SEC Appendix C-Presentation to SEC Appendix D - FHFA Deferred Tax Presentation Appendix E-Confirmation Letter Appendix F-Comparison of Weighting Tables

EXECUTIVE SUMMARY

Fannie Mae ("We/Us" or the "Company") has deferred income tax assets ("DTAs") of $59.0 billion as of December 31, 2012. The Company has concluded, as of December 31, 2012, that, based on the weight of available positive and negative evidence, it is more likely than not that substantially of all of the DTAs will not be realized. Therefore, the Company will continue to record a valuation allowance against its DTA except for certain DTAs and deferred tax liabilities ("DTLs") related to unrealized gains and losses in our available-for-sale ("AFS") securities portfolio.

The Company arrived at this conclusion after substantial analysis conducted since the beginning of January when 2012 results were being generated, and discussions with the Federal Housing Finance Agency ("FHFA" or the "Conservator") and the Securities and Exchange Commission ("SEC"). The Company provided a comprehensive analysis on February 28, 2013 to the United States Securities and Exchange Commission ("SEC") which supported its initial position to release the valuation allowance as of December 31, 2012 After a series of discussions, the SEC did not object to the Company's position of releasing the valuation allowance as of December 31, 2012 but also suggested that other reasonable people reviewing the same set of facts and evidence may come to another conclusion and that they did not object to releasing the allowance in a future period. After these events, the Company reconsidered its initial analysis, reviewed the weighing of the evidence, and had further discussions with FHFA.

In subsequent discussions, FHFA clarified its view on conservatorship and the amount of available capital necessary for the Company. In a presentation provided to the Company on March 14, 2013 (see Appendix D) FHFA indicated that releasing the valuation allowance and causing a reduction in available capital of $34 billion (the amount of reduction in available capital if the Company released the valuation allowance as of December 31, 2012) would force the Conservator to take certain actions. The Conservator advised us that, if the amount of funds available under the agreement was reduced as a result of our releasing the valuation allowance in the fourth quarter of 2012, they would need to ensure the preservation of our remaining capital and undertake regulatory actions that could severely restrict our operations, increase our costs, or otherwise substantially limit or change our business in order to ensure the continued safety and soundness of our operations.

While the evidence related to our limitation of the amount of funds available for future draws was included in the original analysis as negative evidence, FHFA's specific actions to limit certain business activities to preserve capital had not been previously provided to the Company. Based on this new objective negative evidence of the consequences from a reduction in our capital, an increased negative weighting on our recent profitability highlighted by our SEC discussion combined with the evidence previously considered, the Company's updated analysis of all available evidence provided that the negative evidence outweighed the positive evidence and therefore we concluded that it is not more likely than not that we will we realize our DTA amounts as of December 31, 2012.

I. BACKGROUND

After completing the initial analysis and having extensive discussions with senior management as well as the audit committee and the entire Board of Directors, management sought to consult with the SEC. We provided the SEC with our fourth quarter 2012 Valuation Allowance memorandum as of February 26, 2013 (see Appendix A), our accounting policy framework for evaluating the release of the valuation allowance (see Appendix B), and a presentation of the summary of the facts and evidence considered (see Appendix C). This included stress testing of our book and other market factors, future projections, and actual 2012 results. Three discussions were held with the SEC.

In the initial meeting on February 28, 2013, based on facts known at that time, the Company presented an analysis to release the valuation allowance as of December 31, 2012 and requested that the SEC provide a viewpoint on the analysis provided. The second meeting via telephone conference call on March 5, 2013 was to answer follow-up questions from the SEC. These questions were related to the credit models and our process on forecasting.

The third meeting was via telephone conference on Friday March 8, 2013 in which the SEC provided their conclusion to Fannie Mae and FHFA. The SEC did not object with the Company's position to release the valuation allowance in the fourth quarter of 2012, but suggested that a reasonable person could come to an alternate conclusion. The basis for an alternate conclusion is that a reasonable person could weigh evidence differently and therefore, the SEC would not object to a later period. The SEC suggested that different weight could be applied to 1) the three year cumulative pre-tax book loss, 2) the recent nature of positive financial results, and 3) the status of the Company in conservatorship and the impact that could have on the Company's business. The SEC said that they would provide a "no objection" confirming letter to the Company based on the final conclusion arrived at with FHFA.

On March 14, 2013, the Conservator presented the Company with key factors in their analysis (see Appendix D) of the need for a valuation allowance against the DTA. They provided new information for the Company to review in its analysis. The key points in their analysis included:

- Reduction to capital was the key driver for their concerns. The reduction in capital capacity from the U.S. Treasury and the Senior Preferred Stock Purchase Agreement ("SPSPA") agreements places undue risk on the future of the Company in conservatorship. FHFA will require the Company to further curtail our current and future business activities and reduce the risk in the existing book commensurate with sharply reduced capital levels. Any capital constrained entity would be required to limit new business, improve risk adjusted returns, and initiate actions to preserve the franchise value, thus, a change to the business model.
- The Conservator would need to take action if the Company has a reduction in available capital. The specific array of actions that would be possible is not known.
- In their view, the Treasury credit facility under the SPSPA can no longer be amended.

The Company's management met with the Audit Committee and Board of Directors several times to discuss the analysis and process. These included meetings or calls on:

DT-055485

February 24, 2013 – Audit Committee Conference Call regarding DTA and Discussion of FHFA feedback
March 12, 2013 – Board of Directors Conference Call regarding 10-K Filing Status Update
March 19, 2013 – Audit Committee Conference Call regarding 10-K Filing Status Update
March 20, 2013 – Audit Committee Meeting regarding 10-K Filing Status Update

The Board of Directors supported the Company's position that was presented to the SEC but the Board of Directors thought the company should take into consideration all of the points raised by the SEC and confirm the Company's position. In the Audit committee meeting on march 20, 2013, the Company presented its revised analysis which included the table in the analysis section of this memo and the audit Committee supported the assessment presented that the Company should not release the valuation allowance on the DTAs as of December 31, 2013.

II. ANALYSIS AND CONCLUSION

Given the feedback from FHFA and the SEC, the Company reassessed the weight ascribed to each piece of evidence and updated the chart used to weigh the available evidence in determining whether it is more likely than not that the DTA will or will not be realized. The chart identifies the objective and subjective evidence weighed by the Company. In this memo we enhanced our original analysis by employing not only a qualitative assessment of the evidence but also a quantitative weighing of the evidence by creating a numerical scale for each type and weight of evidence. Objective evidence was weighted 50% higher than subjective which we believe was sufficient to comply with the guidance that ascribes more weight to objective evidence. Additionally, we reduced and condensed the list of evidence to categories which we believe represented the most critical factors in making a determination.

Deferred Tax Asset – Evidence Grid
For the period ended December 31, 2012

	Rating				Weighted	Max	
Objective Factors	**Description**		**#**	**Weight**	**Rating**	**Weight**	**%**
Positive book and tax results	Positive	High	3.00	1.50	4.50	4.50	
Recent profitability	Negative	Medium	(2.00)	1.50	(3.00)	4.50	
Good book	Positive	High	3.00	1.50	4.50	4.50	
Bad book	Negative	Medium	(2.00)	1.50	(3.00)	4.50	
Existing revenue streams	Positive	High	3.00	1.50	4.50	4.50	
State of housing market	Negative	Low	(1.00)	1.50	(1.50)	4.50	
Cumulative 3 year pretax book gain/loss	Negative	Low	(1.00)	1.50	(1.50)	4.50	
Declining DTA balance (use of tax attributes)	Positive	Low	1.00	1.50	1.50	4.50	
Reduction in capital available	Negative	High	(3.00)	1.50	(4.50)	4.50	
Conservatorship	Negative	Medium	(2.00)	1.50	(3.00)	4.50	
Subjective Factors							
Positive forecast	Positive	High	3.00	1.00	3.00	3.00	
Uncertainty about forecast	Negative	Low	(1.00)	1.00	(1.00)	3.00	
Uncertainty in economy	Negative	Low	(1.00)	1.00	(1.00)	3.00	
Limited availability of federal draw	Negative	Medium	(2.00)	1.00	(2.00)	3.00	
Average for objective factors			(0.10)		(0.15)	4.50	
Average for subjective factors			(0.25)		(0.25)	3.00	
Average for objective and subjective factors			**(0.14)**		**(0.18)**	**4.07**	**45.61%**

The most significant changes of the evidence in the revised analysis from the original analysis provided to the SEC and managements initial conclusion is the Conservator's view of the Company's access to available capital, the reduction of capital due to the release of the valuation allowance in the fourth quarter of 2012, and the actions that the Conservator would take in response to a fourth quarter release to constrain the Company's business which in turn would impact the Company's positive financial results and make future projections of income no longer supportable. This is significant evidence which we weigh as a high negative as of December 31, 2012.

The Company added additional negative weight to the recent nature of our profits. Additionally, we changed the rating of the declining DTA balance (use of tax attributes) to a low positive because the tax attributes only comprise approximately 10 percent of the overall DTA. The Conservator provided its input on the weighting of other evidence and suggested that more negative weight should be assigned to the three-year cumulative pre-tax book loss as of December 31, 2012. While we considered this change, we ultimately did not change the weight primarily because this has been addressed through adding additional negative weight given to recent profitability. As of the date of our final conclusion, the three-year cumulative pre-tax book loss (calculated on a basis of twelve rolling quarters) is currently in a three-year cumulative pre-tax book income. This will be the Company's fifth quarter with pre-tax book income. For a complete list of original factors and a comparison to the new table see Appendix F.

Based on the weighing of the evidence as shown in the above evidence grid, the Company believes that the negative evidence slightly outweighs the positive evidence as of December 31, 2012. Thus it is more likely than not that the DTA will not be realized and a valuation allowance will be maintained.

We will continue to evaluate the recoverability of our deferred tax assets each quarter. Our evaluation in future quarters will be made by reviewing all relevant factors as of the end of those periods, including the factors discussed above to the extent applicable. Releasing all of a portion of the valuation allowance after December 31, 2012 will not reduce the funding available to us under the SPSPA. In addition, we expect that, as of the first quarter of 2013, we will no longer be in a three-year cumulative loss position. Accordingly, we believe that we may release the valuation allowance as early as the first quarter of 2013.

.

Appendix A – 4Q12 Valuation Allowance Memo sent to SEC

SEC_VA
Memo_2-26-2013.pdf

Appendix B-Accounting Policy Framework sent to SEC

Framework - Release
of Valuation Allowanc

Appendix C-Presentation to SEC

SEC_Deck_2_26_201
3.pdf

Appendix D - FHFA Deferred Tax Presentation

Appendix D - FHFA
Presentation_FNM_D

Appendix E-Confirmation Letter

Appendix E - SEC
Confirmation Letter.P

Appendix F-Comparison of Weighting Tables

Appendix F -
Comparison of Weigh