FANNIE MAE REPORT ON COMPENSATION

TO

THE COMMITTEE ON FINANCIAL SERVICES

OF THE U.S. HOUSE OF REPRESENTATIVES

AND

THE COMMITTEE ON BANKING, HOUSING,
AND URBAN AFFAIRS

OF THE U.S. SENATE

PURSUANT TO P.L. 102-550

SECTION 1381(j)(2)

JUNE 27, 2011

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I. INTRODUCTION

Section 1381(j)(2) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("the 1992 Act") requires that Fannie Mae (also referred to as "the company") submit an annual report on compensation to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs (collectively, "the Committees"). Specifically, the 1992 Act requires that Fannie Mae report on:

> "(i) the comparability of the compensation policies of the corporation with the compensation policies of other similar businesses,
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> (ii) in the aggregate, the percentage of total cash compensation and payments under employee benefit plans (which shall be defined in a manner consistent with the corporation's proxy statement for the annual meeting of shareholders for the preceding year) earned by executive officers[1] of the corporation during the preceding year that was based on the corporation's performance, and
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> (iii) the comparability of the corporation's financial performance with the performance of other similar businesses.

The report shall include a copy of the company's proxy statement for the annual meeting of shareholders for the preceding year."[2]

Fannie Mae has not issued a proxy statement for the preceding year, because the company has not scheduled an annual meeting of shareholders. The information relating to compensation that would have been disclosed in Fannie Mae's proxy statement relating to the preceding year's compensation is included in Fannie Mae's annual report on Form 10-K for the year ended December 31, 2010 ("2010 Form 10-K"), and the relevant sections of the 2010 Form 10-K are being provided with this report.

Fannie Mae has 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.

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[1] For the purposes of this report, the list of executive officers consists of the officer positions designated by the Federal Housing Finance Agency ("FHFA") effective as of April 7, 2011, as those positions were occupied as of December 2010. As defined in the 1992 Act, "executive officer" means "the chairman of the board of directors, chief executive officer, chief financial officer, president, vice chairman, and executive vice president, and any senior vice president in charge of a principal business unit, division, or function." 12 U.S.C. 4502(12). By agreement in 2005 with the Office of Federal Housing Enterprise Oversight, FHFA's predecessor, Fannie Mae segregated the functions of the Chairman of the Board and Chief Executive Officer. As a result, the Chairman of the Board is not an employee or officer of Fannie Mae and is not included in this discussion of performance-based compensation for executive officers.

[2] 12 U.S.C. 1723a(d)(3)(A).

The conservator has since delegated specified authorities to Fannie Mae's Board of Directors and has delegated to management the authority to conduct the company's day-to-day operations.

II. COMPARABILITY OF COMPENSATION POLICIES OF THE COMPANY

The 1992 Act requires that this report address the comparability of the compensation policies of Fannie Mae with the compensation policies of other similar businesses. Congress has recognized that Fannie Mae must compete with other large financial institutions for the purpose of setting reasonable compensation. Section 309(d)(2) of the Federal National Mortgage Association Charter Act ("Charter Act") establishes the authority of the Board to hire employees and to set reasonable compensation that is "comparable with compensation for employment in other similar businesses (including other publicly-held financial institutions or major financial services companies) involving similar duties and responsibilities" and provides that "any such action shall be without regard to the Federal civil service and classification laws."[3]

A. Overview

The executive compensation program used by the company for 2009 and 2010 compensation decisions was approved by the company's Board of Directors as well as its conservator, FHFA, in consultation with the Department of the Treasury ("Treasury"). FHFA worked with the company's management and Board of Directors, and sought the guidance of Treasury's Special Master for Troubled Asset Relief Program ("TARP") Executive Compensation, to develop an executive compensation program that reflects evolving standards regarding executive compensation and, to the extent appropriate, is generally consistent with the structural standards created for firms that received exceptional TARP assistance. The new program also represents a change from the company's previous executive compensation structure and takes into account the extraordinary market environment and conditions the company is facing and taking actions to address. The company's 2009 and 2010 compensation actions for its SEC executive officers[4] were approved by FHFA.

Congress has recognized Fannie Mae's need to have market-based compensation so that the company may attract and retain employees, and the company's Charter Act[5] authorizes the Board to pay compensation that is reasonable and comparable with compensation for employment in other similar businesses involving similar duties. Accordingly, Fannie Mae's Board reviews similar financial institutions or major financial

[3] 12 U.S.C. 1723a(d)(2).

[4] An "SEC executive officer" is an "executive officer" under the rules of the United States Securities and Exchange Commission.

[5] 12 U.S.C. 1716 et seq.

services companies to determine a peer group for compensation. This peer group includes companies such as AIG, Prudential, and Bank of New York, as well as Freddie Mac. In addition, when making compensation determinations, the company's Board receives the advice of a compensation consultant that is independent from management. Fannie Mae has immense responsibilities, and the complexity of the challenges the company confronts requires deep experience, expertise, and seasoned employees. The company's compensation program is vital to its ability to recruit and retain qualified employees who address these challenges.

In his testimony before the U.S. House of Representatives Committee on Financial Services hearing on "Compensation in the Financial Industry – Government Perspectives" on February 25, 2009, Edward J. DeMarco, the Acting Director of FHFA, discussed the issues involved in placing Fannie Mae into conservatorship and noted that it remains imperative that Fannie Mae and Freddie Mac (the "Enterprises") attract and retain the particular and specialized skills needed to manage their activities. Acting Director DeMarco also discussed the development of the new compensation structure for senior executives of the Enterprises, including that:

- Under the senior preferred stock purchase agreements that provide financial support to the Enterprises, FHFA has agreed to consult with Treasury about new compensation arrangements with SEC executive officers at the Enterprises. After Kenneth Feinberg was appointed Special Master for the TARP Executive Compensation, Treasury asked FHFA to consult with him. FHFA discussed with the Special Master how FHFA could adapt the approach he was developing for financial institutions that have received exceptional TARP assistance to the Enterprises.

- In adapting the approach developed for TARP companies, a major consideration was that compensating Enterprise executives with company stock would be ineffective because of the questionable value of such stock. Further, large grants of low-priced stock could provide substantial incentives for executives to seek and take large risks. Accordingly, all components of executive compensation at the Enterprises are in cash.

- Another consideration noted by Acting Director DeMarco is the uncertain future of the Enterprises as continuing entities, which is in the hands of Congress and beyond the control of Enterprise executives.

- FHFA also looked to existing practice elsewhere to determine the appropriate levels of total target compensation for the most senior positions. FHFA considered data from consultants to both Enterprises, data received earlier from its own consultant, and the reported plans of TARP-assisted firms. It was important to set pay at levels sufficient to compete for quality talent because the Enterprises had many key vacancies to fill and potential departures to avoid, and pay has been a significant issue in some cases.

- The considerations discussed above must be balanced by FHFA's efforts to keep the cost to taxpayers as low as FHFA possibly can.

More recently, in his testimony before the U.S. House of Representatives Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises hearing on "Legislative Proposals: Overhaul of Housing-Related Government Sponsored Enterprises" on March 31, 2011, Acting Director DeMarco noted that, as conservator, FHFA has reduced the Enterprises' compensation overall, and that since conservatorship, there has been a 40 percent decrease in overall executive compensation at the Enterprises. Acting DeMarco further indicated that, consistent with the approach taken for Federal workers, FHFA directed each Enterprise to maintain 2011 compensation for all employees at 2010 levels,[6] and that when higher compensated employees leave, the companies seek to fill those positions at lower compensation levels than paid to the departing employees, including at the executive level.

Acting Director DeMarco also addressed the issue of how to preserve and conserve the value of human capital in the face of an uncertain future at the March 31, 2011 hearing before the U.S. House of Representatives Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises, noting that:

- Recruiting and retaining executives and staff of the Enterprises is one of FHFA's principal risk management challenges as conservator.

- The boards, senior management, and staff at each Enterprise who have remained since conservatorship, or joined one of the companies since that time, should be acknowledged for the hard work that has been and is being done to fix each company's shortcomings, to develop and execute improved loan loss mitigation strategies, and to ensure the continued functioning of the country's secondary mortgage market.

- Leadership changes will continue to take place, with several key executive-level departures at each company already in 2011. The Enterprises need to be able to continue to attract and retain executive-level talent and professional staff to navigate through this period of uncertainty.

- For the duration of the conservatorships, he believes the best way to protect taxpayer interests in the Enterprises is by ensuring each company has experienced, qualified people managing the day-to-day business operations. Any other approach puts at risk the management of more than $5 trillion in mortgage holdings and guarantees supported by taxpayers through the Treasury preferred stock purchase agreements.

[6] Pay increases associated with promotions or significant changes in an employee's duties were permitted, consistent with the company's pay programs.

B. Executive Compensation Program Components for 2010

As discussed below, Fannie Mae's compensation program for executive officers for 2010 consisted of three primary elements: base salary, deferred pay and a long-term incentive award. The executive officers also received employee benefits, including supplemental retirement plan benefits available to management, and other employee benefits generally available to Fannie Mae's employees and certain limited perquisites. Information on the determination of the target compensation levels for the company's named executive officers,[7] including the use of outside compensation consultants and the development of the company's comparator group, is discussed in the company's 2009 Form 10-K.

1. Base Salary

Base salary is paid in cash throughout the year on a bi-weekly basis and provides a minimum, fixed level of cash compensation for the executive officers. Base salary reflects the executive officer's level of responsibility and experience, as well as individual performance over time. Base salary is capped at $500,000 for all of the company's executive officers other than the Chief Executive Officer and Chief Financial Officer.

2. Deferred Pay

Deferred pay is paid to executive officers in cash in quarterly installments in the year following the performance year. Deferred pay is designed to replicate the "stock salary" element of the compensation program applicable to financial institutions that received exceptional TARP assistance and is also intended to serve as a retention incentive for the executive officers; however, deferred pay is paid in cash, not stock. Given the low market value of Fannie Mae's common stock since its entry into conservatorship, Fannie Mae and FHFA believe that stock-based compensation would not provide appropriate retention incentives. In addition, Fannie Mae is prohibited from paying new stock-based compensation under the senior preferred stock purchase agreement without Treasury's consent. Half of 2010 deferred pay is based on the Compensation Committee's determination of corporate performance in 2010, as approved by FHFA; the remaining half of 2010 deferred pay is service based. Accordingly, the performance-based portion of deferred pay that an executive officer actually receives may be more or less than the executive officer's target.

[7] A "named executive officer" is a "named executive officer" under the rules of the United States Securities and Exchange Commission.

3. Long-term Incentive Award

A long-term incentive award is a performance-based cash award that is paid over two calendar years. Long-term incentive awards are designed to provide incentives to the executive officers to achieve corporate and individual performance goals, and to serve as a retention incentive.

Half of the 2010 long-term incentive award was based on corporate and individual performance for 2010, and was paid in February 2011. The remaining half of the award will be determined and paid in early 2012 based on corporate and individual performance for both 2010 and 2011. Because the award is performance based, the long-term incentive award that an executive officer actually receives may be more or less than the executive officer's target compensation. In addition, each long-term incentive award paid to an SEC executive officer must be approved by FHFA.

4. Employee Benefits

Employee benefits are also a fundamental part of the company's compensation program, and serve as an important tool in attracting and retaining employees. Employee benefits include retirement benefits, limited perquisites, and benefits available to the company's employee population as a whole, including medical insurance plans, a life insurance program and matching charitable gifts program. Executive officers are also eligible to participate in the company's voluntary supplemental long-term disability plan, which is available to many of the company's employees.

As discussed in more detail in the company's 2010 Form 10-K, beginning with compensation for the 2009 performance year, Fannie Mae's SEC executive officers' compensation is subject to forfeiture and repayment provisions, also known as "clawback" provisions, in the event of certain circumstances, including the grant of incentive compensation based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria.

III. EXECUTIVE COMPENSATION AND PERFORMANCE-BASED PAY

This section addresses performance-based compensation for Fannie Mae's executive officers. Fannie Mae structures its compensation program in accordance with its statutory obligations under the Federal National Mortgage Association Charter Act, 12 U.S.C. 1716 et seq. The Charter Act requires that compensation be reasonable and comparable to that of similar businesses, and that a significant portion of potential compensation for all executive officers of Fannie Mae be based on the company's performance.[8]

[8] The Charter Act provides that "[t]he board of directors of the corporation shall have the power to select and appoint or employ such officers, attorneys, employees, and agents, to vest them with such powers and duties, and to fix and to cause the corporation to pay such compensation to them for their services, as the

Under the company's 2010 executive compensation program, all of the 2010 long-term incentive awards and half of the 2010 deferred pay awards are at-risk, variable and based on corporate performance and, in the case of the long-term incentive award, individual performance. Under the SEC rules governing the Summary Compensation Table included in the company's 2010 Form 10-K, 37% of total compensation earned by executive officers in 2010 was performance-based.[9]

IV. COMPARABILITY OF FINANCIAL PERFORMANCE

The 1992 Act requires that Fannie Mae report on the comparability of Fannie Mae's financial performance with the performance of other similar businesses. In prior years, Fannie Mae provided information on the five-year cumulative return for shareholders of Fannie Mae measured against two financial indices. This information for the five-year period ending in 2010 is provided below. However, for 2010, neither Fannie Mae's Board of Directors nor FHFA measured Fannie Mae's performance by reference to the cumulative return for shareholders. Rather, as discussed in more detail below, Fannie Mae's Board of Directors and FHFA approved 2010 corporate goals focused on providing liquidity to the mortgage market, prudently managing the customer's book of business and being an effective steward of the government's support.

A. Information Regarding Shareholders' Cumulative Return

The return for shareholders is measured against two indices – Standard & Poor's S&P 500 and S&P Financials. Fannie Mae's common stock was delisted from the New York Stock Exchange and the Chicago Stock Exchange on July 8, 2010 and since then has been traded in the over-the-counter market and quoted on the OTC Bulletin Board under the symbol "FNMA."

As of year-end 2010, Fannie Mae's five-year cumulative total return was substantially less than that of both the S&P 500 and of the S&P Financials, as illustrated by the chart

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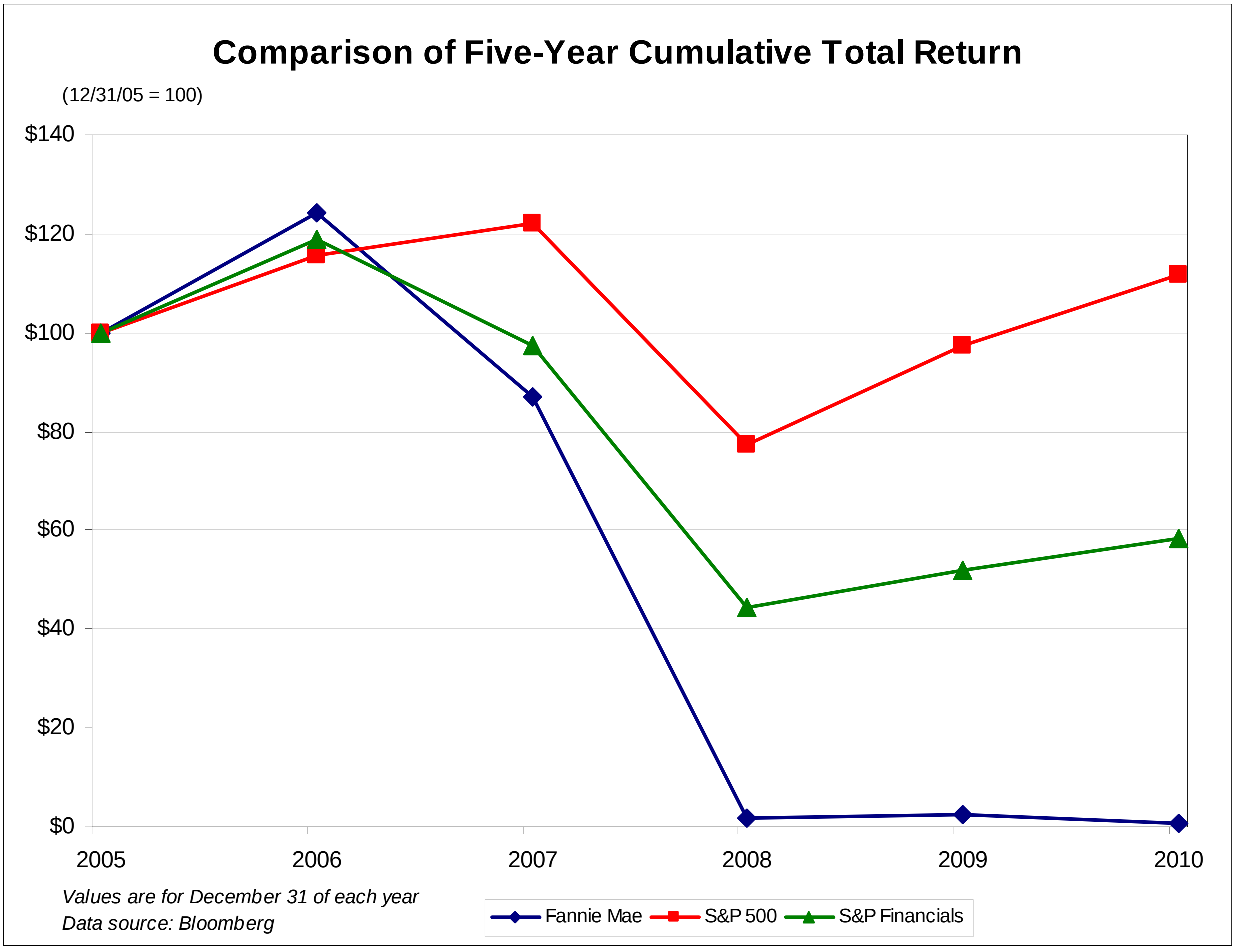
board of directors determines reasonable and comparable with compensation for employment in other similar businesses (including other publicly-held financial institutions or major financial services companies) involving similar duties and responsibilities, except that a significant portion of potential compensation of all executive officers . . . of the corporation shall be based on the performance of the corporation . . ." 12 U.S.C. 1723a(d)(2). As noted above, the conservatorship and the senior preferred stock purchase agreement limit the authority of the Board of Directors.

[9] For this calculation, total compensation is defined as it is for the "total" column in the Summary Compensation Table and includes salary, bonus, non-equity incentive plan compensation, stock awards (no stock awards were granted in 2010), changes in pension value, and "all other compensation" (as defined by the SEC). Variable, at-risk compensation for purposes of this calculation consists of the first installment of the 2010 long-term incentive award and the performance-based portion of the 2010 deferred pay award. The amount of the second installment of the 2010 long-term incentive award is determined using performance in 2010 and 2011, and the amount of this installment will not be determined or paid until 2012.

below. A $100 investment in Fannie Mae common stock at the end of 2005 (assuming full reinvestment of dividends) would have yielded $0.67 by the end of 2010. A similar $100 investment during the same period (1) in companies included in the S&P 500 would have yielded $111.89 and (2) in S&P Financials would have yielded $58.27.



Return in Dollars Based on $100 Investment in Each Category			
Year	Fannie Mae	S&P 500	S&P Financials
2005	100.00	100.00	100.00
2006	124.36	115.61	118.92
2007	87.05	121.95	97.34
2008	1.71	77.38	44.56
2009	2.65	97.44	51.99
2010	0.67	111.89	58.27

Assuming full reinvestment of dividends

Note: Fannie Mae stock price data prior to 2010 reflects NYSE quotes. Fannie Mae stock price data for year-end 2010 reflects OTC Bulletin Board quotes.

B. Discussion of Corporate Performance Goals for the 2010 Executive Compensation Program

As discussed in more detail in the relevant sections of the 2010 Form 10-K provided with this report, the company's 2010 corporate performance goals were designed to support the company's current business objectives, which include providing support to the housing and mortgage markets during this critical time while minimizing the company's credit losses from delinquent mortgages. As such, the company's goals for 2010 were to achieve the company's mission of providing liquidity, stability and affordability to the U.S. housing and mortgage markets, build a more streamlined and higher-performing company, and build a stronger service and delivery model. Fannie Mae's Compensation Committee determined that the company's performance against these goals was strong in many areas in 2010. For example, the company provided significant liquidity to the market while maintaining the credit quality and expected economic returns of the company's new business. Based on the Compensation Committee's review of the company's corporate performance for 2010, the Compensation Committee determined that, subject to FHFA approval, the performance-based portion of 2010 deferred pay would be paid at 90% of target and the pool for the first installment of the 2010 long-term incentive awards would be funded at 90% of target. Payment of the first installment of the 2010 long-term incentive awards was also subject to individual performance. FHFA reviewed and approved the Compensation Committee's determinations.

In a hearing on March 31, 2011, Acting Director DeMarco noted that "the Enterprises' financial results in 2010 were much better than in recent years, which resulted in smaller draws from the Treasury under the Senior Preferred Stock Purchase Agreements (PSPAs) with the Enterprises. In part, these results reflected much-improved underwriting on their post-conservatorship books of business. Still, the Enterprises had substantial losses for the year as they continued to experience credit losses associated with mortgages originated principally between 2005 and 2008."[10]

V. CONCLUSION

Given Fannie Mae's essential role in providing liquidity to the mortgage market and supporting the housing market, as well as the need to prudently manage the company's $3.2 trillion book of business, a primary goal of Fannie Mae's Board of Directors and FHFA in developing the executive compensation program is to attract and retain the executive talent needed to continue to fulfill these roles and responsibilities. Fannie Mae's executive compensation program is also intended to drive a pay for performance environment by rewarding executive officers for company and individual performance through the use of performance-based long-term incentive awards and deferred pay. In addition, FHFA worked with the company's management and Board of Directors, and sought the guidance of Treasury's Special Master for TARP Executive Compensation, to

[10] Testimony of Acting Director DeMarco before the U.S. House of Representatives Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises hearing on "Legislative Proposals: Overhaul of Housing-Related Government Sponsored Enterprises" on March 31, 2011.

develop an executive compensation program that reflects evolving standards regarding executive compensation and, to the extent appropriate, is generally consistent with the structural standards created for firms that received exceptional TARP assistance.