

# CEO Report

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**Dan Mudd**  
**July 19, 2005**

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# Executive Summary

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- **Business Update:** Stable performance but competition remains fierce across the board; must reevaluate strategies in light of environment
- **Restatement:** Planning to staffing to broad engagement
- **Housing and Minority Lending Goals:** HUD goals on track but minority lending goals require a new approach; initiated several strategies to mitigate projected shortfall
- **Single-Family CORE:** Wholesale change of management team; retention of advisor for the project duration; engaging external Independent Verification and Validation Services
- **HR Update:** Focusing on senior team, culture and diversity
- **Legislative Status:** House draft bill out, Senate bill pending, and Administration seeking tougher reforms; key issues continue to be portfolio growth limits and MBA bright line
- **180-day Plan:** Completing key links in the chain and extensive outreach

**Challenge of old model / culture caught in a new environment**

# Business Update: Guaranty Business

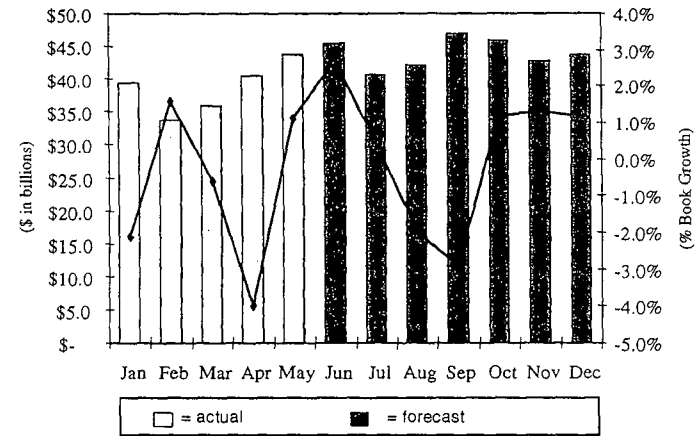
## Single-Family

- Volume through May (\$193B) under plan
- Volume outlook for the year (\$500B) on par with plan
- Full year book growth forecast (-0.2%) under plan
- Net charged fee through May (25.14 bps) under plan
- Credit risks and affordability concerns have increased dramatically in the highly competitive mortgage market
- Continuing to focus on:
  - Business retention
  - Competitive pressures (private label and subprime)
  - Regulatory and minority lending goals

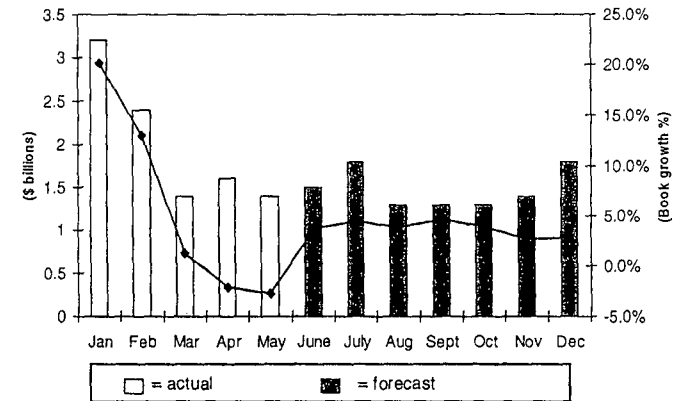
## Multifamily

- Volume through June (\$11.2B) \$2.1B above plan; pipelines are holding steady
- Charged guaranty fee through June (24.1 bps) above plan (22.8 bps)
- Pricing for loans on conventional properties continues to be extremely low due to competition; balanced out with higher fees on specialty products
- Profitability and credit standards are major concern
- DUS Advisory Council met June 2-3 – they are concerned with low pricing and diminished historical advantages
- Lender Delegation Pilot planned for September 1 roll-out to address DUS concern

Single-Family Volume and Book Growth



Multifamily Debt & Equity Volume and Debt Book Growth



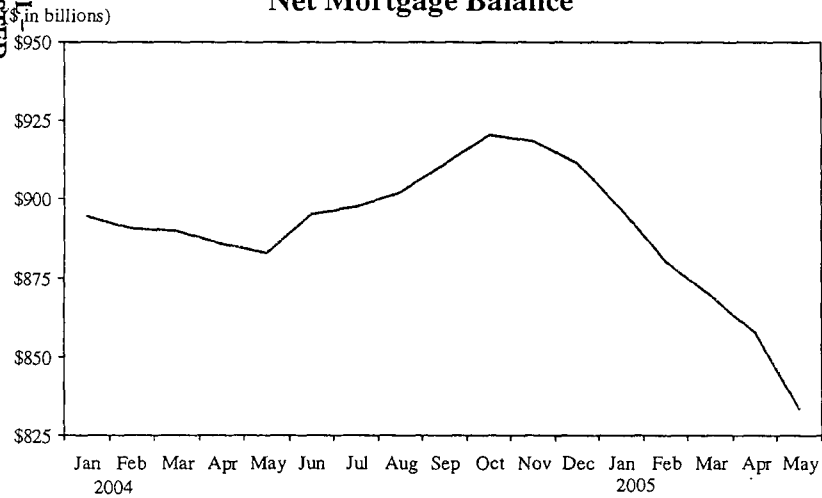
# Business Update: Portfolio Business

- Short-term interest rates have gradually increased over the year in line with the continuation of Fed Funds rate hikes
- Debt to swap spreads have improved considerably over the course of the year due to decreased agency issuance and perceived changes in the regulatory environment
- Mortgage option adjusted spreads have remained very tight despite lower levels of agency purchase activity
- Continuing to actively manage the portfolio duration gap position, with the monthly gap reported at +/- 1 month or less through May
- Mortgage balance growth through May is -20% annualized, driven by tight mortgage option adjusted spreads and our need to conserve statutory capital in support of the Capital Restoration Plan

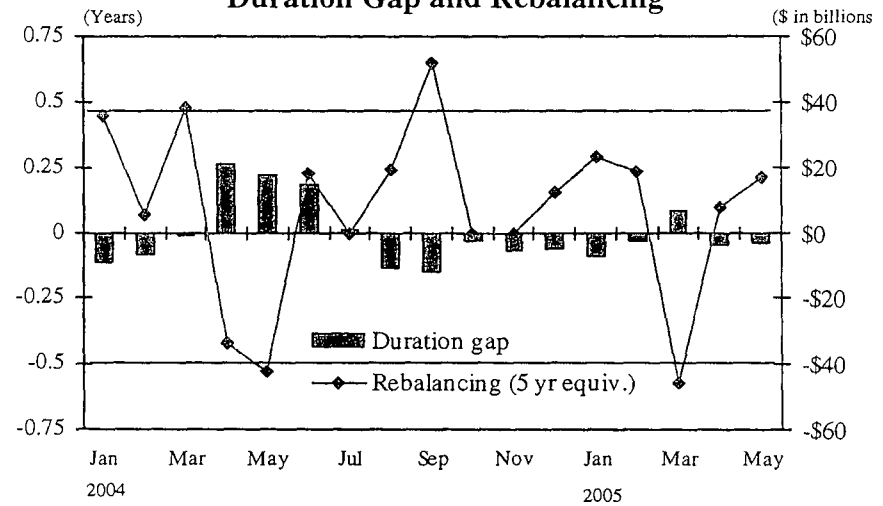
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**Net Mortgage Balance**



**Duration Gap and Rebalancing**



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# Housing and Minority Lending Goals

## STATUTORY HOUSING GOALS

	FY05 Plan	5/05 YTD Actual
Low Mod (Affordable)	52.0%	55.5%
Special Affordable	22.0%	26.7%
Underserved	37.0%	41.3%
	FY05 SF PMM Sub-Goal Plan	5/05 YTD Actual
Low Mod (Affordable)	45.0%	45.5%
Special Affordable	17.0%	18.9%
Underserved	32.0%	32.5%

- Ahead of targets for all housing goal categories
- Loss of share to subprime, interest only, and option ARMs products, all attracting mission borrowers relative to our “core” products

## MINORITY LENDING GOALS

	FY05 Target	5/05 YTD Actual
African American	5.4%	5.5%
Hispanic	11.6%	11.0%
Total Minority	24.7%	23.8%

- Results through May behind goal for Hispanic (10.99% vs. goal of 11.6%) and total minority (23.78% vs. goal of 24.7%)
- Though minority lending scores are trending down, we have initiated several strategies to mitigate the projected shortfall:
  - Puerto Rico transactions
  - CRA transactions
  - My Community Mortgage enhancements
- The results of these efforts should begin to show in June; our preliminary total minority score for June is 24.62%. Further improvement possible upon receipt of Countrywide's June borrower data in July

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# Single-Family CORE Update

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## Original Goal of the Project

- Replace Fannie Mae's core infrastructure in 18 months
- Retire 35 legacy systems; enable mass customized products
- Make it easier for customers to do business with us

## What Happened?

- "Big Bang" development/rollout strategy was front-loaded
- Project was too big, ramped quickly; parallel development efforts ensued
- Team made several heroic but unsuccessful implementation attempts
- System design did not scale to meet performance requirements
- Not all of the functionality could be tested due to performance issues
- Multiple external reviews conducted throughout project
- CEO requested additional external review of status/viability

## What Do We Have?

- Database is solid; software licenses and hardware useable
- Software is in various stages of development, testing, and re-write
- Some requirements are missing, not traceable, and potentially stale
- Significant rewrite required to move from interactive model to batch
- Loss of credibility with internal and external stakeholders; team morale low

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# Single-Family CORE Update

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## What We've Done So Far to Fix it

- Implementation of consultants' recommendations:
  - Simplifying databases; making systems less interactive
  - Building better test environments
- Wholesale change of management team; retention of the CSC advisor for the project duration; engaging external "Independent Verification and Validation" services
- Reorganization of CORE into a group of smaller, more manageable projects with a multi-phase release strategy; focusing first on Servicing and Investor Reporting
- Creation of a standard development and release strategy and abandoning the "Big Bang"
- Engagement of Accenture to review and ensure integrity of all financial reporting controls

## What's Next

- Replace customer-facing components of the Acquisitions systems
- Servicing for cash business can be implemented in late 2006
- MBS and Investor Reporting will follow in 2007
- Reduce scope to reduce implementation risk
- Acquisitions systems are still under review and will take 60 more days to assess
- Moving some Securitization components to Conduit effort

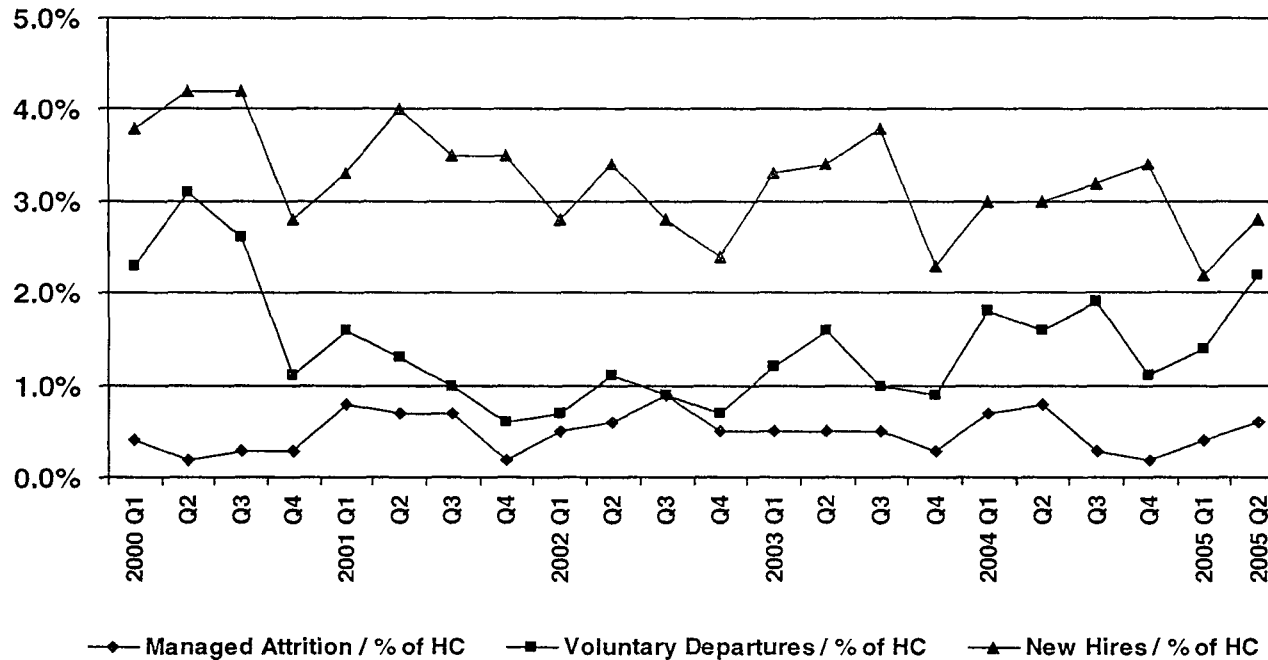
## Costs

- Re-planning in process to be completed by the end of September
- Estimated costs for Servicing and Investor Reporting: \$60-75M for each of the next two years (current run rate is \$80M for 2005).

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# HR Update – Turnover

Attrition and Onboarding as a Percent of Total Headcount (2000 – Present)



Headcount as of 12/31	4,144	4,486	4,735	5,057	5,309
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- 44% of our people have been with the company less than 5 years
- Voluntary attrition is generally low
  - High water mark was during 2000 dot-com boom
- Managed attrition rates are very low
  - High water mark was in 2002: 2.6%
  - 2005 YTD is 1%

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# HR Update – Key Management Changes

- Officer changes from 11/04 – 6/05

	Departed	New
EVP and above	4	0
SVP	8	7
VP	10	15

- Changes to Senior Management Group since December

- 24% departure
- 34% change in role
- 13% new to company
- 42% no change

**Total of 58% in six months compared to 57% at Freddie Mac in 18 months**

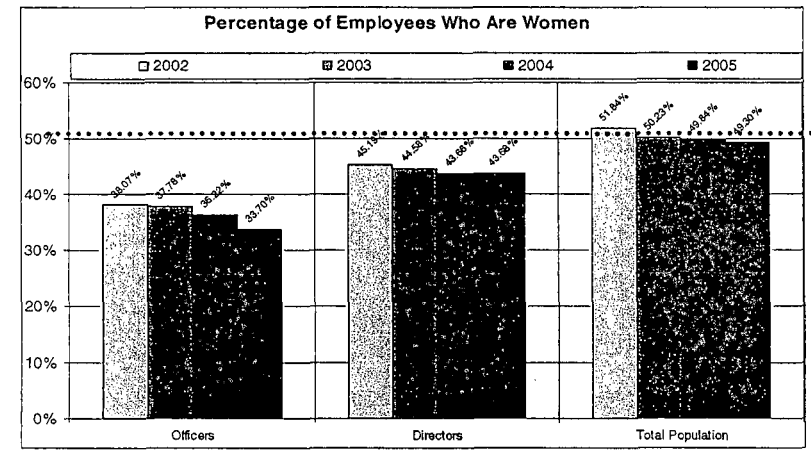
- Six new hires in Senior Management Group
  - Scott Blackley, SVP, Accounting Policy (June)
  - Mary Doyle, SVP, Financial Controls & Systems (June)
  - Jean Hinrichs, SVP, Internal Audit (July)
  - David Hisey, SVP, Controller (January)
  - Greg Kozich, SVP, Accounting (May)
  - Paul Noring, SVP, Finance (May)

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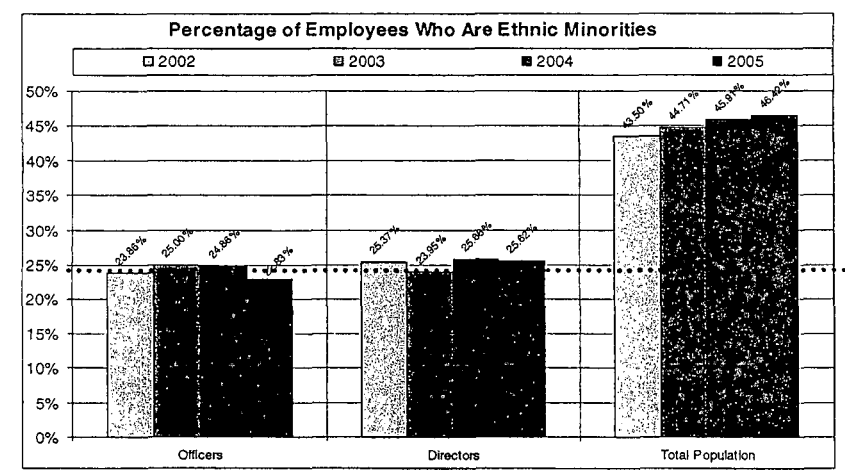
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# HR Update – Diversity



- The representation of women in our Management Group (officers and directors) is declining.

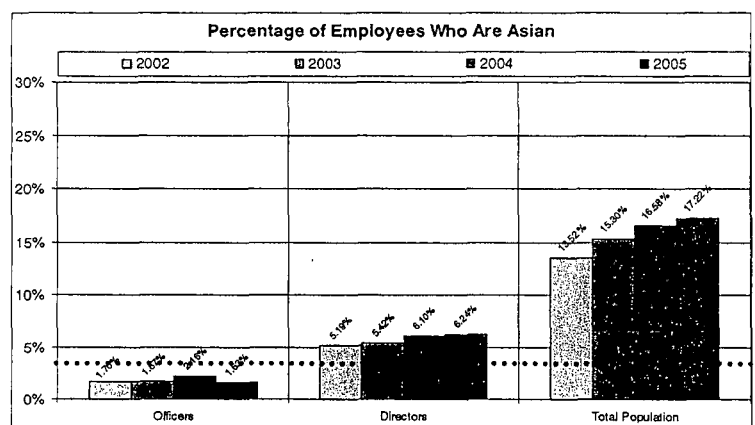
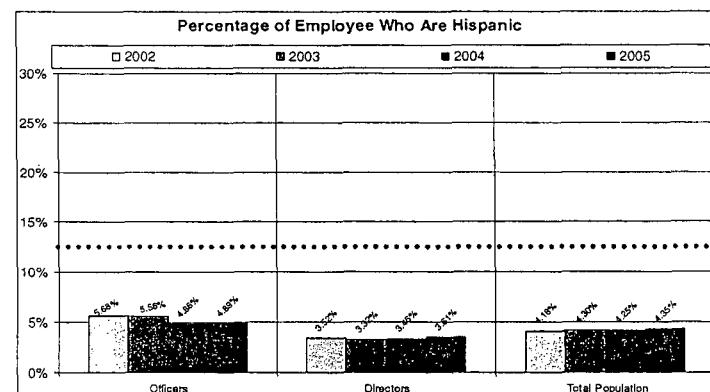
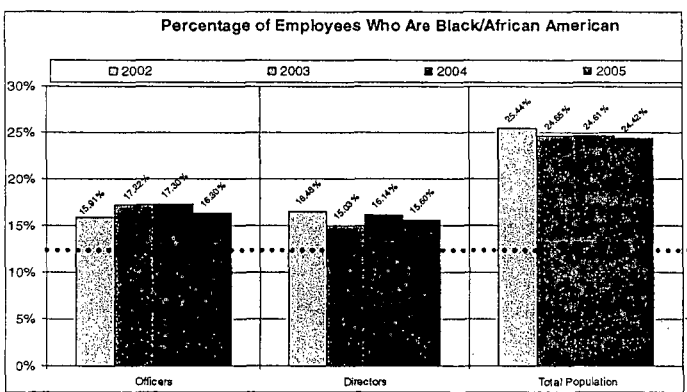


- Ethnic minorities are down in Officer ranks but slightly up in director category and overall.

Note: Blue dotted lines represents "Look Like America" Goals



# HR Update – Diversity (continued)



Note: Blue dotted lines represents "Look Like America" Goals

- Increase in the minority number is in large part due to the increase in Asians (mostly Level 4-5s in ESO and Credit) particularly in 2004
- Hispanics are significantly under-represented throughout the company (4.25% overall)
- Hispanics are the largest and fastest growing minority group in the US (over 14%)

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# HR Update – Culture

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- January 2005: intensive outreach/listening tour begun by Senior Management with external constituents, including customers, partners and legislators
- Since January: increased frequency and quality of all-employee communications including town halls (3 YTD) and HomeSite messages with change in tone of communications to reflect more direct and open engagement
- May 2005: adopted SEAM (Service, Engagement, Accountability, Management) as attributes expected of all employees when working internally and externally
- June/July: all officers have begun conducting local town halls with specific focus on culture/SEAM (167 completed to date)
- June: all employees invited to leave voice mails on cultural issues that were shared at Sr. Management Group offsite
- Three-hour discussion at SMG offsite dedicated to cultural/people issues. “All-in” people strategy being developed with Mercer incorporating strategies for performance management, compensation, training & development, etc., that will have significant operational and cultural impact
- Instituted culture as part of QBR report-outs (beginning with July QBR)
- Developing new Accountability Survey as part of annual performance review process; measures managers’ performance on people management skills and cultural leadership

**Culture emerges as the principal obstruction to everything we need to do**

# Legislative Status

Focus of meetings shifted to Senate: Chairman Richard Shelby (R-AL), Senator Mike Crapo (R-ID), Senator Rick Santorum (R-PA), Senator Tom Carper (D-DE), Senator Jack Reed (D-RI), Senator Mike Enzi (R-WY), Senator Jim Bunning (R-KY); plus House leadership Majority Leader Tom DeLay (R-TX), & Chairman Richard Baker (R-LA)

## HOUSE:

- House Financial Services Committee approved draft bill with a 65-5 vote; key provisions acceptable
- Reps Oxley, Frank, and Baker agreed on a "compromise" for the affordable housing fund

## SENATE:

- Senator Shelby draft proposal raises bar in two areas: '33 Act Registration for FNM & FRE securities and portfolio growth constraints; draft does not include "bright line" language; possible bill mark-up July 26
- Senator Reed underscored support for 5% affordable housing fund

## ADMINISTRATION:

- White House continues to urge for tougher reforms on portfolio size and program approval
- Chairman Greenspan restated position for a regulator with authority on par with banking regulators

## INDUSTRY:

- Bulk of the industry remains opposed to portfolio limits and prescriptive statutory "guidance" to the regulator
- MBA and some large lenders continue to push for the "bright line"
- ACB and MBA oppose '33 Act registration for the FHLBs, Fannie Mae, and Freddie Mac

**Odds of 2005 bill declining**

# Foundation Update

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- The Foundation is in the process of refining its strategic objectives and will decide on the 2006 spending plan at its December 2005 meeting
- At the reduced spending level, the Foundation's currently accessible assets are expected to be depleted by October 2006
- The Foundation continues to plan for its 18<sup>th</sup> annual Help the Homeless campaign, culminating in the 5K Walkathon on the National Mall on Saturday, November 19
- National housing focus sustained and Washington, DC giving not cut
- Leadership / succession plan in cycle

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# 180 Day Plan / Next Steps

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**Overall Goal: Lay foundation for different approach to our business and key relationships**

- Actions
  - Finalize management team
  - Maintain hyper-focus on Five Priorities
  - Finalize organization
  - Finalize compensation approach
- Outreach
  - Top 25 customers
  - Top 20 equity investors
  - Top 15 debt investors
  - Top 10 housing/affinity partners
  - Top 10 industry partners & leaders
  - Policy makers
  - Media
  - All 3 rating agencies
  - 15 cities
  - Business Roundtable / Business Council
  - All-employee town hall (Fall)

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