
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the Quarterly Period Ended June 30, 2003

Commission File No.: 0-50231

Federal National Mortgage Association

(Exact name of registrant as specified in its charter)

Fannie Mae

Federally chartered corporation

(State or other jurisdiction of incorporation or organization)

52-0883107

(I.R.S. Employer Identification No.)

3900 Wisconsin Avenue, NW
Washington, DC

(Address of principal executive offices)

20016

(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 No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes No

As of the close of business on July 31, 2003, there were 973,819,180 shares of common stock outstanding.

CROSS-REFERENCE INDEX TO FORM 10-Q

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The interim financial information provided in this report reflects all adjustments that, in the opinion of management, are necessary for a fair presentation of the results for such periods. Such adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q. The results of operations in our interim financial statements are not necessarily indicative of the results that may be expected for the full year. The interim financial information should be read in conjunction with Fannie Mae's 2002 Annual Report on Form 10-K, filed with the Securities and Exchange Commission and available on our Web site at www.fanniemae.com/ir and the SEC's Web site at www.sec.gov under "Federal National Mortgage Association" or CIK number 0000310522. We do not intend these internet addresses to be active links. Therefore, other than our 2002 Annual Report on Form 10-K, the information that appears on these Web sites is not incorporated into this Form 10-Q.

PART I—FINANCIAL INFORMATION

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

SELECTED FINANCIAL DATA

The following selected financial data includes performance measures and ratios based on our reported results and core business earnings, a supplemental non-GAAP (generally accepted accounting principles) measure used by management in operating our business. Our core business earnings measures are not defined terms within GAAP and may not be comparable to similarly titled measures presented by other companies. See “Management’s Discussion and Analysis— Core Business Earnings and Business Segment Results” for a discussion of how we use core business earnings measures and why we believe they are helpful to investors. Our results for the three-month and six-month periods ended June 30, 2003 and 2002 are unaudited and, in the opinion of management, include all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation. We have reclassified certain prior period amounts to conform to our current year presentation. Results for the reported period are not necessarily indicative of the results that may be expected for the full year.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
(Dollars and shares in millions, except per share amounts)				
Reported Earnings Data:				
Net income	\$ 1,102	\$ 1,464	\$ 3,042	\$ 2,672
Preferred stock dividends	(34)	(24)	(64)	(57)
Net income available to common stockholders	\$ 1,068	\$ 1,440	\$ 2,978	\$ 2,615
Basic earnings per common share	\$ 1.09	\$ 1.45	\$ 3.03	\$ 2.63
Diluted earnings per common share	1.09	1.44	3.02	2.61
Weighted-average diluted common shares outstanding	982	1,000	987	1,001
Cash dividends per common share	\$.39	\$.33	\$.78	\$.66
Net interest yield, taxable-equivalent basis	1.63%	1.33%	1.61%	1.32%
Return on average assets	.47	.70	.66	.64
Average equity to average assets	1.9	2.3	1.9	2.3
Return on common equity	31.3	33.9	43.1	32.2
Ratio of earnings to combined fixed charges and preferred stock dividends ⁽¹⁾	1.15:1	1.19:1	1.21:1	1.17:1
Core Business Earnings Data:⁽²⁾				
Core business earnings ⁽³⁾	\$ 1,860	\$ 1,573	\$ 3,710	\$ 3,091
Core business earnings per diluted common share	1.86	1.55	3.70	3.03
Core taxable-equivalent revenues ⁽⁴⁾	3,980	2,971	7,583	5,811
Net interest margin, taxable-equivalent basis ⁽⁵⁾	1.30%	1.16%	1.28%	1.16%
Core return on average assets ⁽⁶⁾	.80	.76	.80	.75
Core return on average realized common equity ⁽⁷⁾	27.7	25.8	27.9	25.8
	June 30, 2003	December 31, 2002		
Balance Sheet Data:				
Mortgage portfolio, net	\$820,276	\$797,693		
Liquid assets	69,089	61,554		
Total assets	923,795	887,515		
Borrowings:				
Due within one year	422,274	382,412		
Due after one year	461,807	468,570		
Total liabilities	906,431	871,227		
Preferred stock	3,883	2,678		
Stockholders’ equity	17,364	16,288		
Core capital ⁽⁸⁾	30,675	28,079		
Total capital ⁽⁹⁾	31,469	28,871		

Other Performance Measures:	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Average effective guaranty fee rate ⁽¹⁰⁾	.212%	.183%	.208%	.184%
Credit loss ratio ⁽¹¹⁾	.005	.004	.004	.005
Administrative expense ratio ⁽¹²⁾	.071	.073	.072	.073
Efficiency ratio ⁽¹³⁾	8.9	10.1	9.2	10.2
Mortgage purchases	\$ 127,960	\$ 56,917	\$ 259,965	\$ 147,863
MBS issues acquired by others ⁽¹⁴⁾	282,502	102,909	486,435	209,713
Outstanding MBS ⁽¹⁵⁾	1,237,461	945,497	1,237,461	945,497
Book of business ⁽¹⁶⁾	2,049,928	1,686,241	2,049,928	1,686,241

(1) "Earnings" consists of (a) income before federal income taxes and (b) fixed charges. Fixed charges represent interest expense.

(2) See Management's Discussion and Analysis of Financial Condition and Results of Operations— Core Business Earnings and Business Segment Results for additional discussion of our supplemental non-GAAP (generally accepted accounting principles) core business earnings measures and for a reconciliation to comparable GAAP measures.

(3) Core business earnings is a non-GAAP measure developed by management in conjunction with the adoption of FAS 133 to evaluate and assess the quality of Fannie Mae's earnings from its principal business activities on a consistent basis. Core business earnings is presented on a net of tax basis and excludes changes in the time value of purchased options recorded under FAS 133 and includes purchased options premiums amortized on a straight-line basis over the original estimated life of the option, together with any acceleration of expense related to options extinguished prior to exercise.

(4) A non-GAAP measure that includes revenues net of operating losses primarily on low-income housing tax credit limited partnerships and purchased options premiums amortization expense, adjusted to include taxable-equivalent amounts of tax-exempt income using the applicable federal income tax rate of 35 percent.

(5) A non-GAAP measure calculated based on annualized core net interest income on a tax-equivalent basis divided by the weighted average net investment balance.

(6) A non-GAAP measure calculated based on core business earnings less preferred stock dividends divided by average assets.

(7) A non-GAAP measure calculated based on core business earnings less preferred stock dividends divided by average realized common stockholders' equity (common stockholders' equity excluding accumulated other comprehensive income).

(8) The sum of (a) the stated value of common stock, (b) the stated value of outstanding noncumulative perpetual preferred stock, (c) paid-in capital, and (d) retained earnings, less treasury stock. Core capital represents a regulatory measure of capital.

(9) The sum of (a) core capital and (b) the total allowance for loan losses and guaranty liability for MBS, less (c) the specific loss allowance. Total capital represents a regulatory measure of capital. Specific loss allowances totaled \$13 million at June 30, 2003 and \$19 million at December 31, 2002.

(10) Calculated based on guaranty fee and related income from outstanding MBS.

(11) Charge-offs, net of recoveries, and foreclosed property income as a percentage of average mortgage portfolio (on an amortized cost basis) and average outstanding MBS.

(12) Administrative expenses as a percentage of average net mortgage portfolio and average outstanding MBS.

(13) Administrative expenses as a percentage of core taxable-equivalent revenues.

(14) Fannie Mae guaranteed MBS and other mortgage-related securities issued and purchased by investors other than Fannie Mae.

(15) Includes MBS and other mortgage-related securities guaranteed by Fannie Mae and held by investors other than Fannie Mae.

(16) Mortgage portfolio and outstanding MBS, based on unpaid principal balances.

Fannie Mae is the nation's largest source of funds for mortgage lenders and investors. Although we operate under a federal charter, we are a private, shareholder-owned company. Our purpose is to facilitate the flow of low-cost mortgage capital to increase the availability and affordability of homeownership for low-, moderate-, and middle-income Americans. We operate exclusively in the secondary mortgage market by purchasing mortgages and mortgage-related securities, including Fannie Mae mortgage-backed securities, from primary market institutions, such as commercial banks, savings and loan associations, mortgage companies, securities dealers, and other investors. We provide additional liquidity in the secondary market by guaranteeing mortgages and issuing and guaranteeing mortgage-related securities. We generate revenue from these activities through our two primary lines of business: *Portfolio Investment Business* and *Credit Guaranty Business*.

This report on Form 10-Q highlights significant factors influencing Fannie Mae's results of operations and financial condition. Management's Discussion and Analysis and other sections of our Form 10-Q contain forward-looking statements based on management's estimates of trends and economic factors in the markets in which Fannie Mae is active as well as the company's business plans. Such estimates and plans may change without notice and future results may vary from expected results if there are significant changes in economic, regulatory, or legislative conditions affecting Fannie Mae or its competitors. For a discussion of these factors, investors should review our Annual Report on Form 10-K for the year ended December 31, 2002. We undertake no duty to update these forward-looking statements.

RESULTS OF OPERATIONS

Overview

Our reported net income for the second quarter of 2003 totaled \$1.102 billion, a decrease of 25 percent over our second quarter 2002 reported results of \$1.464 billion. Diluted earnings per share ("diluted EPS") decreased 24 percent to \$1.09 from \$1.44 in the second quarter of 2002. The decrease in second quarter 2003 reported net income and diluted EPS was driven by an increase in purchased options expense, which more than offset an increase in net interest income, guaranty fee income, and fee and other income. Our reported net income for the first half of 2003 totaled \$3.042 billion, an increase of 14 percent over our first half 2002 reported results of \$2.672 billion. Diluted EPS increased 16 percent to \$3.02 from \$2.61 in the first half of 2002. The increase in reported net income and diluted EPS for the first half of 2003 was driven by an increase in net interest income, guaranty fee income, and fee and other income, which more than offset an increase in purchased options expense. Our reported results are based on generally accepted accounting principles ("GAAP"), which include the effects of Financial Accounting Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("FAS 133"). FAS 133 generates significant volatility in our reported net income because it requires that we record in our income statement changes in the time value of purchased options that we use to manage interest rate risk, but it does not allow us to record in earnings changes in the intrinsic value of some of those options or similar changes in the fair value of options in all of our callable debt or mortgage assets. We expect purchased options expense to vary, often substantially, from period to period with changes in interest rates, expected interest rate volatility, and derivative activity. Purchased options expense for the second quarter and first half of 2003 increased \$1.385 billion and \$1.222 billion, respectively, over the corresponding prior year periods.

Reported net interest income for the second quarter and first half of 2003 increased 38 percent in each period to \$3.501 billion and \$6.869 billion, respectively, while guaranty fee income increased 49 percent and 42 percent to \$632 million and \$1.179 billion, respectively. Increases in net interest income were driven primarily by growth in our reported net interest yield and our mortgage portfolio, while increases in guaranty fee income were driven primarily by growth in outstanding MBS balances and our effective guaranty fee rate. Our market—residential mortgage debt outstanding—remained strong, growing at an annualized rate of 11.5 percent during the first quarter of 2003 despite slow economic growth and high market volatility. Record amounts of refinancing volumes during the first half of 2003 led to strong growth in our MBS. Rapid refinancings also led to a rise in the effective guaranty fee rate as rapid prepayments caused deferred guaranty fee revenues to be recognized more quickly. Despite the strong market, our

mortgage portfolio grew slowly during the first half of 2003 due to continued demand for mortgages from banks and other financial institutions. However, this slow portfolio growth was offset by a further temporary increase in our net interest yield, which benefited from the steep yield curve and low short-term interest rates that persisted throughout the first half of the year.

Management also tracks and analyzes Fannie Mae's financial results based on a supplemental non-GAAP measure called "core business earnings" (previously referred to by us as "operating net income"). While core business earnings is not a substitute for GAAP net income, we rely on core business earnings in operating our business because we believe core business earnings provides our management and investors with a better measure of our financial results and better reflects our risk management strategies than our GAAP net income. We developed core business earnings in conjunction with our January 1, 2001 adoption of FAS 133 to adjust for accounting differences between alternative transactions we use to hedge interest rate risk that produce similar economic results but require different accounting treatment under FAS 133. For example, our core business earnings measure allows management and investors to evaluate the quality of earnings from Fannie Mae's principal business activities in a way that accounts for comparable hedging transactions in a similar manner. We discuss our core business earnings results in "MD&A— Core Business Earnings and Business Segment Results."

Net Interest Income

Table 1 presents Fannie Mae's net interest yield based on reported net interest income calculated on a taxable-equivalent basis. The net interest yield calculation subsequent to our adoption of FAS 133 does not fully reflect the cost of our purchased options (see "MD&A— Core Business Earnings and Business Segment Results— Core Net Interest Income" for a discussion of our supplemental non-GAAP measures, core net interest income and net interest margin).

Table 1: Net Interest Yield

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
(Dollars in millions)				
Interest income:				
Mortgage portfolio	\$ 12,256	\$ 12,326	\$ 24,846	\$ 24,497
Nonmortgage investments and cash equivalents	336	420	642	826
Total interest income	12,592	12,746	25,488	25,323
Interest expense:⁽¹⁾				
Short-term debt	697	646	1,447	1,430
Long-term debt	8,394	9,568	17,172	18,930
Total interest expense	9,091	10,214	18,619	20,360
Net interest income	3,501	2,532	6,869	4,963
Taxable-equivalent adjustment on tax-exempt investments ⁽²⁾	119	126	242	249
Taxable-equivalent net interest income	\$ 3,620	\$ 2,658	\$ 7,111	\$ 5,212
Average balances:⁽³⁾				
Interest-earning assets:⁽⁴⁾				
Mortgage portfolio, net	\$808,215	\$732,796	\$806,510	\$724,200
Nonmortgage investments and cash equivalents	81,966	69,187	74,550	67,176
Total interest-earning assets	890,181	801,983	881,060	791,376
Interest-free funds ⁽⁵⁾	(32,431)	(24,196)	(30,432)	(24,083)
Total interest-earning assets funded by debt	857,750	777,787	850,628	767,293
Interest-bearing liabilities:⁽¹⁾				
Short-term debt	231,718	128,885	221,063	130,153
Long-term debt	626,032	648,902	629,565	637,140
Total interest-bearing liabilities	\$857,750	\$777,787	\$850,628	\$767,293
Average interest rates:^(2, 3)				
Interest-earning assets:				
Mortgage portfolio, net	6.07%	6.77%	6.17%	6.81%
Nonmortgage investments and cash equivalents	1.66	2.45	1.74	2.49
Total interest-earning assets	5.66	6.40	5.80	6.44
Interest-free return ⁽⁵⁾	.21	.18	.18	.18
Total interest-earning assets and interest-free return	5.87	6.58	5.98	6.62
Interest-bearing liabilities:⁽¹⁾				
Short-term debt	1.19	1.99	1.29	2.18
Long-term debt	5.36	5.90	5.46	5.94
Total interest-bearing liabilities	4.24	5.25	4.37	5.30
Net interest yield	1.63%	1.33%	1.61%	1.32%

(1) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on effective maturity or repricing date, taking into consideration the effect of derivative financial instruments. In the first quarter of 2003, we revised our method of classifying interest expense between short-term and long-term on certain derivative instruments. This reclassification does not affect Fannie Mae's total interest expense. We reclassified \$73 million and \$31 million between short-term and long-term interest expense for the three months and six months ended June 30, 2002 to conform to our current year presentation.

(2) Reflects non-GAAP adjustments to permit comparison of yields on tax-exempt and taxable assets based on a 35 percent marginal tax rate.

(3) Averages have been calculated on a monthly basis based on amortized cost.

(4) Includes average balance of nonaccrual loans of \$5.9 billion and \$4.5 billion for the three months ended June 30, 2003 and 2002, respectively, and \$5.8 billion and \$4.3 billion for the six months ended June 30, 2003 and 2002, respectively.

(5) Interest-free funds represent the portion of our investment portfolio funded by equity and non-interest bearing liabilities.

Reported net interest income for the second quarter and first half of 2003 increased 38 percent in each period over the corresponding prior year periods to \$3.501 billion and \$6.869 billion, respectively, driven by an 11 percent increase in our average net investment balance for each period, and a 30 basis point and 29 basis point expansion in our reported net interest yield to 1.63 percent and 1.61 percent, respectively. Our average net investment balance (also referred to as total interest-earning assets) consists of our mortgage portfolio (net of unrealized gains and losses on available-for-sale securities and deferred balances) and nonmortgage investments. The upfront cost of purchased options is not included in our reported net interest income and net interest yield. However, the interest expense on callable debt is included in reported net interest income. Accordingly, our net interest yield benefited from increases in the amount of purchased options used as a substitute for callable debt.

A rate/volume analysis of the changes in our reported net interest income between the second quarter and first half of 2003 and the second quarter and first half of 2002 is shown in Table 2.

Table 2: Rate/Volume Analysis of Reported Net Interest Income

	Increase (Decrease)	Attributable to Changes in ⁽¹⁾	
		Volume	Rate
(Dollars in millions)			
Second Quarter 2003 vs. Second Quarter 2002			
Interest income:			
Mortgage portfolio	\$ (70)	\$1,205	\$(1,275)
Nonmortgage investments and cash equivalents	(84)	68	(152)
Total interest income	(154)	1,273	(1,427)
Interest expense: ⁽²⁾			
Short-term debt	51	378	(327)
Long-term debt	(1,174)	(328)	(846)
Total interest expense	(1,123)	50	(1,173)
Change in net interest income	\$ 969	\$1,223	\$ (254)
Change in taxable-equivalent adjustment on tax-exempt investments ⁽³⁾	(7)		
Change in taxable-equivalent net interest income	\$ 962		
First Six Months 2003 vs. First Six Months 2002			
Interest income:			
Mortgage portfolio	\$ 349	\$2,645	\$(2,296)
Nonmortgage investments and cash equivalents	(184)	83	(267)
Total interest income	165	2,728	(2,563)
Interest expense: ⁽²⁾			
Short-term debt	17	743	(726)
Long-term debt	(1,758)	(222)	(1,536)
Total interest expense	(1,741)	521	(2,262)
Change in net interest income	\$ 1,906	\$2,207	\$ (301)
Change in taxable-equivalent adjustment on tax-exempt investments ⁽³⁾	(7)		
Change in taxable-equivalent net interest income	\$ 1,899		

(1) Combined rate/volume variances, a third element of the calculation, are allocated to the rate and volume variances based on their relative size.

(2) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on effective maturity or repricing date, taking into consideration the effect of derivative financial instruments.

(3) Reflects non-GAAP adjustments to permit comparison of yields on tax-exempt and taxable assets based on a 35 percent marginal tax rate.

Guaranty Fee Income

Guaranty fee income grew 49 percent and 42 percent over the second quarter and first half of 2002 to \$632 million and \$1.179 billion, respectively. The increase in guaranty fee income in the second quarter of 2003 was driven by a 29 percent growth in average outstanding MBS and a 16 percent increase in the average effective guaranty fee rate on outstanding MBS. The increase in guaranty fee income in the first half of 2003 was driven by a 26 percent growth in average outstanding MBS and a 13 percent increase in the average effective guaranty fee rate on outstanding MBS. We use the term "MBS" (mortgage-backed securities) to refer to mortgage-related securities we issue or on which Fannie Mae guarantees timely payment of scheduled principal and interest.

Average outstanding MBS totaled \$1.193 trillion and \$1.135 trillion in the second quarter and first half of 2003, respectively, compared with \$927 billion and \$902 billion in the second quarter and first half of 2002. MBS issues acquired by other investors totaled \$283 billion and \$486 billion in the second quarter and first half of 2003, respectively, versus \$103 billion and \$210 billion in the second quarter and first half of 2002. MBS issuances expanded in response to increased

demand from lenders and investors as the result of an increase in refinance activity driven by lower interest rates. The growth in the average effective guaranty fee rate between the second quarters and first six months of 2003 and 2002 was largely the result

of faster revenue recognition of deferred fees due to accelerated mortgage prepayments, together with somewhat higher fee rates on new business.

Fee and Other Income, Net

Fee and other income totaled \$232 million and \$345 million in the second quarter and first half of 2003, up from \$42 million and \$45 million of income in the second quarter and first half of 2002. During the first half of 2003, we experienced a significant increase in transaction, technology, and multifamily fees due to a surge in business volumes associated with a stronger refinancing market. Transaction, technology, and multifamily fees totaled \$283 million and \$524 million for the second quarter and first half of 2003, increases of \$187 million and \$341 million over the second quarter and first half of 2002.

We recorded \$99 million and \$32 million of gains from the sale of mortgage-related securities classified as available-for-sale during the three months ended June 30, 2003 and 2002. We recorded \$110 million and \$21 million of gains from the sale of mortgage-related securities classified as available-for-sale during the six months ended June 30, 2003 and 2002.

We recognized impairment totaling \$102 million and \$197 million in the second quarter and first half of 2003, respectively, due to other than temporary declines in the fair value of certain mortgage and nonmortgage securities or investments. These securities were downgraded during the year and their fair values were significantly lower than cost. It is uncertain whether we will receive all principal and interest due to us.

Credit-Related Expenses

Our overall credit performance remained relatively stable in the second quarter and first half of 2003 compared to the corresponding prior year periods. Credit-related expenses, which include provision for losses and foreclosed property income, declined slightly to \$23 million and \$43 million in the second quarter and first half of 2003, compared with \$24 million and \$46 million in the second quarter and first half of 2002. The decrease in credit-related expenses was driven by a decline in provision for losses, which more than offset a decline in foreclosed property income. Provision for losses decreased \$7 million and \$12 million from the second quarter and first half of 2002 to \$26 million and \$49 million, respectively. Foreclosed property income totaled \$3 million and \$6 million in the second quarter and first half of 2003, down from \$9 million and \$15 million in the second quarter and first half of 2002, primarily due to less income on foreclosed property dispositions.

Credit-related losses, which include charge-offs plus foreclosed property income, remained low in the first half of 2003 due to continued home price gains resulting from the strong housing market, the use of credit enhancements to manage our credit risk, and aggressive management of problem loans. Credit-related losses increased slightly to \$23 million and \$43 million in the second quarter and first half of 2003, from \$17 million and \$39 million in the second quarter and first half of 2002, primarily due to a decline in foreclosed property income.

Administrative Expenses

Administrative expenses totaled \$354 million and \$698 million in the second quarter and first half of 2003, increases of 18 percent over both the second quarter and first half of 2002. The above-average growth in administrative expenses was due primarily to costs incurred in reengineering Fannie Mae's core technology infrastructure to enhance our ability to process and manage the risk on mortgage assets and the expensing of new stock-based compensation. On January 1, 2003, we adopted the expense recognition provisions of the fair value method of accounting for stock-based compensation under Financial Accounting Standard No. 123, *Accounting for Stock-Based Compensation* ("FAS 123") and began expensing all new stock-based compensation.

We evaluate growth in administrative expenses based on growth in core taxable-equivalent revenues and our average book of business. Core taxable-equivalent revenues is a supplemental non-GAAP measure

discussed further in “MD&A— Core Business Earnings and Business Segment Results.” Despite the above-average growth in administrative expenses, our efficiency ratio— the ratio of administrative expenses to core taxable-equivalent revenues— improved to 8.9 percent and 9.2 percent in the second quarter and first half of 2003 from 10.1 percent and 10.2 percent in the second quarter and first half of 2002. The ratio of administrative expenses as a percentage of our average book of business improved to .071 percent and .072 percent in the second quarter and first half of 2003, compared with .073 percent in both the second quarter and first half of 2002.

Purchased Options Expense

Purchased options expense totaled \$1.883 billion and \$2.508 billion in the second quarter and first half of 2003, respectively, up significantly from \$498 million and \$1.286 billion in the second quarter and first half of 2002. The mark-to-market of the time value of our purchased options will vary from period to period with changes in interest rates, expected interest rate volatility, and derivative activity.

Debt Extinguishments

We recognized \$740 million and \$1.132 billion in losses on debt extinguishments during the second quarter and first half of 2003, respectively, up from \$225 million and \$396 million in losses on debt extinguishments that we recognized during the second quarter and first half of 2002. These losses resulted from the call and repurchase of \$73 billion and \$121 billion of debt during the second quarter and first half of 2003, respectively, and the call and repurchase of \$30 billion and \$60 billion of debt during the second quarter and first half of 2002, respectively. The year-over-year increase in debt extinguishment activity was driven by attractive opportunities to repurchase relatively high-cost debt. We regularly call or repurchase debt as part of our interest rate risk management strategy.

Income Taxes

Our effective tax rate on reported net income in the second quarter and first half of 2003 was 19 percent and 24 percent based on a provision for federal income taxes of \$263 million and \$970 million, respectively. In comparison, our effective tax rate for the same prior year periods was 25 percent and 24 percent and our tax provision totaled \$485 million and \$848 million in the second quarter and first half of 2002. Because of the significant decrease in our pre-tax reported income for the second quarter of 2003, our tax-exempt income and the tax credits we receive on our tax-advantaged investments provided disproportionate tax benefit to our base of pre-tax reported income which reduced our effective tax rate. Our effective tax rate based on core business earnings, which is adjusted for the impact of FAS 133 on our purchased options, was 27 percent and 26 percent in the second quarter and first half of 2003, compared with 26 percent in the same prior year periods.

CORE BUSINESS EARNINGS AND BUSINESS SEGMENT RESULTS

Management relies primarily on core business earnings, a supplemental non-GAAP measure developed in conjunction with our adoption of FAS 133, to evaluate Fannie Mae’s financial performance. While core business earnings is not a substitute for GAAP net income, we rely on core business earnings in operating our business because we believe core business earnings provides our management and investors with a better measure of our financial results and better reflects our risk management strategies than our GAAP net income. Core business earnings excludes the unpredictable volatility in the time value of purchased options because we intend to hold these options to maturity, and we do not believe the period-to-period variability in our reported net income from changes in the time value of our purchased options accurately reflects the underlying risks or economics of our hedging strategies. Core business earnings includes amortization of purchased option premiums on a straight-line basis over the original expected life of the options, together with any acceleration of expense related to any options extinguished prior to exercise or expiration. The net amount of purchased options amortization expense recorded under our core business earnings measure will equal the net amount of purchased options expense ultimately recorded under FAS 133 in our reported net income over the life of our options. However, our amortization treatment is

more consistent with the accounting for embedded options in our callable debt and more accurately reflects the underlying economics of our use of purchased options as a substitute for issuing callable debt— two alternate hedging strategies that are economically very similar but require different accounting treatment. The calculation of core capital and total capital includes retained earnings, which incorporates GAAP net income, not core business earnings. Our core capital and total capital levels are important determinants of the amount of capital available to shareholders for dividends and our dividend policies take into account these capital levels.

Management also relies on several other non-GAAP performance measures related to core business earnings to evaluate Fannie Mae's performance. These key performance measures include core taxable-equivalent revenues, core net interest income, and net interest margin. We discuss these measures further in this section and provide a discussion of our business segments, which we also evaluate based on core business earnings. Our core business earnings measures are not defined terms within GAAP and may not be comparable to similarly titled measures reported by other companies.

Core Business Earnings

Core business earnings for the second quarter of 2003 grew 18 percent over the second quarter of 2002 to \$1.860 billion. Core business earnings per diluted common share increased 20 percent to \$1.86 from \$1.55 in the second quarter of 2002 and increased 22 percent to \$3.70 from \$3.03 in the first half of 2002. Increases in our core business earnings and core business earnings per diluted common share were due primarily to strong growth in our core net interest income, guaranty fee income, and fee and other income. Highlights of our second quarter 2003 performance compared with second quarter 2002 include:

- *34 percent increase in core taxable-equivalent revenues to \$3.980 billion*
- *26 percent increase in core net interest income to \$2.785 billion*
- *14 basis point increase in the net interest margin to 1.30 percent*
- *49 percent increase in guaranty fee income*
- *\$190 million increase in fee and other income to \$232 million*
- *Losses of \$740 million from the call and repurchase of debt compared with \$225 million*
- *29 percent annualized growth in our combined book of business (gross mortgage portfolio and outstanding MBS) during the second quarter of 2003, up from 14 percent annualized growth in the second quarter of 2002*

While our core business earnings measures should not be construed by investors as an alternative to net income and other measures determined in accordance with GAAP, they are critical performance indicators for Fannie Mae's management. Core business earnings is the primary financial performance measure used by Fannie Mae's management not only in developing the financial plans of our lines of business and tracking results, but also in establishing corporate performance targets and determining incentive compensation. In addition, the investment analyst community has traditionally relied on our core business earnings measures to evaluate Fannie Mae's earnings performance and to issue earnings guidance. We believe these measures also can serve as valuable assessment tools for investors to judge the quality of our earnings because they provide more consistent accounting and reporting for economically similar interest rate risk hedging transactions, which allows investors to more readily identify sustainable trends and gauge potential future earnings trends.

Table 3 shows our line of business and consolidated core business earnings results for the second quarter and first half of 2003 and 2002. The only difference between core business earnings and reported net income relates to the FAS 133 accounting treatment for purchased options, which affects our Portfolio Investment business. Core business earnings does not exclude any other accounting effects related to the application of FAS 133. The FAS 133 related reconciling items between our core business earnings and reported results have no effect on our Credit Guaranty business.

Table 3: Reconciliation of Core Business Earnings to Reported Results

Three Months Ended June 30, 2003					
	Portfolio Investment	Credit Guaranty	Total Core Business Earnings	Reconciling Items Related to Purchased Options	Reported Results
(Dollars in millions)					
Net interest income	\$3,280	\$ 221	\$3,501	\$ —	\$ 3,501
Purchased options amortization expense	(716)	—	(716)	716 ⁽²⁾	—
Core net interest income	2,564	221	2,785	716	3,501
Guaranty fee income (expense)	(404)	1,036	632	—	632
Fee and other income, net	231	1	232	—	232
Credit-related expenses ⁽¹⁾	—	(23)	(23)	—	(23)
Administrative expenses	(103)	(251)	(354)	—	(354)
Purchased options expense under FAS 133	—	—	—	(1,883) ⁽³⁾	(1,883)
Debt extinguishments	(740)	—	(740)	—	(740)
Income before federal income taxes	1,548	984	2,532	(1,167)	1,365
Provision for federal income taxes	(454)	(218)	(672)	409 ⁽⁴⁾	(263)
Net income	\$1,094	\$ 766	\$1,860	\$ (758)	\$ 1,102
Three Months Ended June 30, 2002					
	Portfolio Investment	Credit Guaranty	Total Core Business Earnings	Reconciling Items Related to Purchased Options	Reported Results
Net interest income	\$2,375	\$ 157	\$2,532	\$ —	\$2,532
Purchased options amortization expense	(330)	—	(330)	330 ⁽²⁾	—
Core net interest income	2,045	157	2,202	330	2,532
Guaranty fee income (expense)	(336)	759	423	—	423
Fee and other income, net	82	(40)	42	—	42
Credit-related expenses ⁽¹⁾	—	(24)	(24)	—	(24)
Administrative expenses	(91)	(210)	(301)	—	(301)
Purchased options expense under FAS 133	—	—	—	(498) ⁽³⁾	(498)
Debt extinguishments	(225)	—	(225)	—	(225)
Income before federal income taxes	1,475	642	2,117	(168)	1,949
Provision for federal income taxes	(430)	(114)	(544)	59 ⁽⁴⁾	(485)
Net income	\$1,045	\$ 528	\$1,573	\$(109)	\$1,464

(1) Credit-related expenses include the income statement line items "Provision for losses" and "Foreclosed property income."

(2) Represents the straight-line amortization of purchased options expense that we allocate to interest expense over the original expected life of the options. We include this amount in core business earnings instead of recording changes in the time value of purchased options because this treatment is more consistent with the accounting for the embedded options in our callable debt and the vast majority of our mortgages.

(3) Represents changes in the fair value of the time value of purchased options recorded in accordance with FAS 133. We exclude this amount from our core business earnings measure because the period-to-period fluctuations in the time value portion of our options do not reflect the economics of our current risk management strategy, which generally is to hold our purchased options to maturity or exercise date. Consequently, we do not expect to realize the period-to-period fluctuations in time value. In addition, the accounting for purchased options under FAS 133 is inconsistent with the accounting for embedded options in our callable debt and mortgages.

(4) Represents the net federal income tax effect of core business earnings adjustments based on the applicable federal income tax rate of 35 percent.

Six Months Ended June 30, 2003

	Portfolio Investment	Credit Guaranty	Total Core Business Earnings	Reconciling Items Related to Purchased Options	Reported Results
(Dollars in millions)					

Net interest income	\$ 6,466	\$ 403	\$ 6,869	\$ —	\$ 6,869
Purchased options amortization expense	(1,481)	—	(1,481)	1,481 ⁽²⁾	—
Core net interest income	4,985	403	5,388	1,481	6,869
Guaranty fee income (expense)	(807)	1,986	1,179	—	1,179
Fee and other income, net	353	(8)	345	—	345
Credit-related expenses ⁽¹⁾	—	(43)	(43)	—	(43)
Administrative expenses	(204)	(494)	(698)	—	(698)
Purchased options expense under FAS 133	—	—	—	(2,508) ⁽³⁾	(2,508)
Debt extinguishments	(1,132)	—	(1,132)	—	(1,132)
Income before federal income taxes	3,195	1,844	5,039	(1,027)	4,012
Provision for federal income taxes	(938)	(391)	(1,329)	359 ⁽⁴⁾	(970)
Net income	\$ 2,257	\$ 1,453	\$ 3,710	\$ (668)	\$ 3,042

Six Months Ended June 30, 2002

	Portfolio Investment	Credit Guaranty	Total Core Business Earnings	Reconciling Items Related to Purchased Options	Reported Results
Net interest income	\$4,647	\$ 316	\$ 4,963	\$ —	\$ 4,963
Purchased options amortization expense	(641)	—	(641)	641(2)	—
Core net interest income	4,006	316	4,322	641	4,963
Guaranty fee income (expense)	(654)	1,485	831	—	831
Fee and other income, net	142	(97)	45	—	45
Credit-related expenses ⁽¹⁾	—	(46)	(46)	—	(46)
Administrative expenses	(176)	(415)	(591)	—	(591)
Purchased options expense under FAS 133	—	—	—	(1,286) ⁽³⁾	(1,286)
Debt extinguishments	(396)	—	(396)	—	(396)
Income before federal income taxes	2,922	1,243	4,165	(645)	3,520
Provision for federal income taxes	(858)	(216)	(1,074)	226(4)	(848)
Net income	\$2,064	\$1,027	\$ 3,091	\$ (419)	\$ 2,672

(1) Credit-related expenses include the income statement line items “Provision for losses” and “Foreclosed property income.”

(2) Represents the straight-line amortization of purchased options expense that we allocate to interest expense over the original expected life of the options. We include this amount in core business earnings instead of recording changes in the time value of purchased options because this treatment is more consistent with the accounting for the embedded options in our callable debt and the vast majority of our mortgages.

(3) Represents changes in the fair value of the time value of purchased options recorded in accordance with FAS 133. We exclude this amount from our core business earnings measure because the period-to-period fluctuations in the time value portion of our options do not reflect the economics of our current risk management strategy, which generally is to hold our purchased options to maturity or exercise date. Consequently, we do not expect to realize the period-to-period fluctuations in time value. In addition, the accounting for purchased options under FAS 133 is inconsistent with the accounting for embedded options in our callable debt and mortgages.

(4) Represents the net federal income tax effect of core business earnings adjustments based on the applicable federal income tax rate of 35 percent.

The guaranty fee income that we allocate to the Credit Guaranty business for managing the credit risk on mortgage-related assets held by the Portfolio Investment business is offset by a corresponding guaranty fee expense allocation to the Portfolio Investment business in our line of business results. Thus, there is no inter-segment elimination adjustment between our total line of business guaranty fee income and our reported guaranty fee income. For line of business reporting purposes, we allocate transaction fees that we earn for structuring and facilitating securities transactions primarily to our Portfolio Investment business. We allocate technology-related fees that we earn from providing Desktop Underwriter and other technology services to our customers and fees we earn for providing credit enhancement alternatives to our customers primarily to our Credit Guaranty business.

Core Taxable-Equivalent Revenues

Core taxable-equivalent revenues for the second quarter and first half of 2003 increased 34 percent and 30 percent over the second quarter and first half of 2002 to \$3.980 billion and \$7.583 billion, primarily due to strong growth in core net interest income, guaranty fee income, and fee and other income. Table 4 reconciles core taxable-equivalent revenues to taxable-equivalent revenues and provides a comparison between the second quarter and first half of 2003 and 2002.

Table 4: Core Taxable-Equivalent Revenues

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	(Dollars in millions)			
Net interest income	\$3,501	\$2,532	\$ 6,869	\$4,963
Guaranty fees	632	423	1,179	831
Fee and other income, net ⁽¹⁾	232	42	345	45
Total revenues	4,365	2,997	8,393	5,839
Taxable-equivalent adjustments:				
Investment tax credits ⁽²⁾	212	178	429	364
Tax-exempt investments ⁽³⁾	119	126	242	249
Taxable-equivalent revenues	4,696	3,301	9,064	6,452
Purchased options amortization expense ⁽⁴⁾	(716)	(330)	(1,481)	(641)
Core taxable-equivalent revenues	\$3,980	\$2,971	\$ 7,583	\$5,811

(1) Includes net losses on certain tax-advantaged investments totaling \$52 million and \$75 million for the three months ended June 30, 2003 and 2002, respectively, and \$124 million and \$140 million for the six months ended June 30, 2003 and 2002, respectively.

(2) Represents non-GAAP taxable-equivalent adjustments for tax credits related to losses on certain affordable housing tax-advantaged equity investments and other investment tax credits using the applicable federal income tax rate of 35 percent.

(3) Represents non-GAAP adjustments to permit comparisons of yields on tax-exempt and taxable assets based on a 35 percent marginal tax rate.

(4) Represents non-GAAP adjustment for straight-line amortization of purchased options premiums that would have been recorded prior to the adoption of FAS 133 in 2001.

Core Net Interest Income

Table 5 reconciles taxable-equivalent core net interest income to our reported net interest income and presents an analysis of our net interest margin. Our taxable-equivalent core net interest income and net interest margin are significantly different than our reported taxable-equivalent net interest income and net interest yield because our core measures include the amortization of our purchased options premiums on a straight-line basis over the life of the option, which is not in accordance with GAAP.

Table 5: Net Interest Margin

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	(Dollars in millions)			
Net interest income	\$ 3,501	\$ 2,532	\$ 6,869	\$ 4,963
Purchased options amortization expense ⁽¹⁾	(716)	(330)	(1,481)	(641)
Core net interest income	2,785	2,202	5,388	4,322
Taxable-equivalent adjustment on tax-exempt investments ⁽²⁾	119	126	242	249
Taxable-equivalent core net interest income	\$ 2,904	\$ 2,328	\$ 5,630	\$ 4,571
Average balances: ⁽³⁾				
Interest-earning assets: ⁽⁴⁾				
Mortgage portfolio, net	\$808,215	\$732,796	\$806,510	\$724,200
Nonmortgage investments and cash equivalents	81,966	69,187	74,550	67,176
Total interest-earning assets	890,181	801,983	881,060	791,376
Interest-free funds ⁽⁵⁾	(32,431)	(24,196)	(30,432)	(24,083)
Total interest-earning assets funded by debt	857,750	777,787	850,628	767,293
Interest-bearing liabilities: ⁽⁶⁾				
Short-term debt	231,718	128,885	221,063	130,153
Long-term debt	626,032	648,902	629,565	637,140
Total interest-bearing liabilities	\$857,750	\$777,787	\$850,628	\$767,293
Average interest rates: ^(2, 3)				
Interest-earning assets:				
Mortgage portfolio, net	6.07%	6.77%	6.17%	6.81%
Nonmortgage investments and cash equivalents	1.66	2.45	1.74	2.49
Total interest-earning assets	5.66	6.40	5.80	6.44
Interest-free return ⁽⁵⁾	.20	.18	.20	.19
Total interest-earning assets and interest-free return	5.86	6.58	6.00	6.63
Interest-bearing liabilities: ⁽⁶⁾				
Short-term debt	1.43	2.21	1.54	2.39
Long-term debt	5.72	6.06	5.83	6.10
Total interest-bearing liabilities	4.56	5.42	4.72	5.47
Net interest margin	1.30%	1.16%	1.28%	1.16%

(1) Reflects non-GAAP adjustment for straight-line amortization of purchased options premiums that would have been recorded prior to the adoption of FAS 133 in 2001.

(2) Reflects non-GAAP adjustments to permit comparison of yields on tax-exempt and taxable assets based on a 35 percent marginal tax rate.

(3) Averages have been calculated on a monthly basis based on amortized cost.

(4) Includes average balance of nonaccrual loans of \$5.9 billion and \$4.5 billion for the three months ended June 30, 2003 and 2002, respectively, and \$5.8 billion and \$4.3 billion for the six months ended June 30, 2003 and 2002, respectively.

(5) Interest-free funds represent the portion of our investment portfolio funded by equity and non-interest bearing liabilities.

(6) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on effective maturity or repricing date, taking into consideration the effect of derivative financial instruments. The cost of debt includes expense for the amortization of purchased options.

Core net interest income for the second quarter and first half of 2003 increased \$583 million and \$1.066 billion, or 26 percent and 25 percent, over the second quarter and first half of 2002 to \$2.785 billion and \$5.388 billion. The increase was due primarily to 11 percent growth in our average net investment balance (total interest earning assets) in each period and a 14 basis point and 12 basis point increase in the net interest margin to 1.30 percent and 1.28 percent in the second quarter and first half of 2003, respectively. Table 6 shows changes in core net interest income between the second quarter and first half of 2003 and the second quarter and first half of 2002.

Table 6: Rate/Volume Analysis of Changes in Core Net Interest Income

	Increase (Decrease)	Attributable to Changes in ⁽¹⁾	
		Volume	Rate
(Dollars in millions)			
Second Quarter 2003 vs. Second Quarter 2002			
Interest income:			
Mortgage portfolio	\$ (70)	\$1,205	\$(1,275)
Nonmortgage investments and cash equivalents	(84)	68	(152)
Total interest income	(154)	1,273	(1,427)
Interest expense: ⁽²⁾			
Short-term debt	51	378	(327)
Long-term debt	(1,174)	(328)	(846)
Total interest expense	(1,123)	50	(1,173)
Change in net interest income	\$ 969	\$1,223	\$ (254)
Change in purchased options amortization expense ⁽³⁾	(386)		
Change in core net interest income	\$ 583		
Change in taxable-equivalent adjustment on tax-exempt investments ⁽⁴⁾	(7)		
Change in taxable-equivalent core net interest income	\$ 576		
First Six Months 2003 vs. First Six Months 2002			
Interest income:			
Mortgage portfolio	\$ 349	\$2,645	\$(2,296)
Nonmortgage investments and cash equivalents	(184)	83	(267)
Total interest income	165	2,728	(2,563)
Interest expense: ⁽²⁾			
Short-term debt	17	743	(726)
Long-term debt	(1,758)	(222)	(1,536)
Total interest expense	(1,741)	521	(2,262)
Change in net interest income	\$ 1,906	\$2,207	\$ (301)
Change in purchased options amortization expense ⁽³⁾	(840)		
Change in core net interest income	\$ 1,066		
Change in taxable-equivalent adjustment on tax-exempt investments ⁽⁴⁾	(7)		
Change in taxable-equivalent core net interest income	\$ 1,059		

(1) Combined rate/volume variances, a third element of the calculation, are allocated to the rate and volume variances based on their relative size.

(2) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on effective maturity or repricing date, taking into consideration the effect of derivative financial instruments.

(3) Reflects non-GAAP adjustment for straight-line amortization of purchased options premiums that we would have recorded under GAAP prior to adopting FAS 133.

(4) Reflects non-GAAP adjustments to permit comparison of yields on tax-exempt and taxable assets based on a 35 percent marginal tax rate.

Business Segment Results

Portfolio Investment Business

Fannie Mae's Portfolio Investment business manages the interest rate risk of our mortgage portfolio and nonmortgage investments. Core business earnings generated by our Portfolio Investment business is primarily reflected in core net interest income. Second quarter and first half 2003 core business earnings for our Portfolio Investment business grew 5 percent and 9 percent over the corresponding periods in 2002 to \$1.094 billion and \$2.257 billion, respectively. This growth was driven primarily by strong growth in core net interest income in both periods, partially offset by a significant increase in losses from debt extinguishments.

The increase in core net interest income for our Portfolio Investment business was driven by an increase in our net interest margin, which averaged 130 basis points and 128 basis points in the second quarter and first half of 2003, respectively, compared with 116 basis points in both the second quarter and first half of 2002. These increases in our net interest margin were partially offset by slower growth in our mortgage portfolio, which declined at an annualized rate of 2 percent during the second quarter of 2003 and slowed

to an annualized growth rate of 6 percent during the first half of 2003. This relatively slow growth in the portfolio was driven by continued high levels of liquidations together with strong competition for mortgages from banks and other investors that periodically narrowed spreads between mortgage yields and our debt costs (mortgage-to-debt spreads) which produced less attractive purchase opportunities. In addition, during the second quarter of 2003 we took advantage of favorable pricing in the forward market and delayed settlement on many of our mortgage purchase commitments. As these commitments settle during the second half of the year, our portfolio growth should accelerate noticeably.

Our net interest margin for the second quarter and first half of 2003 benefited significantly from very low mortgage rates and high levels of anticipated refinancing. We had expected our net interest margin to begin to decline in early 2003 as interest rates leveled off or moved higher. However, interest rates dropped further in the first half of 2003, resulting in an increase in projected mortgage liquidations. As a result, we maintained an unusually high percentage of short-term financing at a lower cost for longer than we had anticipated, which reduced our interest expense and caused a further temporary increase in our net interest margin.

Losses from debt extinguishments increased by \$515 million and \$736 million during the second quarter and first half of 2003, respectively. These increases were driven by attractive opportunities to repurchase high-cost debt.

Mortgage Portfolio

Table 7 summarizes mortgage portfolio activity on a gross basis and average yields for the second quarter and first half of 2003 and 2002, and Table 8 shows the distribution of Fannie Mae's mortgage portfolio by product type at June 30, 2003 and December 31, 2002.

Table 7: Mortgage Portfolio Activity⁽¹⁾

	Purchases		Sales		Repayments ⁽²⁾	
	Three Months Ended June 30,		Three Months Ended June 30,		Three Months Ended June 30,	
	2003	2002	2003	2002	2003	2002
(Dollars in millions)						
Single-family:						
Government insured or guaranteed	\$ 1,493	\$ 5,879	\$ —	\$ 67	\$ 4,536	\$ 2,708
Conventional:						
Long-term, fixed-rate	102,204	35,712	5,116	3,562	102,860	34,621
Intermediate-term, fixed-rate	17,904	11,667	107	—	15,239	6,715
Adjustable-rate	3,896	1,928	202	—	2,817	2,030
Total conventional single-family	124,004	49,307	5,425	3,562	120,916	43,366
Total single-family	125,497	55,186	5,425	3,629	125,452	46,074
Multifamily	2,463	1,731	—	—	494	401
Total	\$127,960	\$56,917	\$5,425	\$3,629	\$125,946	\$46,475
Average net yield	5.09%	6.37%			6.45%	6.89%
Annualized repayments as a percentage of average mortgage portfolio					61.8%	25.2%
	Purchases		Sales		Repayments ⁽²⁾	
	Six Months Ended June 30,		Six Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002	2003	2002
Single-family:						
Government insured or guaranteed	\$ 2,421	\$ 7,134	\$ 58	\$ 73	\$ 8,818	\$ 5,549
Conventional:						
Long-term, fixed-rate	207,988	109,974	6,075	6,120	196,917	85,549
Intermediate-term, fixed-rate	37,474	23,535	307	74	19,540	11,019
Adjustable-rate	7,451	3,442	256	114	5,231	4,420
Total conventional single-family	252,913	136,951	6,638	6,308	221,688	100,988
Total single-family	255,334	144,085	6,696	6,381	230,506	106,537
Multifamily	4,631	3,778	—	379	1,048	910
Total	\$259,965	\$147,863	\$6,696	\$6,760	\$231,554	\$107,447
Average net yield	5.22%	6.34%			6.52%	6.96%
Annualized repayments as a percentage of average mortgage portfolio					57.1%	29.4%

(1) Excludes premiums, discounts, and other deferred price adjustments.

(2) Includes mortgage loan prepayments, scheduled amortization, and foreclosures.

Table 8: Mortgage Portfolio Composition⁽¹⁾

	June 30, 2003	December 31, 2002
(Dollars in millions)		
Mortgages		
Single-family:		
Government insured or guaranteed	\$ 6,045	\$ 5,458
Conventional:		
Long-term, fixed-rate	110,488	103,220
Intermediate-term, fixed-rate ⁽²⁾	67,946	54,503
Adjustable-rate	10,600	9,045
Total conventional single-family	189,034	166,768
Total single-family	195,079	172,226
Multifamily:		
Government insured or guaranteed	1,212	1,353
Conventional	14,855	12,218
Total multifamily	16,067	13,571
Total mortgages	\$211,146	\$185,797
Mortgage-related securities		
Single-family:		
Government insured or guaranteed	\$ 26,137	\$ 33,293
Conventional:		
Long-term, fixed-rate	506,704	510,435
Intermediate-term, fixed-rate ⁽²⁾	43,284	39,409
Adjustable-rate	14,564	13,946
Total conventional single-family	564,552	563,790
Total single-family	590,689	597,083
Multifamily:		
Government insured or guaranteed	8,012	7,370
Conventional	7,620	7,050
Total multifamily	15,632	14,420
Total mortgage-related securities	\$606,321	\$611,503
Mortgage portfolio, net		
Single-family:		
Government insured or guaranteed	\$ 32,182	\$ 38,751
Conventional:		
Long-term, fixed-rate	617,192	613,655
Intermediate-term, fixed-rate ⁽²⁾	111,230	93,912
Adjustable-rate	25,164	22,991
Total conventional single-family	753,586	730,558
Total single-family	785,768	769,309
Multifamily:		
Government insured or guaranteed	9,224	8,723
Conventional	22,475	19,268
Total multifamily	31,699	27,991
Total mortgage portfolio	817,467	797,300
Unamortized premium, discount, and deferred price adjustments, net ⁽³⁾	2,892	472
Allowance for loan losses ⁽⁴⁾	(83)	(79)
Mortgage portfolio, net	\$820,276	\$797,693
Average net yield	5.99%	6.45%

(1) Data reflects unpaid principal balance adjusted to include mark-to-market gains and losses on available-for-sale securities.

(2) Intermediate-term, fixed-rate consists of portfolio loans with contractual maturities at purchase equal to or less than 20 years and MBS and other mortgage-related securities held in portfolio with maturities of 15 years or less at issue date.

(3) Includes net unamortized premiums of \$1,587 million at June 30, 2003 and \$135 million at December 31, 2002 related to available-for-sale and held-to-maturity mortgage-related securities.

(4) Guaranty liability for probable losses on loans underlying Fannie Mae guaranteed MBS is included in "Guaranty liability for MBS."

Nonmortgage Investments

Nonmortgage investments consist of our Liquid Investment Portfolio ("LIP") and other non-mortgage related investments. Nonmortgage investments increased 12 percent to \$67 billion at June 30, 2003, from

\$60 billion at December 31, 2002. We regularly review these investments for other than temporary declines in their fair value and record impairment where appropriate in fee and other income.

Table 9 shows the composition, weighted-average maturities, and credit ratings of our available-for-sale and held-to-maturity nonmortgage investments at June 30, 2003 and December 31, 2002.

Table 9: Nonmortgage Investments

Available-for-Sale

June 30, 2003						
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Maturity in Months	% Rated A or Better
(Dollars in millions)						
Available-for-sale:						
Asset-backed securities	\$27,533	\$ 83	\$(40)	\$27,576	24.0	99.3
Floating rate notes ⁽¹⁾	12,649	17	(4)	12,662	14.4	92.5
Corporate bonds	1,134	44	—	1,178	21.8	73.1
Taxable auction notes	784	—	—	784	.5	100.0
Auction rate preferred stock	63	2	—	65	1.0	—
Other	50	—	—	50	7.8	100.0
	—	—	—	—	—	—
Total	\$42,213	\$146	\$(44)	\$42,315	20.6	96.4
December 31, 2002						
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Maturity in Months	% Rated A or Better
(Dollars in millions)						
Available-for-sale:						
Asset-backed securities	\$22,281	\$ 98	\$ (68)	\$22,311	30.0	100.0
Floating rate notes ⁽¹⁾	11,754	10	(29)	11,735	10.6	87.6
Corporate bonds	1,149	42	—	1,191	12.8	25.2
Taxable auction notes	949	—	—	949	.2	100.0
Commercial paper	100	—	—	100	2.2	100.0
Auction rate preferred stock	112	—	(4)	108	2.5	43.5
Other	400	—	—	400	1.1	100.0
	—	—	—	—	—	—
Total	\$36,745	\$150	\$(101)	\$36,794	22.0	93.5

(1) As of June 30, 2003 and December 31, 2002, 100 percent of floating rate notes repriced at intervals of 90 days or less.

Held-to-Maturity

June 30, 2003						
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Maturity in Months	% Rated A or Better
(Dollars in millions)						
Held-to-maturity:						
Repurchase agreements	\$18,294	\$ —	\$ —	\$18,294	.5	100.0
Federal funds	5,100	—	—	5,100	.3	100.0
Auction rate preferred stock	774	—	—	774	.8	100.0
Other	441	—	—	441	7.3	100.0
Total	\$24,609	\$ —	\$ —	\$24,609	.6	100.0

December 31, 2002						
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Maturity in Months	% Rated A or Better
(Dollars in millions)						
Held-to-maturity:						
Repurchase agreements	\$20,732	\$ —	\$ —	\$20,732	.5	100.0
Federal funds	150	—	—	150	1.9	100.0
Auction rate preferred stock	402	—	—	402	1.0	100.0
Eurodollar time deposits	1,398	—	—	1,398	.8	100.0
Commercial paper	100	—	—	100	.7	100.0
Other	268	1	—	269	4.9	100.0
Total	\$23,050	\$ 1	\$ —	\$23,051	.6	100.0

Our nonmortgage investments combined with cash and cash equivalents represent our total liquid investments. Our liquid investments totaled \$69 billion at June 30, 2003, compared with \$62 billion at December 31, 2002.

Debt Securities

Total debt outstanding increased 4 percent to \$884 billion at June 30, 2003 from \$851 billion at December 31, 2002. Table 10 shows a comparison of debt issuances and repayments between the second quarter and first half of 2003 and the second quarter and first half of 2002.

Table 10: Debt Activity

	Three Months Ended June 30,	
	2003	2002
(Dollars in millions)		
Issued:		
Amount	\$686,729	\$389,024
Average cost	1.23%	2.27%
Redeemed:		
Amount	\$679,863	\$372,815
Average cost	1.78%	2.31%
Six Months Ended June 30,		
	2003	2002
Issued:		
Amount	\$1,337,602	\$912,889
Average cost	1.32%	2.19%
Redeemed:		
Amount	\$1,308,238	\$890,169
Average cost	1.75%	2.28%

We adjust the maturity and redemption value of our outstanding debt to show the effect of our use of derivatives to supplement our issuance of debt and to hedge against fluctuations in interest rates. Table 11 shows that we increased the relative amount of our effective short-term debt relative to effective long-term debt and

in mortgage asset liquidations and the steep yield curve. Table 12 shows the maturity and cost of our effective long-term debt.

Table 11: Effective Short-Term and Long-Term Debt

	June 30, 2003	December 31, 2002
(Dollars in millions)		
Outstanding:		
Short-term: ⁽¹⁾		
Net amount	\$294,432	\$192,702
Cost	1.28%	1.52%
Weighted-average maturity (in months)	2	3
Percent of total debt outstanding	34%	23%
Long-term: ⁽²⁾		
Net amount	\$579,676	\$651,827
Cost	5.57%	5.48%
Weighted-average maturity (in months)	74	75
Percent of total debt outstanding	66%	77%
Total:		
Net amount ⁽³⁾	\$874,108	\$844,529
Cost	4.13%	4.81%
Weighted-average maturity (in months)	50	58

(1) Represents the redemption value of short-term debt adjusted to include the effect of derivative instruments that replicate short-term, variable-rate debt securities and exclude short-term debt securities that have been economically converted into long-term debt funding through interest rate swaps.

(2) Represents the redemption value of long-term debt adjusted to include the effect of short-to-long interest rate swaps that economically convert short-term debt securities into long-term debt securities and exclude long-term debt securities that have been economically converted into short-term funding through interest rate swaps.

(3) Represents the redemption value of outstanding debt at period end. Excludes the effect of amortization of premiums, discounts, issuance costs, and hedging results.

Table 12: Maturities of Effective Long-Term Debt

	Contractual Maturity		Assuming Callable Debt Redeemed at Initial Call Date	
	Amount Outstanding ⁽¹⁾	Accounting Cost ⁽²⁾	Amount Outstanding ⁽¹⁾	Accounting Cost ⁽²⁾
(Dollars in millions)				
Currently callable	\$ —	—%	\$ 3,445	5.08%
2003	28,889	6.07	132,125	4.57
2004	89,444	4.99	195,942	5.24
2005	84,890	4.21	82,386	5.28
2006	78,622	4.24	70,922	5.27
2007	49,411	5.95	36,562	7.11
2008 and later	248,420	6.55	58,294	8.88
	\$579,676	5.57	\$579,676	5.57

(1) Amount outstanding includes long-term debt, effective fixed-rate debt and notional amount of long-term interest rate swaps. Also includes debt linked to swaptions, which makes it effective callable debt. Excludes effective variable-rate debt.

(2) Accounting cost represents the monthly equivalent yield that discounts the amount due at maturity to the net proceeds over the expected life of the debt. Includes the impact of debt swaps.

Seventy-five percent of our mortgage portfolio had option-embedded protection at June 30, 2003, the same level that we had at December 31, 2002, but still above the average range of the past three years. Effectively callable debt accounted for 78 percent of the \$618 billion in option-embedded debt outstanding at June 30, 2003. In comparison, effectively callable debt accounted for 58 percent of the \$601 billion in option-embedded debt outstanding at December 31, 2002. Table 13 presents option-embedded debt instruments as a percentage of our net mortgage portfolio at June 30, 2003 and 2002, and December 31, 2002.

Table 13: Option-Embedded Debt Instruments

	Six Months Ended June 30,		December 31,
	2003	2002	2002
	(Dollars in millions)		
Issued during period	\$213	\$117	\$384
Outstanding	618	430	601
Percentage of net mortgage portfolio	75%	58%	75%

Credit Guaranty Business

Our Credit Guaranty business has primary responsibility for managing all of our mortgage credit risk. Core business earnings generated by our Credit Guaranty business are primarily reflected in guaranty fee income, administrative expenses, and net interest income. Second quarter and first half 2003 core business earnings for our Credit Guaranty business grew 45 percent and 41 percent over the corresponding periods in 2002 to \$766 million and \$1.453 billion, respectively. The increase in core business earnings for our Credit Guaranty business was driven primarily by a 36 percent and 34 percent increase in guaranty fee income. Guaranty fee income for our Credit Guaranty business increased largely due to 20 percent and 19 percent growth in our average book of business and a 2 basis point increase in the average fee rate for each period to 20.8 basis points and 20.5 basis points, respectively. The increase in the average fee rate was a result of higher fee rates on new business, together with the faster revenue recognition of deferred fees due to accelerated prepayments. The average fee rate for our Credit Guaranty business includes the effect of guaranty fee income allocated to the Credit Guaranty business for managing the credit risk on mortgage-related assets held by the Portfolio Investment business. It therefore differs from our consolidated average effective guaranty fee rate, which excludes guaranty fees on Fannie Mae MBS held in our portfolio because these fees are reported as interest income.

OFF-BALANCE SHEET ARRANGEMENTS

We enter into off-balance sheet arrangements to facilitate our statutory purpose of providing mortgage funds to the secondary market and reduce Fannie Mae's exposure to interest rate fluctuations. These arrangements may involve elements of credit and interest rate risk in excess of amounts recognized on Fannie Mae's balance sheet. Table 14 shows our off-balance sheet arrangements at June 30, 2003 and December 31, 2002, which primarily include guaranteed MBS and other mortgage-related securities and commitments to purchase mortgage assets or issue and guarantee MBS.

Table 14: Off-Balance Sheet Arrangements

	June 30, 2003	December 31, 2002
		(Dollars in billions)
Contractual amounts:		
Outstanding MBS ⁽¹⁾	\$1,237	\$1,029
Master commitments:		
Mandatory	60	41
Optional	10	6
Portfolio purchase commitments:		
Mandatory	135	85
Optional	4	3
Credit enhancements	12	12
Other investments	3	3

(1) MBS held by investors other than Fannie Mae.

Table 15 summarizes outstanding MBS and total MBS outstanding at June 30, 2003 and December 31, 2002. In addition, it presents total MBS issued plus MBS issues acquired by others, including REMICs, in the second quarter and first half of 2003 and 2002.

Table 15: Outstanding MBS⁽¹⁾

	June 30, 2003	December 31, 2002
	(Dollars in millions)	
Outstanding MBS held by other investors	\$1,237,461	\$1,029,456
Total MBS outstanding ⁽²⁾	1,749,896	1,538,287
	Three Months Ended June 30,	
	2003	2002
MBS issues acquired by others	\$282,502	\$102,909
Total MBS issued ⁽³⁾	352,985	132,042
	Six Months Ended June 30,	
	2003	2002
MBS issues acquired by others	\$486,435	\$209,713
Total MBS issued ⁽⁴⁾	645,558	305,958

(1) MBS may be resecured to back Fannie Megas, SMBS, or REMICs. With respect to those MBS, the amounts shown only include the principal amount of the MBS once. Amounts also include REMICs created from whole loans not owned or guaranteed by Fannie Mae.

(2) Includes \$512 billion at June 30, 2003 and \$509 billion at December 31, 2002 of MBS in Fannie Mae's portfolio.

(3) Total issued for the three months ended June 30, 2003 and 2002 includes \$70 billion and \$29 billion, respectively, of MBS purchased by Fannie Mae. Total issued for the three months ended June 30, 2003 and 2002 excludes \$3 billion of MBS that we issued from loans in our portfolio.

(4) Total issued for the six months ended June 30, 2003 and 2002 includes \$159 billion and \$96 billion, respectively, of MBS purchased by Fannie Mae. Total issued for the six months ended June 30, 2003 and 2002 excludes \$9 billion and \$5 billion, respectively, of MBS that we issued from loans in our portfolio.

REMIC issuances totaled \$72 billion and \$145 billion in the second quarter and first half of 2003, compared with \$22 billion and \$58 billion in the second quarter and first half of 2002. Lower interest rates continued to fuel MBS issuances, making more collateral available for REMICs. The REMIC market continued to be attractive to investors because of the effect of the steep yield curve. The outstanding balance of REMICs (including REMICs held in Fannie Mae's portfolio) was \$382 billion at June 30, 2003, compared with \$347 billion at December 31, 2002.

CRITICAL ACCOUNTING POLICIES

Fannie Mae's financial statements and reported results are based on GAAP, which requires us in some cases to use estimates and assumptions that may affect our reported results and disclosures. We believe the application of the following accounting policies involve the most critical or complex estimates and assumptions used in preparing Fannie Mae's financial statements: determining the adequacy of the allowance for loan losses and guaranty liability for MBS; projecting mortgage prepayments to calculate the amortization of deferred price adjustments on mortgages and mortgage-related securities held in portfolio and guaranteed mortgage-related securities; and estimating the time value of our purchased options. We discuss the assumptions involved in applying these policies in Fannie Mae's 2002 Annual Report on Form 10-K under "Management's Discussion and Analysis of Financial Condition and Results of Operation—Application of Critical Accounting Policies"

As of June 30, 2003, we have not made any significant changes to the estimates and assumptions used in applying our critical accounting policies from our audited financial statements except as follows. In conjunction with this ongoing assessment and continual updating of assumptions, management significantly changed the prepayment projections for mortgages and mortgage-related securities held in portfolio and

guaranteed mortgage-related securities as a result of substantially lower interest rates. This resulted in an acceleration of the recognition of deferred price adjustments related to our guaranty business as discussed in the guaranty fee section. While we believe our estimates and assumptions are reasonable based on historical experience and other factors, actual results could differ from those estimates and these differences could be material to the financial statements.

RISK MANAGEMENT

Fannie Mae is exposed to several major areas of risk, including interest rate risk and credit risk, that are discussed in our Annual Report on Form 10-K for the year ended December 31, 2002 under “Management’s Discussion and Analysis of Financial Condition and Results of Operation—Risk Management.”

Corporate Financial Disciplines

We recently completed a comprehensive assessment of our corporate financial disciplines. We concluded that with our risk-based capital standard in place—and given the growing scale of our business and the potential for continued financial market volatility—it was prudent to review our financial disciplines, and to consider updating the business risk management strategies they govern. During our review we formalized the following internal financial discipline objectives.

- To maintain a standalone “risk-to-the-government” credit rating from Standard and Poor’s of at least AA-, and to maintain a standalone “bank financial strength” credit rating from Moody’s of at least A-:

Our senior debt securities carry AAA/Aaa ratings. We also are given “standalone” credit ratings by both Standard and Poor’s and Moody’s. These standalone ratings are important external indicators of Fannie Mae’s intrinsic financial strength.

- To sufficiently capitalize and hedge our mortgage portfolio and credit guaranty business so that each is able to withstand internal and external “stress tests” set to at least a AA/Aa standard:

The most common way that regulators, rating agencies and financial analysts judge the adequacy of a company’s capital and the quality of its risk management practices is by assessing how well that company would perform under conditions of extreme and prolonged economic and financial stress.

Our regulator now uses a quarterly risk-based capital stress test to evaluate Fannie Mae’s capital adequacy, and it makes the results of these tests public. This risk-based capital test provides the company with a direct regulatory incentive to maintain a low risk profile. We traditionally have used stress tests internally as well.

- To keep our mortgage prepayment and credit risks low enough that over time our core business earnings are less variable than the median of all AA/Aa and AAA/Aaa S&P 500 companies.

We examined the net income pattern over the past ten years of all of the companies that were able to maintain ratings of AA-/Aa3 or higher during the entire period. From this review we determined that we should set as an objective to manage our interest rate and credit risks so that Fannie Mae’s long-term earnings variability remains below the median of all AA/Aa and AAA/Aaa companies. In conjunction with our stress test standards, we believe that meeting this income variability objective will allow us to maintain our standalone ratings with a comfortable margin of safety, and possibly to improve them.

Interest Rate Risk Management

Interest rate risk is the risk of loss to future earnings or long-term value that may result from changes in interest rates. We utilize a wide range of risk measures and analyses to manage the interest rate risk inherent in the mortgage portfolio, including ongoing business risk measures and run-off measures of the existing portfolio. We rely on *net interest income at risk* as our primary ongoing business measure of interest rate risk and the *portfolio duration gap* as our primary run-off measure of interest rate risk. We

disclose our net interest income at risk and duration gap measures on a monthly basis. We believe these measures together provide a more informative profile of our overall interest rate risk position than either measure alone.

• Net Interest Income at Risk

Net interest income at risk measures the projected impact of changes in the level of interest rates and the shape of the yield curve on the mortgage portfolio's expected or "base" core net interest income over the immediate future one- and four-year periods. Our net interest income at risk disclosure represents the extent to which our core net interest income over the next one-year and four-year periods is at risk due to a plus or minus 50 basis point parallel change in the current Fannie Mae yield curve and from a 25 basis point change in the slope of Fannie Mae's yield curve. These changes in interest rates were selected as part of our six voluntary initiatives announced in 2000.

Table 16 compares our June 30, 2003 and December 31, 2002 net interest income at risk over a one-year and four-year period under each of the interest rate scenarios. A positive number indicates the percent by which projected adjusted net interest income could be reduced by the rate shock. These calculations reflect management's assumptions of most likely market conditions. Actual portfolio core net interest income may differ from these calculations because of specific interest rate movements, changing business conditions, changing prepayments, and management actions.

Table 16: Net Interest Income at Risk

	Assuming a 50 basis point change in interest rates		Assuming a 25 basis point change in slope of the yield curve	
	One-year	Four-year	One-year	Four-year
June 30, 2003	2.1%	6.6%	3.9%	5.9%
December 31, 2002	.6	1.6	4.7	6.6

• Duration Gap

We apply the same interest rate process, prepayment models, and volatility assumptions used in our net interest income at risk measure to generate the portfolio duration gap. However, we do not incorporate projected future business activity or nonmortgage investments into our duration gap measure. The duration gap measures the difference between the estimated durations of portfolio assets and liabilities and summarizes the extent to which estimated cash flows for assets and liabilities are matched, on average, over time and across interest rate scenarios. A positive duration gap signals a greater exposure to rising interest rates because it indicates that the duration of our assets exceeds the duration of our liabilities. A negative duration gap signals a greater exposure to declining interest rates because the duration of our assets is less than the duration of our liabilities.

For March 2003, disclosed in April, we began reporting our duration gap as a weighted average for the month. Previously, we had reported the duration gap as of the last business day of each month. We believe that reporting a weighted average monthly duration gap provides a more representative measure of our portfolio's risk position for the month and reduces the effect of any financial anomalies that may occur on the last day of the month. Fannie Mae's duration gap for June 2003 calculated on a monthly average basis was minus 1 month. In comparison, the duration gap calculated at month end was minus 5 months at December 31, 2002.

We maintain to the extent possible a relatively close match between the durations of the assets and liabilities in our mortgage portfolio investment business, using a combination of option-based funding and

rebalancing actions to meet this objective. Prior to this year, Fannie Mae's duration gap has been wider than plus or minus 6 months approximately one-third of the time. Going forward, our objective will be to maintain the portfolio's duration gap within a range of plus-or-minus six months substantially all of the time. This narrower range for the portfolio duration gap should reduce potential core business earnings variability, but also could produce a somewhat lower net interest margin over the longer term.

Derivatives

Derivative instruments are important tools that we use to manage interest rate risk and supplement our issuance of debt in the capital markets. We are an end user of derivatives and do not take speculative positions with derivatives. We primarily use interest rate derivative instruments as a substitute for notes and bonds we issue in the debt markets. The ability to either issue debt securities or modify debt through the use of derivatives increases our funding flexibility and potentially reduces our overall funding costs. The funding flexibility provided by using derivatives also helps us to better match the cash flow variability inherent in mortgages. The types of derivatives we use— primarily interest-rate swaps, basis swaps, swaptions, and caps— are generally regarded in the marketplace as relatively straightforward interest rate derivatives.

Table 17 summarizes the notional balances and fair values of our derivatives by type at June 30, 2003 and December 31, 2002.

Table 17: Derivative Notional Amounts and Net Fair Values

	June 30, 2003		December 31, 2002	
	Notional Amounts	Net Fair Values ⁽¹⁾	Notional Amounts	Net Fair Values ⁽¹⁾
	(Dollars in millions)			
Pay-fixed swaps	\$219,307	\$(20,433)	\$168,512	\$(17,892)
Receive-fixed swaps	142,938	6,676	52,370	4,010
Basis swaps	24,250	1	25,525	4
Caps and swaptions	410,733	15,265	397,868	12,834
Other	14,165	(1,007)	12,320	(987)
Total	\$811,393	\$ 502	\$656,595	\$ (2,031)

(1) Based on end of period fair values, estimated by calculating the cost, on a net present value basis, to settle at current market rates all outstanding derivative contracts.

Table 18 shows the additions and maturities of derivatives by type during the first and second quarters of 2003, along with the expected maturities of derivatives outstanding at June 30, 2003.

Table 18: Derivative Activity and Maturity Data

	Pay-Fixed/ Receive-Variable Swaps ⁽²⁾			Receive-Fixed/ Pay-Variable Swaps	Basis Swaps	Caps and Swaptions	Other ⁽⁴⁾	Total
	Amount	Pay Rate ⁽³⁾	Receive Rate ⁽³⁾					
(Dollars in millions)								
Notional Amounts: ⁽¹⁾								
Notional balance at December 31, 2002	\$168,512	6.07%	1.67%	\$ 52,370	\$25,525	\$397,868	\$12,320	\$656,595
Additions	32,515	3.12	1.36	29,409	5,975	18,350	5,138	91,387
Maturities ⁽⁵⁾	4,700	5.50	1.69	11,438	9,785	41,000	3,701	70,624
Notional balance at March 31, 2003	\$196,327	5.59%	1.39%	\$ 70,341	\$21,715	\$375,218	\$13,757	\$677,358
Additions	34,125	2.83	1.18	87,186	10,280	100,285	5,745	237,621
Maturities ⁽⁵⁾	11,145	5.08	1.34	14,589	7,745	64,770	5,337	103,586
Notional balance at June 30, 2003	\$219,307	5.32%	1.28%	\$142,938	\$24,250	\$410,733	\$14,165	\$811,393
Future Maturities of Notional Amounts: ⁽⁶⁾								
2003	\$ 14,085	4.90%	1.26%	\$ 3,365	\$ 5,050	\$ 49,228	\$ 4,908	\$ 76,636
2004	15,550	5.54	1.27	11,420	18,125	66,850	1,200	113,145
2005	25,160	3.92	1.28	12,125	175	68,500	1,409	107,369
2006	21,265	4.58	1.26	12,690	430	15,650	300	50,335
2007	16,000	5.26	1.27	27,585	—	14,000	3,346	60,931
Thereafter	127,247	5.73	1.28	75,753	470	196,505	3,002	402,977
Total	\$219,307	5.32%	1.28%	\$142,938	\$24,250	\$410,733	\$14,165	\$811,393

(1) Dollars represent notional amounts that indicate only the amount on which payments are being calculated and do not represent the amount at risk of loss.

(2) Notional amounts include callable swaps of \$36 billion, \$35 billion, and \$35 billion with weighted-average pay rates of 6.73 percent, 6.74 percent, and 6.75 percent and weighted-average receive rates of 1.29 percent, 1.40 percent and 1.68 percent at June 30, 2003, March 31, 2003, and December 31, 2002, respectively.

(3) The weighted-average interest rate payable and receivable is as of the date indicated. The interest rates of the swaps may be variable rate, so these rates may change as prevailing interest rates change.

(4) Includes foreign currency swaps, futures contracts, and derivative instruments that provide a hedge against interest rate fluctuations. Derivatives that served as economic hedges but did not meet the criteria for hedge accounting under FAS 133 totaled \$444 million at June 30, 2003.

(5) Includes matured, called, exercised, and terminated amounts.

(6) Based on stated maturities. Assumes that variable interest rates remain constant at June 30, 2003 levels.

At June 30, 2003, 100 percent of the \$811 billion notional amount of our outstanding derivative transactions were with counterparties rated A or better both by Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's"). Our derivative instruments were diversified to reduce our credit risk concentrations among 22 counterparties at June 30, 2003, compared with 21 counterparties at December 31, 2002. At June 30, 2003, six counterparties with credit ratings of A or better represented approximately 69 percent of the total notional amount of outstanding derivatives transactions. The outstanding notional amount for each of these six counterparties ranged between 7 percent and 14 percent of our total outstanding notional amount at June 30, 2003. Each of the remaining counterparties accounted for less than five percent of the total outstanding notional amount at June 30, 2003. In comparison, eight counterparties with credit ratings of A or better represented approximately 76 percent of the total notional amount of outstanding derivatives transactions at December 31, 2002.

Our primary credit exposure on a derivative transaction is that a counterparty might default on payments due, which could result in Fannie Mae having to replace the derivative with a different counterparty at a higher cost. Although notional principal is a commonly used measure of volume in the derivatives market,

it is not a meaningful measure of market or credit risk since the notional amount does not change hands other than in the case of foreign currency swaps. Counterparties use the notional amounts of derivative instruments to calculate contractual cash flows to be exchanged. However, the notional amount is significantly greater than the potential market or credit loss that could result from such transactions. The replacement cost, after consideration of offsetting arrangements such as master netting agreements and collateral held, to settle at current market prices all outstanding derivatives in a gain position is a more meaningful measure of our credit market exposure on derivatives. Table 19 shows our exposure on derivatives at June 30, 2003 and December 31, 2002 by maturity and counterparty credit ratings based on these maturities.

Table 19: Derivative Credit Loss Exposure⁽¹⁾

	June 30, 2003					December 31, 2002				
	Credit Rating				Total	Credit Rating				Total
	AAA	AA	A	BBB		AAA	AA	A	BBB	
	(Dollars in millions)									
Less than 1 year	\$ —	\$ 28	\$ 16	\$ —	\$ 44	\$ —	\$ 69	\$ 6	\$ —	\$ 75
1 to 5 years	1	843	388	—	1,232	—	486	116	—	602
Over 5 years	28	2,086	3,080	—	5,194	21	1,334	2,328	—	3,683
Subtotal	29	2,957	3,484	—	6,470	21	1,889	2,450	—	4,360
Maturity Distribution Netting ⁽²⁾	(29)	(485)	(572)	—	(1,086)	(21)	(368)	(670)	—	(1,059)
Exposure	—	2,472	2,912	—	5,384	—	1,521	1,780	—	3,301
Collateral Held	—	2,223	2,864	—	5,087	—	1,382	1,722	—	3,104
Exposure Net of Collateral ⁽³⁾	\$ —	\$ 249	\$ 48	\$ —	\$ 297	\$ —	\$ 139	\$ 58	\$ —	\$ 197
Notional Amount ⁽⁴⁾	\$19,120	\$397,526	\$394,380	\$ 0	\$811,026	\$21,045	\$316,813	\$318,487	\$250	\$656,595
Number of Counterparties	3	11	8	0	22	2	11	7	1	21

(1) Represents the exposure to credit loss on derivative instruments, which is estimated by calculating the cost, on a present value basis, to replace all outstanding derivative contracts in a gain position. Reported on a net-by-counterparty basis where a legal right of offset exists under an enforceable master settlement agreement. Derivative gains and losses with the same counterparty in the same maturity category are presented net within the maturity category.

(2) Represents impact of netting of derivatives in a gain position and derivatives in a loss position for the same counterparty across maturity categories.

(3) “Exposure Net of Collateral” may not be exactly equal to “Exposure” minus “Collateral Held” due to rounding.

(4) Total at June 30, 2003 excludes \$367 million notional amount of unrated, mortgage-related derivatives with a fair value of less than \$1 million.

Our derivative credit loss exposure, net of collateral held, was \$297 million at June 30, 2003, compared with \$197 million at December 31, 2002. We expect the credit exposure on derivative contracts to fluctuate as interest rates change. Our derivative credit loss exposure, net of collateral held, at June 30, 2003 represented approximately 2 weeks of annualized pre-tax core business earnings.

At June 30, 2003 and December 31, 2002, 100 percent of our exposure on derivatives, before consideration of collateral held, was with counterparties rated A or better by S&P and Moody’s. Five counterparties with credit ratings of A or better accounted for approximately 88 percent and 92 percent, respectively, of our exposure on derivatives before consideration of collateral held at June 30, 2003 and December 31, 2002. Seventy-four percent of our net exposure of \$297 million at June 30, 2003 was with five counterparties rated AA or better by S&P and Aa or better by Moody’s. The percentage of our exposure with each of these five counterparties ranged from 12 to 17 percent. In comparison, six counterparties rated AA or better by S&P and Aa or better by Moody’s accounted for 71 percent of our net exposure of \$197 million at December 31, 2002.

Fannie Mae has never experienced a loss on a derivative transaction due to credit default by a counterparty. The credit risk on our derivative transactions is low because our counterparties are of very high credit quality. Our counterparties consist of large banks, broker-dealers, and other financial institutions that have a significant presence in the derivatives market, most of whom are based in the United States. We manage derivative counterparty credit risk by contracting only with experienced counterparties that have high credit ratings. We initiate derivative contracts only with counterparties rated

A or better. As an additional precaution, we have a conservative collateral management policy with provisions for requiring collateral on our derivative contracts in gain positions. Additional information on derivative instruments is presented in the Notes to Financial Statements.

Credit Risk Management

Credit risk is the risk of loss to future earnings or future cash flows that may result from the failure of a borrower or institution to fulfill its contractual obligation to make payments to Fannie Mae or an institution's failure to perform a service for us.

Mortgage Credit Risk

As shown in Table 20, our overall credit performance remained relatively stable in the second quarter and first half of 2003 compared to the second quarter and first half of 2002 despite an increase in the number of properties acquired through foreclosure. The serious delinquency rate information in Table 20 is based on conventional loans in our single-family mortgage credit book for which we have access to loan level data and our total multifamily mortgage credit book of business.

Table 20: Mortgage Credit Performance

	Credit-Related Losses ⁽¹⁾		Number of Properties Acquired		Serious Delinquency Rate ⁽²⁾	
	Three Months Ended June 30,		Three Months Ended June 30,		June 30, 2003	December 31, 2002
	2003	2002	2003	2002		
	(Dollars in millions)					
Single-family	\$ 19	\$ 16	6,569	4,688	.56%	.57%
Multifamily	4	1	2	—	.13	.05
Total	\$ 23	\$ 17				
Credit loss ratio ⁽³⁾	.005%	.004%				
Charge-off ratio ⁽⁴⁾	.005%	.006%				

	Credit-Related Losses ⁽¹⁾		Number of Properties Acquired		Serious Delinquency Rate ⁽²⁾	
	Six Months Ended June 30,		Six Months Ended June 30,		June 30, 2003	December 31, 2002
	2003	2002	2003	2002		
	(Dollars in millions)					
Single-family	\$ 38	\$ 37	12,487	9,025	.56%	.57%
Multifamily	5	2	3	—	.13	.05
Total	\$ 43	\$ 39				
Credit loss ratio ⁽³⁾	.004%	.005%				
Charge-off ratio ⁽⁴⁾	.005%	.007%				

(1) Includes charge-offs and foreclosed property income.

(2) Serious delinquency rate for conventional single-family includes loans 90 days or more past due and loans in the process of foreclosure and is calculated based on number of loans. Serious delinquency rate for multifamily includes loans 60 days or more past due and is calculated based on unpaid principal balance ("UPB").

(3) Represents annualized credit losses divided by average book of business.

(4) Represents annualized charge-offs divided by average book of business.

Our credit loss ratio— annualized credit losses as a percentage of Fannie Mae's average book of business— was .5 basis points in the second quarter of 2003 and .4 basis points in the first half of 2003, compared with .4 basis points in the second quarter of 2002 and .5 basis points in the first half of 2002. Our book of business includes mortgages and MBS in our mortgage portfolio and outstanding MBS held by other investors. Our lower credit loss ratio in the first half of 2003 reflects some economic strengthening since the recessionary lows of 2001 and 2002 combined with continued strong housing markets, the efficacy of our loss mitigation strategies, and the targeting of our credit enhancements. While the number of single-family properties acquired rose by 1,881 to 6,569 properties as of June 30, 2003, our single-family credit-

related losses, which include charge-offs plus foreclosed property income, only increased \$3 million and \$1 million in the second quarter and first half of 2003 from the prior year periods.

Table 21 compares the serious delinquency rates for conventional single-family loans with credit enhancements and without credit enhancements at June 30, 2003 and December 31, 2002. The information in Table 21 is based on conventional loans in our single-family mortgage credit book for which we have access to loan level data.

Table 21: Conventional Single-Family Serious Delinquency Rates

	June 30, 2003		December 31, 2002	
	Book Outstanding ⁽¹⁾	Serious Delinquency Rate ⁽²⁾	Book Outstanding ⁽¹⁾	Serious Delinquency Rate ⁽²⁾
Credit enhanced	23%	1.42%	27%	1.29%
Non-credit enhanced	77	.29	73	.31
	—		—	
Total conventional loans	100%	.56%	100%	.57%

(1) Reported based on unpaid principal balance.

(2) Reported based on number of loans.

The serious delinquency rate for conventional loans in our single-family mortgage credit book at June 30, 2003 decreased to .56 percent from the December 31, 2002 rate of .57 percent. The serious delinquency rate for conventional loans in our single-family mortgage credit book without credit enhancement improved to .29 percent at June 30, 2003, compared with .31 percent at December 31, 2002. The serious delinquency rate for conventional loans in our single-family mortgage credit book with credit enhancement increased to 1.42 percent from 1.29 percent at the end of 2002. These loans have a higher risk profile and tend to be more sensitive to changes in the economy than loans without credit enhancement.

Institutional Counterparty Credit Risk

Non-derivative institutional counterparty risk primarily includes exposure created through the potential nonperformance of our counterparties on mortgage insurance policies, other credit enhancement arrangements with lenders and others, mortgage servicing contracts with lenders, and liquidity investments in corporate obligations or nonmortgage asset-backed securities.

Mortgage Servicers

We have purchased mortgage-related securities secured by manufacturing housing loans that were issued by entities other than Fannie Mae both for our portfolio and, to a limited extent, for securitization into REMIC securities we have issued and guaranteed. At July 31, 2003, we owned or guaranteed approximately \$9.1 billion of these securities, approximately 70 percent of which are serviced by Green Tree Investments Holding LLC, successor as servicer of the securities to Conseco Finance Corp. On March 14, 2003, the U.S. Bankruptcy Court for the Northern District of Illinois issued a final order approving the servicing arrangements for the securities then serviced by Conseco Finance. The order, based upon an agreement reached between Conseco Finance, Green Tree (under its former name, CFN Investment Holdings), Fannie Mae and other certificate holders, provided for revised servicing fees and an enhanced servicing protocol. Green Tree completed the acquisition in June 2003.

Table 22 presents the credit ratings of the securities (or for insured securities, the credit rating of the financial institution providing credit enhancement) purchased or guaranteed by Fannie Mae as of July 31, 2003. As of July 31, 2003, a majority of our securities were rated AA- or better by the major rating agencies or were insured by counterparties rated AA- or better. We have reviewed these securities for other than temporary declines in their fair value and recorded impairment where appropriate in fee and other income. Future ratings will be influenced by the performance of the underlying manufactured housing loan collateral. Additional downgrades may occur in the future, but management believes that any potential additional impairment that might be recorded will not be material to Fannie Mae's operating results.

Table 22: Credit Ratings of Mortgage-Related Securities Secured by Manufactured Housing Loans

Credit rating as of July 31, 2003:	UPB	% of Total UPB
(Dollars in millions)		
<i>Investment Grade:</i>		
AAA/Aaa	\$3,316	36.27%
AA+/Aa1 to AA-/Aa3	2,723	29.79
A+/A1 to A-/A3	775	8.47
BBB+/Baa1 to BBB-/Baa3	2,253	24.64
Total UPB of Investment Grade Securities	9,067	99.17
<i>Non-Investment Grade:</i>		
BB+/Ba1 to BB-/Ba3	18	.20
B+/B1 to B-/B3	58	.63
Total UPB of Non-Investment Grade Securities	76	.83
Total UPB of Securities	\$9,143	100.00%

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

Our primary sources of liquidity include proceeds from the issuance of debt, principal and interest received on our mortgage portfolio, guaranty fees earned on our MBS, and principal and interest received on our liquid investment portfolio. Primary uses of liquidity include the purchase of mortgage assets, repayment of debt, interest payments, administrative expenses, taxes, and fulfillment of Fannie Mae's MBS guaranty obligations. Our mortgage asset purchases based on unpaid principal balance totaled \$260 billion in the first half of 2003. We issued \$1.338 trillion in debt to fund those purchases and to replace maturing, called or repurchased debt. Our debt securities, and the interest payable thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States or any agency or instrumentality thereof other than Fannie Mae.

As part of our voluntary commitments, we have publicly pledged to maintain a portfolio of high-quality, liquid, nonmortgage-related securities equal to at least 5 percent of total on-balance-sheet assets. Our liquid assets totaled \$69 billion at June 30, 2003, compared with \$62 billion at December 31, 2002. The ratio of our liquid assets to total assets was 7.5 percent at June 30, 2003 and 6.9 percent at December 31, 2002.

Capital Resources

Fannie Mae is subject to capital adequacy standards established by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("1992 Act") and continuous examination by the Office of Federal Housing Enterprise Oversight ("OFHEO"), which was established by the 1992 Act. The capital adequacy standards require that our core capital (defined by OFHEO as the stated value of outstanding common stock, the stated value of outstanding noncumulative perpetual preferred stock, paid-in capital, and retained earnings, less treasury stock) equal or exceed a minimum capital standard and a critical capital standard. Core capital excludes accumulated other comprehensive income/loss ("AOCI") because AOCI incorporates gains (losses) on derivatives and certain securities, but not the gains (losses) on the remaining mortgages and securities or liabilities used to fund the purchase of these items. Table 23 compares Fannie Mae's core capital and total capital at June 30, 2003 and December 31, 2002 to our capital requirements. Total capital is defined by OFHEO as core capital plus the general allowance for losses. Core capital grew to \$30.7 billion at June 30, 2003 from \$28.1 billion at December 31, 2002, while total capital increased by \$2.6 billion to \$31.5 billion at June 30, 2003.

Table 23: Capital Requirements⁽¹⁾

	June 30, 2003	March 31, 2003	December 31, 2002
	(Dollars in millions)		
Core capital ⁽²⁾	\$ 30,675	\$29,517	\$28,079
Required minimum capital ⁽³⁾⁽⁴⁾	29,147	28,226	27,203
Excess of core capital over minimum capital	\$ 1,527	\$ 1,291	\$ 877
Total capital ⁽⁵⁾	\$ 31,469	\$30,309	\$28,871
Required risk-based capital ⁽⁶⁾	Not available	16,555	17,434
Excess of total capital over required risk-based capital ⁽⁶⁾	Not available	\$13,753	\$11,437
Required critical capital ⁽⁷⁾	\$ 14,912	\$14,414	\$13,880
Excess of core capital over required critical capital	15,762	15,103	14,199

(1) Amounts at June 30, 2003 represent estimates, pending OFHEO's certification, which is generally provided no later than 3 months following the end of each quarter.

(2) The sum of (a) the stated value of outstanding common stock; (b) the stated value of outstanding noncumulative perpetual preferred stock; (c) paid-in capital; and (d) retained earnings, less treasury stock. Core capital excludes accumulated other comprehensive income (AOCI).

(3) The sum of (a) 2.50 percent of on-balance sheet assets; (b) .45 percent of outstanding MBS; and (c) .45 percent of other off-balance sheet obligations, which may be adjusted by the Director of OFHEO under certain circumstances (See 12 CFR 1750.4 for existing adjustments made by the Director of OFHEO).

(4) These amounts do not reflect the effect of the December 31, 2002 balance sheet reclassification of amounts associated with the guaranty obligation for MBS that we own from our "Allowance for loan losses" to a "Guaranty liability for MBS."

(5) The sum of (a) core capital and (b) the total allowance for loan losses and guaranty liability for MBS, less (c) the specific loss allowance. Specific loss allowances totaled \$13 million and \$19 million at June 30, 2003 and December 31, 2002, respectively.

(6) Amounts at June 30, 2003 will not be available until the end of September 2003. OFHEO reports on Fannie Mae's risk-based capital at the end of each quarter on a lagged quarterly basis.

(7) The sum of (a) 1.25 percent of on-balance sheet assets; (b) .25 percent of outstanding MBS; and (c) .25 percent of other off-balance sheet obligations, which may be adjusted by the Director of OFHEO under certain circumstances.

Common shares outstanding, net of shares held in treasury, totaled approximately 976 million and 989 million at June 30, 2003 and December 31, 2002, respectively. During the first half of 2003, Fannie Mae issued approximately 1.4 million common shares from treasury for employee and other stock compensation plans. We repurchased 13.9 million common shares during the first half of 2003 at a weighted average cost of \$65.04 per share.

We raised additional equity from the issuance of 8 million shares or \$400 million of variable rate Non-Cumulative Preferred Stock, Series K on March 18, 2003, from the issuance of 6.9 million shares or \$345 million of fixed rate Non-Cumulative Preferred Stock, Series L on April 29, 2003, and from the issuance of 9.2 million shares or \$460 million of fixed rate Non-Cumulative Preferred Stock, Series M on June 10, 2003. Preferred stock accounted for 12.7 percent of our core capital at June 30, 2003, versus 9.5 percent at December 31, 2002.

Subordinated debt totaled \$11.5 billion at June 30, 2003, or 1.2 percent of on-balance sheet assets. Total capital and outstanding subordinated debt represented 3.9 percent of on-balance sheet assets at June 30, 2003 and 3.7 percent of on-balance sheet assets at December 31, 2002. Subordinated debt serves as a supplement to our equity capital, although it is not a component of core capital. By the end of 2003, we intend to issue sufficient subordinated debt to bring the sum of total capital and outstanding subordinated debt to at least 4 percent of on-balance sheet assets, after providing adequate capital to support off-balance sheet MBS.

Our credit quality is continuously monitored by rating agencies. At the end of June 2003 and year-end 2002, our senior unsecured debt had a rating of AAA by S&P, Aaa by Moody's, and AAA by Fitch, Inc, unchanged from the ratings at December 31, 2002. Our short-term debt was rated A-1+, Prime-1 or P-1, and F1+ by S&P, Moody's, and Fitch, respectively, at June 30, 2003, also unchanged from the ratings at December 31, 2002.

PENDING ACCOUNTING STANDARDS

Commitments to Purchase or Sell Mortgages and Mortgage-Related Securities

In April 2003, the FASB issued FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* ("FAS 149"). FAS 149 requires Fannie Mae to account for many commitments to purchase or sell mortgage-related securities existing or entered into after June 30, 2003 and mortgages entered into after June 30, 2003 as derivatives, which will increase our notional balance of derivatives outstanding. Under FAS 149, some of these derivatives will qualify as cash flow hedges of forecasted mortgage purchases or sales. Therefore, we will record changes in the fair values of these derivatives as assets or liabilities with a corresponding increase or decrease in AOCI in the future. Some of these derivatives will not qualify for hedge accounting, particularly those where we have a matched purchase and sale commitment. We will mark those commitments to market through earnings and their values should offset to a significant extent. We expect to record a cumulative after-tax transition gain as a result of the adoption of FAS 149 on July 1, 2003.

Consolidation of Variable Interest Entities

FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46"), was issued in January 2003. FIN 46 provides guidance on when a company should include the assets, liabilities, and activities of a variable interest entity ("VIE") in its financial statements and when it should disclose information about its relationship with a VIE. A VIE is a legal structure used to conduct activities or hold assets, which must be consolidated by a company if it is the primary beneficiary because it absorbs the majority of the entity's expected losses, the majority of the expected returns, or both. Qualified special purpose entities ("QSPEs"), which we use to issue MBS, are exempt from FIN 46 unless a company has the unilateral ability to liquidate or change the QSPE. The provisions of FIN 46 were effective February 1, 2003 for all arrangements entered into after January 31, 2003. FIN 46 is effective in the third quarter of 2003 for those arrangements entered into prior to January 31, 2003.

We are currently reviewing whether we have relationships with VIEs and, if so, whether we should consolidate them and disclose information about them as the primary beneficiary or disclose information about them as an interest holder. We may have to consolidate some of our equity investments in partnerships based on recent interpretations from accounting professionals. We currently record the amount of our investment in these partnerships as an asset on our balance sheet, recognize our share of partnership income or losses in our income statement, and disclose how we account for material types of these investments in our 2002 financial statements. However, we do not yet know the extent of the impact of consolidating the assets and liabilities of these partnerships on our balance sheet because of the complexities of applying FIN 46, the evolving interpretations from accounting professionals, and the nuances of each individual partnership.

Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock

In July 2003, the SEC issued a clarification of Emerging Issues Task Force Topic D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock (Topic D-42)." The SEC stated that the carrying amount of preferred stock should be reduced by the related issuance costs, regardless of where in the stockholders' equity section those costs were initially classified at the time of issuance. As a result, the excess of the fair value of the consideration transferred to preferred stockholders over the carrying amount of the preferred stock must be subtracted from net earnings to determine net earnings available to common stockholders in the calculation of earnings per share. The clarification of Topic D-42 will be effective for us beginning with the third quarter of 2003, and we will restate the financial statements for the corresponding prior periods because we have not previously considered issuance costs in determining the carrying amount of the preferred stock we redeemed in 2003 and 2002. Our reported basic and diluted earnings per share for the three and six months ended June 30, 2003, and the three months ended June 30, 2002, will not change. Our reported basic and diluted earnings per share for the six months ended June 30, 2002 will be reduced by \$.01 per share.

Item 1. Financial Statements

Independent Accountant's Review Report

To the Board of Directors and Stockholders of Fannie Mae:

We have reviewed the accompanying balance sheet of Fannie Mae as of June 30, 2003 and related statements of income, changes in stockholders' equity, and cash flows for the three-month and six-month periods ended June 30, 2003 and 2002. These condensed financial statements are the responsibility of Fannie Mae's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheet of Fannie Mae as of December 31, 2002 (presented herein) and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein). In our report dated January 14, 2003, we expressed an unqualified opinion on those financial statements.

/s/ KPMG LLP

KPMG LLP

Washington, D.C.

July 10, 2003

FANNIE MAE

Statements of Income
(Dollars and shares in millions, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
(Unaudited)				
Interest income:				
Mortgage portfolio	\$12,256	\$12,326	\$24,846	\$24,497
Nonmortgage investments and cash equivalents	336	420	642	826
Total interest income	12,592	12,746	25,488	25,323
Interest expense:				
Short-term debt	697	646	1,447	1,430
Long-term debt	8,394	9,568	17,172	18,930
Total interest expense	9,091	10,214	18,619	20,360
Net interest income	3,501	2,532	6,869	4,963
Other income:				
Guaranty fee income (includes imputed interest of \$18 million and \$21 million for the three and six months ended June 30, 2003— see Note 2)	632	423	1,179	831
Fee and other income, net	232	42	345	45
Total other income	864	465	1,524	876
Other expenses (income):				
Provision for losses	26	33	49	61
Foreclosed property income	(3)	(9)	(6)	(15)
Administrative expenses	354	301	698	591
Purchased options expense	1,883	498	2,508	1,286
Debt extinguishments, net	740	225	1,132	396
Total other expenses (income)	3,000	1,048	4,381	2,319
Income before federal income taxes	1,365	1,949	4,012	3,520
Provision for federal income taxes	(263)	(485)	(970)	(848)
Net income	\$ 1,102	\$ 1,464	\$ 3,042	\$ 2,672
Preferred stock dividends	(34)	(24)	(64)	(57)
Net income available to common stockholders	\$ 1,068	\$ 1,440	\$ 2,978	\$ 2,615
Basic earnings per common share				
	\$ 1.09	\$ 1.45	\$ 3.03	\$ 2.63
Diluted earnings per common share				
	\$ 1.09	\$ 1.44	\$ 3.02	\$ 2.61
Cash dividends per common share				
	\$.39	\$.33	\$.78	\$.66
Weighted-average common shares outstanding:				
Basic	979	995	983	996
Diluted	982	1,000	987	1,001

See Notes to Financial Statements.

FANNIE MAE

Balance Sheets
(Dollars in millions, except per share amounts)

	June 30, 2003	December 31, 2002
	(Unaudited)	
Assets		
Mortgage portfolio:		
Mortgage-related securities:		
Held-to-maturity	\$458,333	\$437,932
Available-for-sale	149,575	173,706
Total	607,908	611,638
Loans held-for-investment	211,136	185,652
Allowance for loan losses	(83)	(79)
Unamortized premiums, discounts, and deferred price adjustments, net	1,305	337
Loans held-for-sale	10	145
Mortgage portfolio, net	820,276	797,693
Nonmortgage investments:		
Held-to-maturity	24,609	23,050
Available-for-sale	42,315	36,794
Cash and cash equivalents	2,165	1,710
Accrued interest receivable	5,424	4,915
Acquired property and foreclosure claims, net	1,242	1,033
Derivatives in gain positions	5,934	3,666
Other	21,830	18,654
Total assets	\$923,795	\$887,515
Liabilities and Stockholders' Equity		
Liabilities:		
Debentures, notes and bonds, net:		
Senior debt:		
Due within one year	\$422,274	\$382,412
Due after one year	450,288	458,600
Subordinated debt:		
Due after one year	11,519	9,970
Total	884,081	850,982
Accrued interest payable	8,620	8,379
Derivatives in loss positions	5,432	5,697
Guaranty liability for MBS	725	729
Other	7,573	5,440
Total liabilities	906,431	871,227
Stockholders' Equity:		
Preferred stock, \$50 stated value, 100 million shares authorized— 77.7 million shares issued and outstanding at June 30, 2003 and 53.6 million shares issued and outstanding at December 31, 2002	3,883	2,678
Common stock, \$.525 stated value, \$.78 of dividends per share paid in the first half of 2003 and \$1.32 of dividends per share paid in 2002; no maximum authorization— 1,129 million shares issued	593	593
Additional paid-in capital	1,842	1,839
Retained earnings	31,595	29,385
Accumulated other comprehensive loss	(13,311)	(11,792)
	24,602	22,703
Less: Treasury stock, at cost, 153 million shares at June 30, 2003 and 140 million shares at December 31, 2002	7,238	6,415
Total stockholders' equity	17,364	16,288
Total liabilities and stockholders' equity	\$923,795	\$887,515

FANNIE MAE

Statements of Changes in Stockholders' Equity
(Dollars and shares in millions)

	Net Common Shares Outstanding	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
					(Unaudited)			
Balance, December 31, 2002	989	\$2,678	\$593	\$1,839	\$29,385	\$(11,792)	\$(6,415)	\$16,288
Comprehensive income:								
Net income	—	—	—	—	3,042	—	—	3,042
Other comprehensive income, net of tax effect:								
Net cash flow hedging losses	—	—	—	—	—	(702)	—	(702)
Unrealized losses on available-for-sale securities	—	—	—	—	—	(817)	—	(817)
Total comprehensive income								1,523
Dividends	—	—	—	—	(832)	—	—	(832)
Shares repurchased	(14)	—	—	—	—	—	(906)	(906)
Preferred stock issued	—	1,205	—	(11)	—	—	—	1,194
Treasury stock issued for stock options and benefit plans	1	—	—	14	—	—	83	97
Balance, June 30, 2003	976	\$3,883	\$593	\$1,842	\$31,595	\$(13,311)	\$(7,238)	\$17,364
Balance, December 31, 2001	997	\$2,303	\$593	\$1,651	\$26,175	\$(7,065)	\$(5,539)	\$18,118
Comprehensive income:								
Net income	—	—	—	—	2,672	—	—	2,672
Other comprehensive income, net of tax effect:								
Net cash flow hedging losses	—	—	—	—	—	(2,154)	—	(2,154)
Unrealized gains on available-for-sale securities	—	—	—	—	—	567	—	567
Total comprehensive income								1,085
Dividends	—	—	—	—	(714)	—	—	(714)
Shares repurchased	(11)	—	—	—	—	—	(841)	(841)
Preferred stock redeemed	—	(375)	—	—	—	—	—	(375)
Treasury stock issued for stock options and benefit plans	3	—	—	58	—	—	99	157
Treasury stock issued for special contribution	4	—	—	136	—	—	164	300
Balance, June 30, 2002	993	\$1,928	\$593	\$1,845	\$28,133	\$(8,652)	\$(6,117)	\$17,730

See Notes to Financial Statements.

FANNIE MAE

Statements of Cash Flows
(Dollars in millions)

	Six Months Ended June 30,	
	2003	2002
	(Unaudited)	
Cash flows from operating activities:		
Net income	\$ 3,042	\$ 2,672
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization of discount/ premium and deferred price adjustments	2,495	3,161
Provision for losses	49	61
Loss on debt extinguishments	1,132	396
Purchased options expense	2,508	1,286
Deferred income taxes	(1,041)	(557)
Other increases, net	512	90
Net cash provided by operating activities	8,697	7,109
Cash flows from (used in) investing activities:		
Mortgage portfolio purchases	(262,667)	(148,999)
Proceeds from sales from mortgage portfolio	6,923	6,783
Mortgage portfolio principal repayments	229,852	106,342
Net proceeds from disposition of foreclosed properties	1,474	1,061
Purchases of held-to-maturity nonmortgage investments	(1,470,026)	(656,678)
Maturities of held-to-maturity nonmortgage investments	1,468,471	668,900
Purchases of available-for-sale nonmortgage investments	(41,343)	(36,876)
Maturities of available-for-sale nonmortgage investments	34,437	33,555
Proceeds from sales of available-for-sale nonmortgage investments	1,425	1,707
Net cash used in investing activities	(31,454)	(24,205)
Cash flows from (used in) financing activities:		
Proceeds from issuance of long-term debt	154,759	111,909
Payments to redeem long-term debt	(162,303)	(76,197)
Proceeds from issuance of short-term debt	1,180,619	798,359
Payments to redeem short-term debt	(1,145,879)	(813,972)
Net payments to purchase or settle hedge instruments	(3,470)	(1,829)
Net payments from stock activities	(514)	(1,819)
Net cash provided by financing activities	23,212	16,451
Net increase (decrease) in cash and cash equivalents	455	(645)
Cash and cash equivalents at beginning of period	1,710	1,518
Cash and cash equivalents at end of period	\$ 2,165	\$ 873
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 18,386	\$ 20,174
Income taxes	2,015	1,542

See Notes to Financial Statements.

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Notes to Financial Statements (Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Results for the three-month and six-month periods ended June 30, 2003 may not necessarily be indicative of the results for the year ending December 31, 2003. The unaudited financial statements should be read in conjunction with Fannie Mae's audited financial statements and related notes included in the Annual Report on Form 10-K filed with the Securities Exchange Commission on March 31, 2003. We have reclassified certain amounts in 2002 to conform to the current presentation.

2. New Accounting Standards

Stock-Based Compensation

Effective January 1, 2003, Fannie Mae adopted the expense recognition provisions of the fair value method of accounting for employee stock compensation pursuant to Financial Accounting Standard No. 123, *Accounting for Stock-Based Compensation* ("FAS 123"). Prior to this date, we used the intrinsic value method under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25") and disclosed the pro forma effect of the fair value method. Under the fair value expense recognition provisions of FAS 123, compensation expense is recognized over the vesting period based on the fair value of stock based compensation as of the date of grant. We elected to apply the prospective method of adoption described in the transition provisions of Financial Accounting Standard No. 148, *Accounting for Stock-Based Compensation — Transition and Disclosure* ("FAS 148"). In accordance with these provisions, we will determine the fair value of all new stock-based compensation awarded on January 1, 2003 and thereafter at the grant date and recognize this amount as expense over the vesting period. We will continue to account for stock-based compensation awarded prior to January 1, 2003 under APB No. 25. The effect on net income and diluted earnings per share in the second quarter and first half of 2003 from the prospective adoption of the fair value method was not material to our financial results. Had compensation cost for all options granted been determined based on the fair value at grant

date consistent with the FAS 123 fair value method, our net income and earnings per share would have been as follows for the second quarter and first half of 2003 and 2002.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	(Dollars in millions, except per share amounts)			
Net income available to common stockholders, as reported	\$1,068	\$1,440	\$2,978	\$2,615
Plus: Stock-based employee compensation expense included in reported net income, net of related tax effects	19	8	33	17
Less: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	(30)	(27)	(58)	(54)
Pro forma net income available to common stockholders	\$1,057	\$1,421	\$2,953	\$2,578
Earnings per share:				
Basic – as reported	\$ 1.09	\$ 1.45	\$ 3.03	\$ 2.63
Basic – pro forma	1.08	1.43	3.00	2.59
Diluted – as reported	1.09	1.44	3.02	2.61
Diluted – pro forma	1.08	1.42	2.99	2.58

The following table summarizes information about our nonqualified stock options outstanding at June 30, 2003.

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Options ⁽¹⁾	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number of Options ⁽¹⁾	Weighted-Average Exercise Price
\$18.00 – \$35.00	3,780	1.4 yrs	\$23.16	3,780	\$23.16
35.01 – 52.00	3,795	4.1	46.25	3,642	45.98
52.01 – 70.00	10,109	7.3	65.61	3,343	66.01
70.01 – 87.00	9,814	7.6	77.21	4,582	75.62
Total	27,498	6.2 yrs	\$61.24	15,347	\$53.57

(1) Options in thousands.

Guarantor's Accounting and Disclosure Requirements for Guarantees

In November 2002, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* ("FIN 45"). FIN 45 requires that upon issuance of a guarantee, the guarantor must disclose and recognize a liability for the fair value of the obligation it assumes under that guarantee. The initial recognition and measurement requirement of FIN 45 is effective for guarantees issued or modified after December 31, 2002. FIN 45 applies primarily to MBS issued and guaranteed by Fannie Mae, acting as trustee, to investors other than Fannie Mae on or after January 1, 2003. We use the term "MBS" (mortgage-backed securities) to refer to mortgage-related securities we issue and on which Fannie Mae guarantees payment of interest and principal.

Under FIN 45, we are required to recognize the fair value of our guaranty obligations as a liability. We record a corresponding amount on our balance sheet as an asset because we are compensated for assuming the guaranty obligation. We subsequently allocate the cash received related to the guaranty fee receivable between a reduction of the receivable and interest income using an imputed interest rate calculated based on the present value of the estimated future cash flows of the guaranty fee receivable. We include the imputed interest income recognized on the guaranty fee receivable in our income statement as a component of "Guaranty fee income." As we reduce the guaranty fee receivable, we will amortize the guaranty fee obligation by a corresponding amount and recognize the reduction of the guaranty fee obligation in our income statement as "Guaranty fee income." Hence, the guaranty fee income reported in our income statement subsequent to the adoption of FIN 45 will equal the cash received on our guaranty obligation and be comparable to guaranty fee income reported prior to our adoption of FIN 45.

During the first half of 2003 we recognized a guaranty fee obligation of \$1.829 billion in accordance with FIN 45 and a corresponding guaranty fee receivable of \$1.829 billion. The guaranty fee obligation is included in our June 30, 2003 balance sheet under "Other liabilities" and the guaranty fee receivable is included in our balance sheet under "Other assets." During the second quarter and first half of 2003, we recognized \$18 million and \$21 million, respectively, of imputed interest income on the guaranty fee receivable that is a component of guaranty fee income and amortized \$35 million and \$39 million, respectively, of the related guaranty fee obligation into guaranty fee income.

Commitments to Purchase or Sell Mortgages and Mortgage-Related Securities

In April 2003, the FASB issued FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* ("FAS 149"). FAS 149 requires Fannie Mae to account for many commitments to purchase or sell mortgage-related securities existing or entered into after June 30, 2003 and mortgages entered into after June 30, 2003 as derivatives, which will increase our notional balance of derivatives outstanding. Under FAS 149, some of these derivatives will qualify as cash flow hedges of forecasted mortgage purchases or sales. Therefore, we will record changes in the fair values of these derivatives as assets or liabilities with a corresponding increase or decrease in AOCI in the future. Some of these derivatives will not qualify for hedge accounting, particularly those where we have a matched purchase and sale commitment. We will mark those commitments to market through earnings and their values should offset to a significant extent. We expect to record a cumulative after-tax transition gain as a result of the adoption of FAS 149 on July 1, 2003.

Consolidation of Variable Interest Entities

FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46"), was issued in January 2003. FIN 46 provides guidance on when a company should include the assets, liabilities, and activities of a variable interest entity ("VIE") in its financial statements and when it should disclose information about its relationship with a VIE. The provisions of FIN 46 were effective February 1, 2003 for all arrangements entered into after January 31, 2003. FIN 46 is effective in the third quarter of 2003 for those arrangements entered into prior to January 31, 2003.

We are currently reviewing whether we have relationships with VIEs and, if so, whether we should consolidate them and disclose information about them as the primary beneficiary or disclose information about them as an interest holder. We may have to consolidate some of our equity investments in partnerships based on recent interpretations from accounting professionals. We currently record the amount of our investment in these partnerships as an asset on our balance sheet, and we currently recognize our share of partnership income or losses in our income statement. However, we do not yet know the extent of the impact of consolidating the assets and liabilities of these partnerships on our balance sheet because of the complexities of applying FIN 46, the evolving interpretations from accounting professionals, and the nuances of each individual partnership. Our maximum exposure to loss as a result of our investments in these entities is our investment balance of \$4 billion and the risk of recapture of tax credits previously recognized. The risk of tax credit recapture is low. Our exposure to loss on these partnerships is mitigated by the strength of our investment sponsors and third party asset managers as well as the condition and financial performance of the underlying properties. Our exposure to loss on guaranteed partnerships is mitigated by the factors above and because our economic return is guaranteed by an investment grade counterparty. The accounting policies for our investments in low income housing tax credit partnerships as a limited partner, our primary partnership investments, are detailed in our 2002 financial statements.

Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock

In July 2003, the SEC issued a clarification of Emerging Issues Task Force Topic D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock (Topic D-42)." The SEC stated that the carrying amount of preferred stock should be reduced by the

related issuance costs, regardless of where in the stockholders' equity section those costs were initially classified at the time of issuance. As a result, the excess of the fair value of the consideration transferred to preferred stockholders over the carrying amount of the preferred stock must be subtracted from net earnings to determine net earnings available to common stockholders in the calculation of earnings per share. The clarification of Topic D-42 will be effective for us beginning with the third quarter of 2003, and we will restate the financial statements for the corresponding prior periods because we have not previously considered issuance costs in determining the carrying amount of the preferred stock we redeemed in 2003 and 2002. Our reported basic and diluted earnings per share for the three and six months ended June 30, 2003, and the three months ended June 30, 2002, will not change. Our reported basic and diluted earnings per share for the six months ended June 30, 2002 will be reduced by \$.01 per share.

3. Mortgage Portfolio

Mortgage-Related Securities

We classify mortgage loans on our balance sheet as either held-for-investment or held-for-sale. Our mortgage portfolio also includes MBS and other mortgage-related securities that we classify as either held-to-maturity or available-for-sale. The following table shows gross unrealized gains and losses on our MBS and mortgage-related securities at June 30, 2003 and December 31, 2002.

	June 30, 2003			
	Amortized Cost ⁽¹⁾	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)			
Held-to-maturity portfolio	\$458,333	\$18,273	\$(405)	\$476,201
Available-for-sale portfolio	144,575	5,670	(670)	149,575
	December 31, 2002			
	Amortized Cost ⁽¹⁾	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)			
Held-to-maturity portfolio	\$437,932	\$18,325	\$(133)	\$456,124
Available-for-sale portfolio	167,202	6,885	(381)	173,706

(1) Amortized cost includes unamortized premiums, discounts, and other deferred price adjustments.

We recorded the following gross realized gains and losses from the sale of mortgage-related securities classified as available-for-sale during the three months and six months ended June 30, 2003 and 2002.

	For the Three Months Ended June 30,	
	2003	2002
	(Dollars in millions)	
Gross realized gains	\$100	\$ 37
Gross realized losses	1	5
	For the Six Months Ended June 30,	
	2003	2002
	(Dollars in millions)	
Gross realized gains	\$112	\$ 41
Gross realized losses	2	20

For the three and six months ended June 30, 2003, we transferred \$7 billion of mortgage-related securities classified as available-for-sale to held-to-maturity, which is permitted by FAS 115. There were no transfers of mortgage-related securities classified as available-for-sale to held-to-maturity in the corresponding prior year periods.

Retained Interests

In some cases, we create real estate mortgage investment conduits (“REMICs”) using assets from our mortgage portfolio and retain an interest in the REMICs. In these instances, we measure our retained interests by allocating the carrying amount of the assets we retained based on their fair value at the transfer date relative to the assets we sold. We are a passive investor with regard to the transferred assets, as our continuing involvement is limited to guaranteeing some of the assets underlying these REMICs.

The following table shows the book value and fair value of our retained interests in REMICs, the weighted-average life, the key assumptions used in measuring the fair value of retained interests at the time of securitization and sensitivities of the key assumptions at June 30, 2003 and December 31, 2002.

	June 30, 2003	December 31, 2002
Net book value of retained interests (dollars in billions)	\$29.3	\$ 41.9
Fair value of retained interests (dollars in billions)	29.6	42.7
Weighted-average life	3.2 years	3.7 years
Key assumptions at date of securitization:		
Weighted-average life	6.0 years	6.0 years
Average lifetime constant prepayment rate (“CPR”) prepayment speed assumption	15.8 %	16.1 %
Average discount rate assumption	5.2	5.2
Estimated effect on fair value of adverse change in assumptions (dollars in millions):		
Prepayment speed assumptions:		
5 percent change in 12 month CPR	\$ (59)	\$ (68)
10 percent change in 12 month CPR	(117)	(131)
15 percent change in 12 month CPR	(171)	(203)
Average 12 month CPR prepayment speed assumption	53.1 %	49.2 %
Discount rate assumptions (dollars in millions):		
5 percent change	\$(220)	\$ (358)
10 percent change	(434)	(711)
15 percent change	(642)	(1,049)
Average discount rate assumption	2.8 %	3.3 %

4. Allowance for Loan Losses and Guaranty Liability for MBS

We maintain a separate allowance for loan losses for our mortgage portfolio as well as a guaranty liability for our guaranty of MBS. The following table summarizes changes during the first and second quarter of 2003.

	Allowance for Loan Losses	Guaranty Liability for MBS	Combined Allowance for Loan Losses and Guaranty Liability for MBS
	(Dollars in millions)		
Balance at December 31, 2002	\$ 79	\$729	\$808
Provision	2	21	23
Charge-offs	(2)	(21)	(23)
Balance at March 31, 2003	\$ 79	\$729	\$808
Provision	6	20	26
Charge-offs	(2)	(24)	(26)
Balance at June 30, 2003	\$ 83	\$725	\$808

The following table summarizes the unpaid principal balance (“UPB”) of impaired loans and specific loss allowance on these loans at June 30, 2003 and December 31, 2002. We recognized approximately

\$2 million in interest income during both the first half of 2003 and the first half of 2002 on loans that were impaired at June 30, 2003 and 2002, respectively.

	June 30, 2003	December 31, 2002
(Dollars in millions)		
UPB of impaired loans ⁽¹⁾	\$307	\$314
UPB of impaired loans with specific loss allowance	107	137
Specific loss allowance on impaired and restructured loans	13	17
UPB of impaired loans without specific loss allowance	200	177
Average UPB of impaired loans ⁽²⁾	319	285

(1) A loan is impaired when, based on current information and events, it is probable we will be unable to collect all amounts due according to the contractual terms of the loan agreement.

(2) Averages have been calculated on a monthly average basis.

5. Nonmortgage Investments

We classify and account for nonmortgage investments as either held-to-maturity or available-for-sale according to FAS 115. The following table shows the amortized cost, fair value, yield, and remaining maturities of our held-to-maturity and available-for sale investments.

	June 30, 2003			December 31, 2002		
	Amortized Cost ⁽¹⁾	Fair Value	Yield	Amortized Cost ⁽¹⁾	Fair Value	Yield
(Dollars in millions)						
Available-for-sale:						
Due within one year	\$ 7,742	\$ 7,758	1.72%	\$ 8,844	\$ 8,851	2.31%
Due after one year through five years	6,938	6,981	1.88	5,620	5,632	2.42
	14,680	14,739	1.80	14,464	14,483	2.35
Asset backed securities ⁽²⁾	27,533	27,576	1.76	22,281	22,311	2.22
Total available-for-sale	42,213	42,315		36,745	36,794	
Held-to-maturity:						
Due within one year	24,609	24,609	1.52	23,016	23,017	1.76
Due after one year through five years	—	—	—	34	34	6.21
Total held-to-maturity	24,609	24,609	1.52	23,050	23,051	1.76
Total	\$66,822	\$66,924	1.68%	\$59,795	\$59,845	2.08%

(1) Amortized cost includes unamortized premiums, discounts, and other deferred price adjustments.

(2) Contractual maturity of asset-backed securities is not a reliable indicator of expected life because borrowers generally have the right to repay their obligation at any time.

The unrealized gains and losses in our available-for-sale and held-to-maturity nonmortgage investments at June 30, 2003 and December 31, 2002 are as follows:

Available-for-Sale

	June 30, 2003			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(Dollars in millions)				
Available-for-sale:				
Asset-backed securities	\$27,533	\$ 83	\$(40)	\$27,576
Floating rate notes ⁽¹⁾	12,649	17	(4)	12,662
Corporate bonds	1,134	44	—	1,178
Taxable auction notes	784	—	—	784
Auction rate preferred stock	63	2	—	65
Other	50	—	—	50
Total	\$42,213	\$146	\$(44)	\$42,315

	December 31, 2002			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(Dollars in millions)				
Available-for-sale:				
Asset-backed securities	\$22,281	\$ 98	\$ (68)	\$22,311
Floating rate notes ⁽¹⁾	11,754	10	(29)	11,735
Corporate bonds	1,149	42	—	1,191
Taxable auction notes	949	—	—	949
Commercial paper	100	—	—	100
Auction rate preferred stock	112	—	(4)	108
Other	400	—	—	400
Total	\$36,745	\$150	\$(101)	\$36,794

(1) As of June 30, 2003 and December 31, 2002, 100 percent of floating rate notes repriced at intervals of 90 days or less.

Held-to-Maturity

	June 30, 2003			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(Dollars in millions)				
Held-to-maturity:				
Repurchase agreements	\$18,294	\$ —	\$ —	\$18,294
Federal funds	5,100	—	—	5,100
Auction rate preferred stock	774	—	—	774
Other	441	—	—	441
Total	\$24,609	\$ —	\$ —	\$24,609

	December 31, 2002			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(Dollars in millions)				
Held-to-maturity:				
Repurchase agreements	\$20,732	\$ —	\$ —	\$20,732
Federal funds	150	—	—	150
Auction rate preferred stock	402	—	—	402
Eurodollar time deposits	1,398	—	—	1,398
Commercial paper	100	—	—	100
Other	268	1	—	269
Total	\$23,050	\$ 1	\$ —	\$23,051

We recorded the following gross realized gains and losses from the sale of nonmortgage investments classified as available-for-sale during the three months and six months ended June 30, 2003 and 2002.

	For the Three Months Ended June 30,	
	2003	2002
(Dollars in millions)		
Gross realized gains	\$ —	\$ —
Gross realized losses	—	—
For the Six Months Ended June 30,		
	2003	2002

Gross realized gains
Gross realized losses

\$ 3
—

\$ 1
2

6. Earnings per Common Share

The following table shows the computation of basic and diluted earnings per common share:

	Three Months Ended June 30,			
	2003		2002	
	Basic	Diluted	Basic	Diluted
	(Dollars in millions, except per share amounts)			
Net income	\$1,102	\$1,102	\$1,464	\$1,464
Preferred stock dividends	(34)	(34)	(24)	(24)
Net income available to common stockholders	\$1,068	\$1,068	\$1,440	\$1,440
Weighted average common shares outstanding	979	979	995	995
Dilutive potential common shares ⁽¹⁾	—	3	—	5
Average number of common shares outstanding used to calculate earnings per common share	979	982	995	1,000
Net earnings per common share	\$ 1.09	\$ 1.09	\$ 1.45	\$ 1.44
	Six Months Ended June 30,			
	2003		2002	
	Basic	Diluted	Basic	Diluted
Net income	\$3,042	\$3,042	\$2,672	\$2,672
Preferred stock dividends	(64)	(64)	(57)	(57)
Net income available to common stockholders	\$2,978	\$2,978	\$2,615	\$2,615
Weighted average common shares outstanding	983	983	996	996
Dilutive potential common shares ⁽¹⁾	—	4	—	5
Average number of common shares outstanding used to calculate earnings per common share	983	987	996	1,001
Net earnings per common share	\$ 3.03	\$ 3.02	\$ 2.63	\$ 2.61

(1) Dilutive potential common shares consist primarily of the dilutive effect from employee stock options and other stock compensation plans.

7. Line of Business Reporting

The following tables reconcile our line of business core business earnings to our reported net income for the three months and six months ended June 30, 2003 and 2002.

	Three Months Ended June 30, 2003				
	Portfolio Investment	Credit Guaranty	Total Core Business Earnings	Reconciling Items Related to Purchased Options	Reported Results
	(Dollars in millions)				
Net interest income	\$3,280	\$ 221	\$3,501	\$ —	\$ 3,501
Purchased options amortization expense	(716)	—	(716)	716 ⁽²⁾	—
Core net interest income	2,564	221	2,785	716	3,501
Guaranty fee income (expense)	(404)	1,036	632	—	632
Fee and other income, net	231	1	232	—	232
Credit-related expenses ⁽¹⁾	—	(23)	(23)	—	(23)
Administrative expenses	(103)	(251)	(354)	—	(354)
Purchased options expense under FAS 133	—	—	—	(1,883) ⁽³⁾	(1,883)
Debt extinguishments	(740)	—	(740)	—	(740)

Income before federal income taxes	1,548	984	2,532	(1,167)	1,365
Provision for federal income taxes	(454)	(218)	(672)	409 ⁽⁴⁾	(263)
Net income	<u>\$1,094</u>	<u>\$ 766</u>	<u>\$1,860</u>	<u>\$ (758)</u>	<u>\$ 1,102</u>

Three Months Ended June 30, 2002

	Portfolio Investment	Credit Guaranty	Total Core Business Earnings	Reconciling Items Related to Purchased Options	Reported Results
			(Dollars in millions)		
Net interest income	\$2,375	\$ 157	\$2,532	\$ —	\$2,532
Purchased options amortization expense	(330)	—	(330)	330 ⁽²⁾	—
Core net interest income	2,045	157	2,202	330	2,532
Guaranty fee income (expense)	(336)	759	423	—	423
Fee and other income, net	82	(40)	42	—	42
Credit-related expenses ⁽¹⁾	—	(24)	(24)	—	(24)
Administrative expenses	(91)	(210)	(301)	—	(301)
Purchased options expense under FAS 133	—	—	—	(498) ⁽³⁾	(498)
Debt extinguishments	(225)	—	(225)	—	(225)
Income before federal income taxes and effect of accounting change	1,475	642	2,117	(168)	1,949
Provision for federal income taxes	(430)	(114)	(544)	59 ⁽⁴⁾	(485)
Net income	\$1,045	\$ 528	\$1,573	\$(109)	\$1,464

(1) Credit-related expenses include the income statement line items “Provision for losses” and “Foreclosed property income.”

(2) Represents the straight-line amortization of purchased options expense that we allocate to interest expense over the original expected life of the options. We include this amount in core business earnings instead of recording changes in the time value of purchased options because this treatment is more consistent with the accounting for the embedded options in our callable debt and the vast majority of our mortgages.

(3) Represents changes in the fair value of the time value of purchased options recorded in accordance with FAS 133. We exclude this amount from our core business earnings measure because the period-to-period fluctuations in the time value portion of our options do not reflect the economics of our current risk management strategy, which generally is to hold our purchased options to maturity or exercise date. Consequently, we do not expect to realize the period-to-period fluctuations in time value. In addition, the accounting for purchased options under FAS 133 is inconsistent with the accounting for embedded options in our callable debt and mortgages.

(4) Represents the net federal income tax effect of core business earnings adjustments based on the applicable federal income tax rate of 35 percent.

Six Months Ended June 30, 2003

	Portfolio Investment	Credit Guaranty	Total Core Business Earnings	Reconciling Items Related to Purchased Options	Reported Results
Net interest income	\$ 6,466	\$ 403	\$ 6,869	\$ —	\$ 6,869
Purchased options amortization expense	(1,481)	—	(1,481)	1,481 ⁽²⁾	—
Core net interest income	4,985	403	5,388	1,481	6,869
Guaranty fee income (expense)	(807)	1,986	1,179	—	1,179
Fee and other income, net	353	(8)	345	—	345
Credit-related expenses ⁽¹⁾	—	(43)	(43)	—	(43)
Administrative expenses	(204)	(494)	(698)	—	(698)
Purchased options expense under FAS 133	—	—	—	(2,508) ⁽³⁾	(2,508)
Debt extinguishments	(1,132)	—	(1,132)	—	(1,132)
Income before federal income taxes	3,195	1,844	5,039	(1,027)	4,012
Provision for federal income taxes	(938)	(391)	(1,329)	359 ⁽⁴⁾	(970)
Net income	\$ 2,257	\$1,453	\$ 3,710	\$ (668)	\$ 3,042

Six Months Ended June 30, 2002

	Portfolio Investment	Credit Guaranty	Total Core Business Earnings	Reconciling Items Related to Purchased Options	Reported Results
Net interest income	\$4,647	\$ 316	\$ 4,963	\$ —	\$ 4,963

Purchased options amortization expense	(641)	—	(641)	641 (2)	—
Core net interest income	4,006	316	4,322	641	4,963
Guaranty fee income (expense)	(654)	1,485	831	—	831
Fee and other income, net	142	(97)	45	—	45
Credit-related expenses ⁽¹⁾	—	(46)	(46)	—	(46)
Administrative expenses	(176)	(415)	(591)	—	(591)
Purchased options expense under FAS 133	—	—	—	(1,286) ⁽³⁾	(1,286)
Debt extinguishments	(396)	—	(396)	—	(396)
Income before federal income taxes and effect of accounting change	2,922	1,243	4,165	(645)	3,520
Provision for federal income taxes	(858)	(216)	(1,074)	226 ⁽⁴⁾	(848)
Net income	\$2,064	\$1,027	\$ 3,091	\$ (419)	\$ 2,672

- (1) Credit-related expenses include the income statement line items “Provision for losses” and “Foreclosed property income.”
- (2) Represents the straight-line amortization of purchased options expense that we allocate to interest expense over the original expected life of the options. We include this amount in core business earnings instead of recording changes in the time value of purchased options because this treatment is more consistent with the accounting for the embedded options in our callable debt and the vast majority of our mortgages.
- (3) Represents changes in the fair value of the time value of purchased options recorded in accordance with FAS 133. We exclude this amount from our core business earnings measure because the period-to-period fluctuations in the time value portion of our options do not reflect the economics of our current risk management strategy, which generally is to hold our purchased options to maturity or exercise date. Consequently, we do not expect to realize the period-to-period fluctuations in time value. In addition, the accounting for purchased options under FAS 133 is inconsistent with the accounting for embedded options in our callable debt and mortgages.
- (4) Represents the net federal income tax effect of core business earnings adjustments based on the applicable federal income tax rate of 35 percent.

The only difference between our core business earnings and reported net income relates to the accounting treatment for purchased options under FAS 133. This difference only affects our *Portfolio Investment* business. Core business earnings and reported net income are the same for our *Credit Guaranty* business. The *Portfolio Investment* business represented \$901 billion, or 98 percent of total assets, at June 30, 2003 and \$869 billion, or 98 percent of total assets, at December 31, 2002.

8. Derivative Instruments and Hedging Activities

The following table shows the outstanding notional balances of derivatives at June 30, 2003 and December 31, 2002 based on the hedge classification. We had no open hedge positions on the anticipatory issuance of debt at June 30, 2003.

	June 30, 2003				December 31, 2002		
	Cash Flow Hedges	Fair Value Hedges	No Hedge Designation	Total	Cash Flow Hedges	Fair Value Hedges	Total
(Dollars in millions)							
Interest rate swaps:							
Pay-fixed	\$193,689	\$ 25,618	\$ —	\$219,307	\$152,157	\$ 16,355	\$168,512
Receive-fixed and basis	109,018	58,170	—	167,188	48,259	29,636	77,895
Interest rate caps	138,228	—	—	138,228	122,393	—	122,393
Swaptions:							
Pay-fixed	152,280	—	—	152,280	129,225	—	129,225
Receive-fixed	34,750	85,475	—	120,225	51,500	94,750	146,250
Other ⁽¹⁾	6,275	7,446	444	14,165	8,200	4,120	12,320
Total	\$634,240	\$176,709	\$444	\$811,393	\$511,734	\$144,861	\$656,595

- (1) Includes foreign currency swaps, forward starting swaps, asset swaps, and other derivatives used to hedge anticipated debt issues.

FAS 133 requires that changes in the fair value of derivative instruments be recognized in earnings unless specific hedge accounting criteria are met. Although Fannie Mae’s derivatives may be effective economic hedges and critical in our interest rate risk management strategy, they may not meet the hedge accounting criteria of FAS 133. At June 30, 2003, we had \$444 million in outstanding notional amount of derivatives that did not qualify for hedge accounting under FAS 133, which we are required to mark-to-market through earnings.

The following table shows the change in AOCI, net of taxes, associated with FAS 133 between December 31, 2002 and June 30, 2003:

	FAS 133 Impact on AOCI
(Dollars in millions)	
Balance at December 31, 2002	\$(16,251)
Losses on cash flow hedges, net	(840)
Reclassifications to earnings, net	1,242
Balance at March 31, 2003	(15,849)
Losses on cash flow hedges, net	(2,301)
Reclassifications to earnings, net	1,198
Balance at June 30, 2003	\$(16,952)

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Quantitative and qualitative disclosure about market risk is set forth on pages 23 to 25 of this Form 10-Q under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Management — Interest Rate Risk Management” and is incorporated herein by reference.

Item 4. Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

In addition, based on this most recent evaluation, we have concluded that there were no changes in our internal control over financial reporting that occurred during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary course of business, we are involved in legal proceedings that arise in connection with properties acquired either through foreclosure on properties securing delinquent mortgage loans we own or by receiving deeds to those properties in lieu of foreclosure. For example, claims related to possible tort liability and compliance with applicable environmental requirements arise from time to time, primarily in the case of single-family REO.

We are a party to legal proceedings from time to time arising from our relationships with our seller/ servicers. Disputes with lenders concerning their loan origination or servicing obligations to us, or disputes concerning termination by us (for any of a variety of reasons) of a lender's authority to do business with us as a seller and/or servicer, can result in litigation. Also, loan servicing and financing issues have resulted from time to time in claims against us brought as putative class actions for borrowers. We also are a party to legal proceedings from time to time arising from other aspects of our business and administrative policies.

Fannie Mae is the subject of a lawsuit filed on September 13, 2002, as a class action in the United States District Court for the District of Columbia seeking declaratory and injunctive relief, as well as statutory and punitive damages. The complaint identifies as a class all minority borrowers who have been denied loans as a result of Fannie Mae's automated underwriting systems ("AUS"). The lawsuit alleges that Fannie Mae's AUS unlawfully fails to give adverse action notices to borrowers who are not approved for the loans for which they apply, and unlawfully discriminates against minorities.

Fannie Mae moved to dismiss the complaint in its entirety and the court granted that motion in part and denied it in part. The court held that Fannie Mae did not have a legal obligation to provide adverse action notices and the court declined plaintiff's motion to reconsider that decision or certify it for appeal. The court held that the plaintiff had met the minimal requirements for pleading the discrimination claim, but that plaintiff must demonstrate that she was qualified to obtain a loan. Fannie Mae anticipates that it will file dispositive motions on a variety of factual and legal grounds, as well as file briefs to defeat class certification.

Claims and proceedings of all types are subject to many uncertain factors that generally cannot be predicted with assurance. However, in the case of the legal proceedings and claims that are currently pending against us, management believes that their outcome will not have a material adverse effect on our financial condition, results of operations or cash flows.

Item 2. Changes in Securities and Use of Proceeds

(a) None.

(b) None.

(c) The securities Fannie Mae issues are "exempt securities" under laws administered by the SEC to the same extent as securities that are obligations of, or guaranteed as to principal and interest by, the United States. Registration statements with respect to Fannie Mae securities are not filed with the SEC, except for the voluntary filing on March 31, 2003, of Form 10 under the Securities Exchange Act of 1934 with respect to Fannie Mae common stock.

During the quarter ended June 30, 2003, Fannie Mae sold (i) 6,900,000 shares of Non-Cumulative Preferred Stock, Series L, through a syndicate of underwriters led by Lehman Brothers and Goldman, Sachs & Co.; the aggregate offering price was \$345,000,000 and the aggregate underwriting discount was \$3,018,750; and (ii) 9,200,000 shares of Non-Cumulative Preferred Stock, Series M, through a syndicate of underwriters led by Lehman Brothers and Merrill Lynch & Co.; the aggregate offering price was \$460,000,000 and the aggregate

underwriting discount was \$4,025,000. The proceeds from both such sales were used for general corporate purposes.

(d) Not applicable.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

The shareholders of the company voted on four matters at the Annual Meeting of Shareholders held on May 20, 2003:

1. The election of 12 directors;
2. Ratification of the appointment of KPMG LLP as independent auditors for 2003;
3. Approval of the Fannie Mae Stock Compensation Plan of 2003; and
4. A shareholder proposal to reinstate cumulative voting for directors.

The following persons were elected as directors of Fannie Mae by the respective votes indicated following their names: Stephen B. Ashley (845,297,830 votes for; 12,681,635 votes withheld); Kenneth M. Duberstein (838,883,157 votes for; 19,096,308 votes withheld); Thomas P. Gerrity (835,236,010 votes for; 22,743,455 votes withheld); Timothy Howard (841,938,392 votes for; 16,041,073 votes withheld); Ann McLaughlin Korologos (844,468,293 votes for; 13,511,172 votes withheld); Frederic V. Malek (835,042,300 votes for; 22,937,165 votes withheld); Donald B. Marron (845,184,528 votes for; 12,794,937 votes withheld); Daniel H. Mudd (841,958,669 votes for; 16,020,796 votes withheld); Anne M. Mulcahy (835,468,474 votes for; 22,510,991 votes withheld); Joe K. Pickett (845,438,154 votes for; 12,541,311 votes withheld); Franklin D. Raines (837,466,596 votes for; 20,512,869 votes withheld); H. Patrick Swygert (841,797,517 votes for; 16,181,948 votes withheld).

In addition to the directors elected by the shareholders, the President of the United States has the authority to appoint five members of Fannie Mae's board. In May, the President reappointed Victor H. Ashe, Molly H. Bordonaro, William R. Harvey, Manual J. Justiz, and Taylor C. Segue, III to the board for a term expiring on the date of the May 2004 annual meeting of shareholders.

The ratification of KPMG LLP as independent auditors for 2003 was approved as follows:

Votes for ratification:	812,238,118
Votes against ratification:	40,243,450
Abstentions:	5,497,897

The Fannie Mae Stock Compensation Plan of 2003 was approved as follows:

Votes for approval:	798,163,864
Votes against approval:	52,174,400
Abstentions:	7,641,201

The shareholder proposal to reinstate cumulative voting for directors was defeated as follows:

Votes for reinstatement:	122,627,153
Votes against reinstatement:	640,653,184
Abstentions:	8,513,420
Broker non-votes:	86,185,708

Item 5. Other Information

Recent Legislative and Regulatory Developments

Several bills recently have been introduced in Congress that propose to alter the regulatory regime under which Fannie Mae operates. These bills seek to transfer regulatory responsibility for overseeing Fannie Mae's financial safety and soundness from our current regulator, OFHEO, to a bureau under the U.S. Department of the Treasury. Some of the bills would also move various of the Department of Housing and Urban Development's regulatory authorities over Fannie Mae to the Treasury bureau. Several bills seek to provide additional or expanded powers to Fannie Mae's regulators. We cannot predict whether any legislation will be approved by Congress and signed into law by the President and, if so, the final form or effective date of such legislation.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit 3.1	Fannie Mae Bylaws, effective as of July 15, 2003
Exhibit 4.1	Certificate of Designation of Terms of Fannie Mae Preferred Stock, Series L (incorporated by reference to Exhibit 4.2 to Fannie Mae's quarterly report on Form 10-Q for the quarter ended March 31, 2003)
Exhibit 4.2	Certificate of Designation of Terms of Fannie Mae Preferred Stock, Series M
Exhibit 10.1	Employment Agreement between Fannie Mae and Franklin D. Raines
Exhibit 10.2	Employment Agreement between Fannie Mae and Daniel H. Mudd
Exhibit 10.3	Employment Agreement between Fannie Mae and J. Timothy Howard
Exhibit 10.4	Fannie Mae Stock Compensation Plan of 2003
Exhibit 12	Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends
Exhibit 31.1	Certification of CEO pursuant to Securities Exchange Act of 1934 Rule 13a-14
Exhibit 31.2	Certification of CFO pursuant to Securities Exchange Act of 1934 Rule 13a-14
Exhibit 32.1	Certification of CEO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2	Certification of CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

On April 15, 2003, we filed a Current Report on Form 8-K dated April 15, 2003, reporting our earnings for the first quarter of fiscal year 2003, and certain other financial data, under Item 9.

On May 14, 2003, we filed a Current Report on Form 8-K dated May 13, 2003, reporting monthly business volumes and certain statistical data for the month of April 2003, under Item 5.

On May 21, 2003, we filed a Current Report on Form 8-K dated May 20, 2003, reporting the appointment of a vice chairman of the corporation, under Item 5.

On May 23, 2003, we filed a Current Report on Form 8-K dated May 23, 2003, disclosing the quarterly business activity supplement for the first quarter of fiscal year 2003, under Item 5.

On June 13, 2003, we filed a Current Report on Form 8-K dated June 12, 2003, reporting monthly business volumes and certain statistical data for the month of May 2003, under Item 5.

No other reports on Form 8-K were filed during the second quarter of 2003; however, on July 15, 2003, we filed a Current Report on Form 8-K dated July 14, 2003, reporting our earnings for the second quarter of fiscal year 2003, and certain other financial data, under Item 9, and on August 13, 2003, we filed a Current Report on Form 8-K dated August 13, 2003, reporting monthly business volumes and certain statistical data for the month of July 2003.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Federal National Mortgage Association

Date: August 14, 2003

By: /s/ J. TIMOTHY HOWARD

J. Timothy Howard
Vice Chairman and Chief Financial Officer

By: /s/ LEANNE G. SPENCER

Leanne G. Spencer
Senior Vice President and Controller

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* Exhibits 31.1 and 31.2 appear immediately following this index in printed copies of the Form 10-Q. Other exhibits filed with the Securities and Exchange Commission as part of the Form 10-Q have been omitted from the printed copy, but may be seen on the Web site of the Commission (www.sec.gov) or on our Web site (www.fanniemae.com/ir).

FANNIE MAE BYLAWS

As Amended Through July 15, 2003

**Legal Department
Fannie Mae
Washington, D.C.**

FANNIE MAE BYLAWS
As Amended Through July 15, 2003

ARTICLE 1

General Provisions

Section 1.01. Name. The name of the corporation is Federal National Mortgage Association. The corporation may also do business under the name Fannie Mae.

Section 1.02. Principal Office and Other Offices. The principal office of the corporation shall be in the District of Columbia. Other offices of the corporation shall be in such places as may be deemed by the Board of Directors or the Chairman of the Board to be necessary or appropriate.

Section 1.03. Seal. The seal of the corporation shall be of such design as shall be approved and adopted from time to time by the Board of Directors, and the seal or a facsimile thereof may be affixed by any person authorized by the Board of Directors or these Bylaws by impression, by printing, by rubber stamp, or otherwise.

Section 1.04. Fiscal Year. The fiscal year of the corporation shall end on the 31st day of December of each year.

Section 1.05. Corporate Governance Practices and Procedures. Pursuant to Section 1710.10(b) of the Office of Federal Housing Enterprise Oversight ("OFHEO") corporate governance regulation, 12 CFR 1710.1 et seq., to the extent not inconsistent with the Charter Act and other Federal law, rules, and regulations, the corporation has elected to follow the applicable corporate governance practices and procedures of the Delaware General Corporation Law, as the same may be amended from time to time. The inclusion of provisions in these Bylaws shall constitute inclusion in the corporation's "certificate of incorporation" for all purposes of the Delaware General Corporation Law.

ARTICLE 2

Capital Stock

Section 2.01. Common Stock. The common stock, all of which is voting and has no par value, shall have a stated value per share as determined from time to time by the Board of Directors. Shares of the corporation may be acquired and held in the treasury of the corporation, and may be disposed of by the corporation for such consideration and for such purposes as may be determined from time to time by the Board of Directors.

Section 2.02. Preferred Stock. The corporation shall have authority to issue up to 200,000,000 shares of preferred stock having no par value. The preferred stock may be issued from time to time in one or more series upon approval by the Board of Directors, or a committee thereof appointed for such purpose, and the Board of Directors or such committee may, by resolution providing for the issuance of such preferred stock, designate with respect to such shares: (a) their voting powers; (b) their rights of redemption; (c) their right to receive dividends (which may be cumulative or non-cumulative) including the dividend rate or rates, conditions to

payment, and the relative preferences in relation to the dividends payable on any other class or classes or series of stock; (d) their rights upon the dissolution of, or upon any distribution of the assets of, the corporation; (e) their rights to convert into, or exchange for, shares of any other class or classes of stock of the corporation, including the price or prices or the rate of exchange; and (f) other relative, participating, optional or special rights, qualifications, limitations or restrictions. Notwithstanding Sections 4.12(a)(6) and 4.15 of these Bylaws, the Board of Directors may authorize a committee of the Board to declare dividends on preferred stock.

Section 2.03. *Payment for Shares.* The consideration to be received by the corporation for the issuance of common shares shall be fixed from time to time by the Board of Directors. A subscriber shall be entitled to issuance of shares upon receipt by the corporation of the consideration for which the shares are to be issued. No certificates shall be issued for any share until the share is fully paid, and, when issued, such shares shall be nonassessable.

Section 2.04. *Certificates Representing Shares.* Each registered holder of the capital stock of the corporation shall be entitled to a certificate or certificates signed by the Chairman of the Board of Directors or the President and by the Secretary or an Assistant Secretary of the corporation, and sealed with the seal of the corporation certifying the number of shares owned by him in the corporation. The certificates shall be in such form as the Board, from time to time, may approve. If any certificate is manually signed (i) by a transfer agent other than the corporation or its employee, or (ii) by a registrar other than the corporation or its employee, any other signature on the certificate, including those of the aforesaid officers of the corporation, may be a facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if he or she were such officer, transfer agent or registrar at the date of issue.

Section 2.05. *Transfers of Stock.* Transfers of stock shall be made upon the books of the corporation (i) upon presentation of the certificates by the registered holder in person or by duly authorized attorney, or (ii) upon presentation of proper evidence of succession, assignment or authority to transfer the stock, and upon surrender of the appropriate certificate(s).

Section 2.06. *Holder of Record.* The corporation shall be entitled to treat the holder of record of any share or shares of stock as the holder in fact thereof and accordingly shall not be bound to recognize any equitable or other claim to or interest in such share on the part of any other person whether or not it shall have express or other notice thereof, save as expressly provided by the laws of the State of Delaware insofar as they are applicable to the stock of stock corporations organized under the Delaware General Corporation Law.

Section 2.07. *Loss or Destruction of Certificate of Stock.* In case of loss or destruction of any certificate of stock, another may be issued in its place, pursuant to such requirements and procedures as may be established by the Secretary of the corporation with the concurrence of the General Counsel (including, without limitation, requiring provision of a surety bond).

Section 2.08. *Stockholder Records.*

(a) The corporation shall keep at its principal place of business, or at the office of its transfer agent or registrar, a record of its stockholders, giving the names and addresses of all stockholders and the number of shares held by each.

(b) The officer who has charge of the stock ledger of the corporation shall prepare and make, at least 10 days before every meeting of stockholders, a complete list of the stockholders entitled to vote at said meeting, arranged in alphabetical order, showing the address of and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, for a period of at least 10 days prior to the meeting, during ordinary business hours, at the principal place of business of the corporation or as may otherwise be permitted by the Delaware General Corporation Law. The list shall be produced and kept at the time and place of the meeting during the whole time thereof and may be inspected by any stockholder who is present.

Section 2.09. Registration of Common Stock. The corporation shall register its common stock with the Securities and Exchange Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934, as amended, and shall take appropriate steps to maintain such registration. Notwithstanding anything to the contrary contained in Article 7 of these Bylaws, this Section 2.09 may be altered, amended, or repealed only by the unanimous vote or consent of all the then incumbent Members of the Board then in office.

ARTICLE 3

The Stockholders

Section 3.01. Place of Meetings. Meetings of the stockholders of the corporation shall be held at such place or places, within or without the District of Columbia, as shall be determined by the Board of Directors; and the Chairman of the Board shall preside at all such meetings.

Section 3.02. Annual Meeting. The annual meeting of the stockholders shall be held at ten o'clock in the morning of the third Thursday in May of each year, if that day is not a legal holiday, and if a holiday, then on the first following day that is not a legal holiday. If any annual meeting is not held at the designated time, the meeting shall be held as promptly as practicable thereafter at a time to be determined by the Board of Directors.

Section 3.03. Special Meetings. Special meetings of the stockholders may be called by the Board of Directors or the Chairman of the Board, or at the request of the holders of not less than one-third of all the shares entitled to vote, to be determined as of the close of the first day of the month preceding the month in which the request is presented to the Secretary. Business transacted at all special meetings shall be confined to the subjects stated in the notice of special meeting.

Section 3.04. Notice of Meetings—Waiver and Adjourned Meetings. Written notice stating the place, date and hour of the meeting, and the purpose or purposes for which the meeting is called, shall be delivered not less than 20, nor more than 55, days before the date of the meeting, by the Secretary of the corporation, to each registered holder entitled to vote at such meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail addressed to the registered holder at his address as it appears on the stock transfer books of the

corporation, with first class postage prepaid. Waiver by a stockholder in writing of notice of a stockholders' meeting, signed by him either before or after the time of the meeting, shall be equivalent to the giving of such notice. Attendance by a stockholder at a stockholders' meeting, whether in person or by proxy, without objection to the notice or lack thereof, shall constitute a waiver of notice of the meeting. Any meeting of stockholders may be adjourned by the chair of the meeting to reconvene at another time or place. When a meeting is adjourned to another time or place, notice need not be given of the adjourned meeting if the time and place thereof are announced at the meeting at which the adjournment is taken. At the adjourned meeting the corporation may transact any business which might have been transacted at the original meeting. If the adjournment is for more than 30 days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

Section 3.05. Fixing Record Date.

(a) For the purpose of determining stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, the Board of Directors may fix a date as the record date. Such date, in any case, shall not precede the date upon which the resolution fixing the record date is adopted by the Board of Directors and shall be not more than 55 days and not less than 20 days prior to the date of such meeting. If no such record date is fixed, the close of business on the day next preceding the day on which notice is given, or, if notice is waived, the close of business on the day next preceding the date on which the meeting is held shall be the record date for the determination of stockholders entitled to notice of or to vote at a meeting of stockholders. When a determination of stockholders entitled to vote at any meeting of stockholders has been made, as provided in this section, the determination shall apply to any adjournment thereof, provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

(b) For the purpose of determining stockholders entitled to receive payment of any dividend, or in order to make a determination of stockholders for any other purpose (except as provided in Section 3.05(a)), the Board of Directors or a duly authorized Committee thereof may fix a date as the record date. Such date, in any case, shall not precede the date upon which the resolution fixing the record date is adopted and shall be not more than 55 days prior to the date on which the particular action is to be taken. If no such record date is fixed, the close of business on the day on which the resolution relating thereto is adopted shall be the record date for the determination of stockholders.

Section 3.06. Quorum. A majority of the shares entitled to vote, represented in person or by proxy, shall constitute a quorum at a meeting of stockholders. The stockholders present at a duly organized meeting may continue to do business until adjournment, notwithstanding the withdrawal of the holders of enough shares to leave less than a quorum. If a meeting cannot be organized because a quorum has not attended, either the chair of the meeting, or those stockholders present, in person or by proxy, by a majority of the votes cast by such stockholders so present, may adjourn the meeting from time to time until a quorum is present when any business may be transacted that may have been transacted at the meeting as originally called.

Section 3.07. Proxies. A stockholder may vote either in person or by proxy

executed in writing by the stockholder or his duly authorized representative. No proxy shall be valid after 11 months from the date of its execution, unless otherwise expressly provided in the proxy.

Section 3.08. Voting. At every meeting of the stockholders, every holder of the common stock shall be entitled to one vote for each share of common stock registered in the name of such holder on the stock transfer books of the corporation at the close of the record date. A proxy purporting to be executed by a corporation shall be presumed to be valid and the burden of proving invalidity shall rest on any challenger. A proxy purporting to be executed by a partnership shall be presumed to be valid and the burden of proving invalidity shall rest on any challenger. At each election for Members of the Board of Directors, every such holder of the common stock shall have the right to cast, for each Board position to be filled, a number of votes equal to the number of shares held by such holder. Such holders shall have no right to cumulate their votes for directors. Unless a higher percentage of affirmative votes is required by the Charter Act, these Bylaws, applicable stock exchange rules or regulations, or other applicable Federal law, rules, or regulations, the stockholders will have approved any matter if, at a meeting at which a quorum is present, the votes cast by the stockholders present, either in person or by proxy and entitled to vote thereon, in favor of such matter exceed the votes cast by such stockholders against such matter. Members of the Board of Directors shall be elected by a plurality of the votes cast.

Section 3.09. Inspectors of Votes. The Board of Directors, in advance of any meeting of stockholders, shall appoint one or more Inspectors of Votes to act at the meeting or any adjournment thereof and make a written report thereof. One or more persons may be designated as alternates to replace any Inspector of Votes who fails to act. In case any person so appointed Inspector of Votes or alternate resigns or fails to act, the vacancy shall be filled by appointment made by the chairman of the meeting. The Inspectors of Votes shall (a) ascertain the number of shares outstanding and the voting power of each and determine all questions concerning the qualification of voters; (b) determine the shares represented at the meeting and the validity of proxies and ballots; (c) determine all questions concerning the acceptance or rejection of votes and, with respect to each vote by ballot, shall collect and count all votes and ballots; (d) determine and retain for a reasonable period a record of the disposition of any challenges made to any determination by the Inspectors of Votes; and (e) report in writing to the secretary of the meeting their determination of the number of shares represented at the meeting, and their count of all votes and ballots. The Inspectors of Votes need not be stockholders of the corporation. No person who is an officer or Member of the Board of Directors of the corporation, or who is a candidate for election as a Member of the Board of Directors, shall be eligible to be an Inspector of Votes. Any report or certificate by the Inspectors of Votes shall be prima facie evidence of the facts stated and of the votes as certified by them.

Section 3.10. Stockholder Notices to the Corporation. Whenever notice is to be given to the corporation by a stockholder under any provision of law or of these Bylaws, such notice shall be delivered to the Secretary at the principal executive offices of the corporation. If delivered by electronic mail or facsimile, the stockholder's notice shall be directed to the Secretary at the electronic mail address or facsimile number, as the case may be, specified in the corporation's most recent proxy statement.

Section 3.11. Conduct of Meetings. The date and time of the opening and the closing of the polls for each matter upon which the stockholders will vote at a meeting shall be announced at such meeting by the person presiding over the meeting. The Board of Directors may adopt by resolution such rules or regulations for the conduct of meetings of stockholders as it shall deem appropriate. Except to the extent inconsistent with such rules and regulations as adopted by the Board of Directors, the chair of any meeting of stockholders shall have the right and authority to prescribe such rules, regulations and procedures and to do all such acts as, in the judgment of such chair, are appropriate for the proper conduct of the meeting. Such rules, regulations or procedures, whether adopted by the Board of Directors or prescribed by the chair of the meeting, may include, without limitation, the following: (a) the establishment of an agenda or order of business for the meeting; (b) rules and procedures for maintaining order at the meeting and the safety of those present; (c) limitations on attendance at or participation in the meeting to stockholders of record of the corporation, their duly authorized and constituted proxies, or such other persons as the chair shall permit; (d) restrictions on entry to the meeting after the time fixed for the commencement thereof; and (e) limitations on the time allotted to questions or comments by participants. Meetings of stockholders shall not be required to be held in accordance with rules of parliamentary procedure.

Section 3.12. Notice of Stockholder Proposal. At an annual meeting of the stockholders, only such business shall be conducted as shall have been properly brought before the meeting. To be properly brought before an annual meeting, business must be (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors; (b) otherwise properly brought before the meeting by or at the direction of the Board of Directors; or (c) otherwise properly brought before the meeting by a stockholder. For business to be properly brought before an annual meeting by a stockholder (other than the nomination of a person for election as a director, which is governed by Section 4.19 of these Bylaws), the stockholder must have given timely notice thereof in writing to the Secretary of the corporation. To be timely, a stockholder's notice must be delivered to or mailed and received at the principal executive offices of the corporation not later than the following dates (1) 60 days in advance of such meeting if such meeting is to be held on a day that is within 30 days preceding the anniversary of the previous year's annual meeting, or 90 days in advance of such meeting if such meeting is to be held on or after the anniversary of the previous year's annual meeting; and (2) with respect to an annual meeting of stockholders held on any other date, the close of business on the 10th day following the date of public disclosure of the date of such meeting. (For purposes of these Bylaws, public disclosure shall be deemed to include a disclosure made in a press release reported by the Dow Jones News Services, Associated Press or a comparable national news service or in a document filed by the corporation with the Securities and Exchange Commission pursuant to Section 13 of the Securities Exchange Act of 1934, as amended.) A stockholder's notice to the Secretary shall set forth as to each matter the stockholder proposes to bring before the annual meeting (A) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting; (B) the name and address, as they appear on the corporation's books, of the stockholder proposing such business; (C) the class and number of shares of the corporation that are beneficially owned by the stockholder; and (D) any material interest of the stockholder in such business. Notwithstanding anything in these Bylaws to the contrary, no business shall be conducted at any annual meeting except in accordance with the procedures set forth in this Section 3.12. The chair of

the annual meeting shall, if the facts warrant, determine and declare to the meeting that business was not properly brought before the meeting in accordance with the provisions of this Section 3.12, and if he or she should so determine, he or she shall so declare to the meeting and any such business not properly brought before the meeting shall not be transacted.

ARTICLE 4

The Board of Directors

Section 4.01. General Policies. General policies governing the operations of the corporation shall be determined by the Board of Directors.

Section 4.02. Membership. The Board of Directors shall consist of those Members appointed and elected as provided by law.

Section 4.03. Term of Members. Each Member shall hold office for the term for which he is elected or appointed and until his successor is chosen and qualified, or his death, resignation, retirement, or removal in accordance with law, whichever event shall first occur.

Section 4.04. Regular Meetings. The Board of Directors shall meet in regular meeting at such times as shall be determined by the Board from time to time, except as provided in section 4.05 and except when the Chairman of the Board shall notify the Secretary of a different date prior to a scheduled regular meeting. Each regular meeting shall be held at the principal office of the corporation in the District of Columbia, unless special provision is made by the Board, in advance of any such regular meeting, to hold that meeting at another place, either within or without the District of Columbia.

Section 4.05. Annual Meeting. Immediately following the annual meeting of the stockholders, the Board of Directors shall meet each year for the purpose of considering any business that may properly be brought before the meeting, and such annual meeting of the Board shall be a regular meeting.

Section 4.06. Special Meetings. Other meetings of the Board of Directors may be held upon the call of the Chairman of the Board of Directors, or of a majority of the then incumbent Members of the Board. Each special meeting shall be held at the principal office in the District of Columbia unless the Chairman of the Board prescribes and the notice specifies another place.

Section 4.07. Notice of Meetings—Waiver. No notice of any kind to Members of the Board of Directors shall be necessary for any regular meeting that is held on a date determined by the Board, or for the annual meeting. In the case of a regular meeting on a different date, notice shall be given to each Member by the Secretary; in the case of a special meeting, notice shall be given to each Member by the Secretary at the direction of the calling authority. Such notice shall be in writing and sent to the address on file with the Secretary of the corporation not later than during the third day immediately preceding the day for the meeting; or by word of mouth, telephone, facsimile or electronic mail, directed to the telephone number, facsimile number or electronic mail address, as the case may be, on file with the Secretary of the corporation, not later than during the second day immediately preceding the day for the meeting. Notice of any such meeting may be waived in writing signed by the

person or persons entitled thereto, either before or after the time of the meeting. Neither the business to be transacted at, nor the purpose of, any meeting of the Board of Directors need be specified in the notice or waiver of notice of the meeting.

Section 4.08. *The Chairman of the Board of Directors.* The Chairman of the Board of Directors may be chosen by the Board at any meeting of the Board from among the Members, and his tenure shall commence immediately and continue until the next succeeding annual meeting of the Board, or until his successor is chosen, whichever first occurs. The Chairman of the Board shall be the Chief Executive Officer of the corporation, and shall have such powers and perform such duties as the Board may prescribe. Except as otherwise provided by law, the corporate charter, these Bylaws, or the Board, the Chairman shall have plenary authority to perform all duties ordinarily incident to the office and such other duties as may be assigned to him from time to time by the Board. The Chairman may prescribe, amend and rescind requirements and procedures governing the manner in which the general business of the corporation shall be conducted. The officers, agents and employees, other than the principal officers, shall be appointed by the Chairman or by any other principal officer to whom the Chairman shall have delegated the authority. During the Chairman's absence or inability to act or during the vacancy of the office, the Vice Chairman and Chief Operating Officer shall perform the duties and exercise the authority of the Chairman.

Section 4.08a. *The Vice Chairman of the Board of Directors.* The Board of Directors may from time to time elect from among the Members of the Board one or more Vice Chairmen of the Board. Any such Vice Chairman shall have such powers and shall perform such duties as the Board of Directors may prescribe or as the Chairman of the Board shall delegate to him.

Section 4.09. *Quorum.* The presence, in person or otherwise in accordance with section 4.16 hereof, of a majority of the then incumbent Members of the Board of Directors or of a Board Committee, as applicable, at the time of any meeting of the Board or such Committee, shall constitute a quorum for the transaction of business. The act of the majority of such Members present at a meeting at which a quorum is present shall be the act of the Board of Directors unless the act of a greater number is required by these Bylaws. Members may not be represented by proxy at any meeting of the Board of Directors.

Section 4.10. *Action Without a Meeting.* Any policy or action that may be approved or taken at a meeting of the Board or of any Board Committee may be approved or taken without a meeting if all incumbent Members of the Board or the Committee, as the case may be, consent thereto in writing and the writings are filed with the minutes of the proceedings of the Board or the Committee.

Section 4.11. *Facsimile Signatures.* The Board of Directors, the Chairman of the Board or the President may authorize the use of facsimile signatures in lieu of manual signatures.

Section 4.12. *Executive Committee.*

(a) The Executive Committee of the Board shall consist of at least five Members who shall be designated by the Board and serve at the pleasure of the Board. One of the members of the Executive Committee shall be the Chief Executive Officer of the corporation who may also, but is not required to, be chair of the Committee. The

designation of such Committee and the delegation thereto of authority shall not alone relieve any director of any duty he owes the corporation. The Executive Committee, during the interim between Board meetings, shall have all the authority of the Board, except that it shall not have the authority to take any of the following actions:

- (1) The submission to stockholders of any action requiring stockholders' authorization.
- (2) The filling of vacancies on the Board of Directors or on the Executive Committee.
- (3) The fixing of compensation of the directors for serving on the Board or on the Executive Committee.
- (4) The appointment or removal of the Chairman of the Board, President, any Vice Chairman, and any Executive Vice President, except that vacancies in established positions may be filled subject to ratification by the Board of Directors.
- (5) The amendment or repeal of these Bylaws or the adoption of new bylaws.
- (6) The declaration of dividends or the authorizing of the issuance of the corporation's stock.
- (7) The amendment or repeal of any resolution of the Board which by its terms is not so amendable or repealable.
- (8) The adoption of an agreement of merger or consolidation or the adoption of a certificate of ownership and merger.
- (9) The recommendation to stockholders of the sale, lease or exchange of all or substantially all of the corporation's property and assets.
- (10) The recommendation to stockholders of a dissolution of the corporation or a revocation of a dissolution.

(b) The Executive Committee shall meet at the call of its chairman or of a majority of its members, and a majority shall constitute a quorum. The action of the majority of the members of the Committee shall be the action of the Committee. Members of the Committee may not be represented by proxy at any meeting of the Committee.

(c) Unless otherwise expressly provided by resolution of the Board of Directors, members of the Executive Committee shall be compensated and shall be reimbursed for travel and expenses on the same basis and at the same rate as is provided for Members of the Board of Directors for attendance at meetings of the Board.

(d) The Executive Committee shall, at each regular meeting of the Board of Directors, present to the Board its report and such recommendations as are in its judgment necessary for the proper operation of the corporation.

Section 4.13. Audit Committee. The Board of Directors shall have an Audit Committee and, as required by Section 1710.11(b)(1) of the OFHEO corporate governance regulation, the Audit Committee shall comply with the charter, independence, composition, expertise and other requirements of the New York Stock Exchange, as the same may be amended from time to time, unless otherwise required by OFHEO.

Section 4.14. Compensation Committee. The Board of Directors shall have a Compensation Committee and, as required by Section 1710.11(b)(2) of the OFHEO corporate governance regulation, the Compensation Committee shall include at least

three independent directors. The duties of the Compensation Committee shall include overseeing the corporation's compensation policies and plans for executive officers and employees and approving the compensation of senior executive officers of the corporation.

Section 4.15. *Other Committees.* In addition to the Executive, Audit and Compensation committees, the Board of Directors may by resolution designate from among its Members such other committees as it deems appropriate, each of which, to the extent provided by resolution of the Board, may exercise all authority of the Board except those actions outside the authority of the Executive Committee. The designation of any such committee and the delegation thereto of authority shall not alone relieve any director of any duty he owes the corporation.

Section 4.16. *Remote Meetings.* Any meeting of the Board of Directors or any meeting of a Board Committee may be held with the Members of the Board or members of such Committee participating in such meeting by telephone or by any other means of communication by which all such persons participating in the meeting are able to speak to and hear one another.

Section 4.17. *Limitation on Liability.* To the fullest extent permitted by Delaware statutory or decisional law, as amended or interpreted, no director of this corporation shall be personally liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director. This Section 4.17 does not affect the availability of equitable remedies for breach of fiduciary duties.

Section 4.18. *Eligibility to Make Nominations.* Nominations of candidates for election as directors at an annual meeting of stockholders called for election of directors may be made (i) by any stockholder entitled to vote at such meeting only in accordance with the procedures established by Section 4.19 of these Bylaws, or (ii) by the Board of Directors or by a duly authorized Committee thereof. In order to be eligible for election as a director, any director nominee must first be nominated in accordance with the provisions of these Bylaws.

Section 4.19. *Procedure for Nominations by Stockholders.* Any stockholder entitled to vote for the election of a director at an annual meeting may nominate one or more persons for such election only if written notice of such stockholder's intent to make such nomination is delivered to or mailed and received by the Secretary of the corporation. Such notice must be received by the Secretary not later than the following dates: (a) with respect to an annual meeting of stockholders, 60 days in advance of such meeting if such meeting is to be held on a day that is within 30 days preceding the anniversary of the previous year's annual meeting or 90 days in advance of such meeting if such meeting is to be held on or after the anniversary of the previous year's annual meeting; and (b) with respect to an annual meeting of stockholders held on any other date, the close of business on the 10th day following the date of public disclosure of the date of such meeting. The written notice shall set forth: (1) the name, age, business address and residence address of each nominee proposed in such notice; (2) the principal occupation or employment of each such nominee; (3) the number of shares of capital stock of the corporation which are beneficially owned by each such nominee; and (4) such other information concerning each such nominee as would be required, under the rules of the Securities and Exchange Commission in a proxy statement soliciting proxies for the election of such nominee as a director. Such notice shall include a signed consent of each such nominee to serve as a director of the corporation, if elected.

Section 4.20. Compliance with Procedures. If the chair of the stockholders' annual meeting determines that a nomination of any candidate for election as a director was not made in accordance with the applicable provisions of these Bylaws, such nomination shall be void.

ARTICLE 5

The Officers

Section 5.01. Number. The principal officers of the corporation shall consist of the Chairman of the Board of Directors, a President, one or more Vice Chairmen of the Board if the Board has elected to fill such position or positions, one or more Executive Vice Presidents and Senior Vice Presidents, a General Counsel, a Controller, a Treasurer, and a Secretary. There shall be such assistant officers, agents, and employees as may be deemed necessary. Any two or more offices may be held by the same person.

Section 5.02. General Authority and Duties. All officers, agents, and employees of the corporation shall have such authority and perform such duties in the management and conduct of the business of the corporation as may be provided for in these Bylaws, as may be established by resolution of the Board of Directors not inconsistent with these Bylaws, or as may be delegated to them in a manner not inconsistent with these Bylaws.

Section 5.03. Election, Tenure, and Qualifications. The principal officers shall be selected by the Board of Directors. Each officer shall hold office until his successor is chosen and qualified, or his death, resignation, retirement, or removal from office, whichever event shall first occur. Selection or appointment without express tenure, of an officer, agent, or employee shall not of itself create contract rights.

Section 5.04. Removal. Any officer, agent, or employee may be removed by the Board of Directors. Any removal shall be in accordance with such procedures and safeguards as the corporation may establish and shall be without prejudice to the contract rights, if any, of the person so removed.

Section 5.05. Vacancies. Any vacancy in any office shall be filled in the manner prescribed in these Bylaws for selection or appointment to the office.

Section 5.06. The President. The President shall have such powers and perform such duties as the Board of Directors may prescribe, or as the Chairman of the Board may delegate to him.

Section 5.07. The Vice Presidents. Each Vice President shall have such powers and perform such duties as the Board of Directors may prescribe or as the Chairman of the Board may delegate to him.

Section 5.08. The Treasurer. The Treasurer shall, in general, perform all the duties ordinarily incident to the office of Treasurer and such other duties as may be assigned to him by the Board of Directors or by the Chairman of the Board. The Treasurer shall render to the Chairman and the Board, whenever the same shall be required, an account of all his transactions as Treasurer. The Treasurer shall, if required to do so by the Board, give the corporation a bond in such amount and with

such surety or sureties as may be ordered by the Board for the faithful performance of the duties of his office and for the restoration to the corporation, in case of his death, resignation, retirement, or removal from office, of all books, papers, vouchers, money, and other property of whatever kind in his possession or under his control belonging to the corporation. The premium for any such bond shall be paid by the corporation.

Section 5.09. *The General Counsel.* The General Counsel shall be the principal consulting officer of the corporation in all matters of legal significance or import; shall be responsible for and direct all counsel, attorneys, employees, and agents in the performance of all legal duties and services for and on behalf of the corporation; shall perform such other duties and have such other powers as are ordinarily incident to the office of the General Counsel; and shall perform such other duties as, from time to time, may be assigned to him by the Board of Directors or by the Chairman of the Board.

Section 5.10. *The Secretary.* The Secretary shall keep or cause to be kept in books provided for the purpose the minutes of the meetings of the Board of Directors and the minutes or transcripts of the meetings of the stockholders; shall see that all notices are duly given as required by law and in accordance with the provisions of these Bylaws; shall be responsible for the custody and maintenance of all related records and the blank stock certificates of the corporation; shall be custodian of the records and of the seal of the corporation; and, in general, shall perform all the duties ordinarily incident to the office of Secretary and such other duties as may be assigned to him by the Board or by the Chairman of the Board. The Secretary and any Assistant Secretary are expressly empowered to attest signatures of officers of the corporation and to affix the seal of the corporation to documents.

Section 5.11. *The Controller.* The Controller shall keep full and accurate accounts of all assets, liabilities, commitments, receipts, disbursements, and other financial transactions of the corporation; shall certify vouchers for payment by the Treasurer or the Treasurer's designee, and shall designate, with the written concurrence of the Chairman of the Board, such other officers, agents, and employees, severally, who may so certify; and in general, shall perform all the duties ordinarily incident to the office of Controller and such other duties as may be assigned to him by the Board of Directors or by the Chairman of the Board.

Section 5.12. *Assistant Officers.* Each assistant to an officer, including but not limited to any Assistant Vice President, any Assistant Treasurer, any Assistant General Counsel, and any Assistant Secretary, and any other such assistant to any officer, shall perform such duties as are, from time to time, delegated to him by the officer to whom he is an assistant, by the Chairman of the Board of Directors or by the Board. At the request of the officer to whom he is an assistant, an assistant officer may temporarily perform the duties of that officer, and when so acting shall have the powers of and be subject to the restrictions imposed upon that officer.

Section 5.13. *Compensation.* The compensation of the Chairman, President, any Vice Chairman, and any Executive Vice President shall be fixed, from time to time, by the Board of Directors.

Section 5.14. *Repealed.*

ARTICLE 6

Indemnification

Section 6.01. General Indemnification. The Board of Directors may, in such cases or categories of cases as it deems appropriate, indemnify and hold harmless, or make provision for indemnifying and holding harmless, Members of the Board of Directors, officers, employees, and agents of the corporation, and persons who formerly held such positions, and the estates of any of them against any or all claims and liabilities (including reasonable legal fees and other expenses incurred in connection with such claims or liabilities) to which any such person shall have become subject by reason of his having held such a position or having allegedly taken or omitted to take any action in connection with such position.

Section 6.02. Indemnification of Board Members and Officers.

(a) To the fullest extent permitted by the Delaware General Corporation Law for a corporation subject to such law, as the same exists or may hereafter be amended (but, in the case of any such amendment, only to the extent that such amendment permits a Delaware corporation to provide broader indemnification rights than said law permitted such corporation to provide prior to such amendment), the corporation will indemnify and hold harmless each Member of the Board and officer of the corporation or any subsidiary against any and all claims, liabilities, and expenses (including attorneys' fees, judgments, fines, and amounts paid in settlement) actually and reasonably incurred and arising from any threatened, pending, or completed action, suit or proceeding, whether civil, criminal, administrative, or investigative, to which any such person shall have become subject by reason of having held such a position or having allegedly taken or omitted to take any action in connection with any such position. However, the foregoing shall not apply to:

- (i) any breach of such person's duty of loyalty to the corporation or its stockholders;
- (ii) any act or omission by such person not in good faith or which involves intentional misconduct or where such person had reasonable cause to believe his conduct was unlawful; or
- (iii) any transaction from which such person derived any improper personal benefit.

(b) The decision concerning whether a particular indemnitee has satisfied the foregoing shall be made by (i) the Board of Directors by a majority vote of a quorum consisting of Members who are not parties to the action, suit, or proceeding giving rise to the claim for indemnity ("Disinterested Directors"), whether or not such majority constitutes a quorum; (ii) a committee of Disinterested Directors designated by a majority vote of Disinterested Directors, whether or not such majority constitutes a quorum; (iii) if there are no Disinterested Directors, or if the Disinterested Directors so direct, by independent legal counsel in a written opinion; or (iv) a vote of the stockholders.

(c) The Board of Directors may authorize the advancement of expenses to any Member of the Board or officer, subject to a written undertaking to repay such advance if it is later determined that the indemnitee does not satisfy the standard of conduct required for indemnification. The Chairman of the Board is authorized to enter into contracts of indemnification with each Member and officer of the corporation with respect to the indemnification provided in the Bylaws and to

renegotiate such contracts as necessary to reflect changing laws and business circumstances.

ARTICLE 7

Amendments

The power to alter, amend, or repeal these Bylaws, or to adopt new bylaws, is vested in the Board of Directors, but the affirmative vote of two-thirds of the then full number of authorized Members of the Board of Directors shall be necessary to effect any such action; or such action may be effected in the manner provided in Section 4.10 of these Bylaws. Except by unanimous consent of all the then incumbent Members of the Board, no such action shall be undertaken until at least one week shall have elapsed from either (i) the introduction of the proposal at a meeting of the Board of Directors at which a quorum shall have attended, or (ii) the circulation of such proposed action to all the then incumbent Members of the Board.

ARTICLE 8

Regulatory Powers

Nothing in these Bylaws shall be deemed to affect the regulatory powers of the Secretary of Housing and Urban Development pursuant to the Charter Act, as amended.

**CERTIFICATE OF DESIGNATION OF TERMS OF
4.75% NON-CUMULATIVE PREFERRED STOCK, SERIES M**

1. Designation, Par Value and Number of Shares.

The designation of the series of preferred stock of the Federal National Mortgage Association ("Fannie Mae") created by this resolution shall be "4.75% Non-Cumulative Preferred Stock, Series M" (the "Series M Preferred Stock"), and the number of shares initially constituting the Series M Preferred Stock is 8,000,000*. Shares of Series M Preferred Stock will have no par value and a stated value and liquidation preference of \$50 per share. The Board of Directors of Fannie Mae, or a duly authorized committee thereof, in its sole discretion, may reduce the number of shares of Series M Preferred Stock, provided such reduction is not below the number of shares of Series M Preferred Stock then outstanding.

2. Dividends.

(a) Holders of record of Series M Preferred Stock (each individually a "Holder", or collectively the "Holders") will be entitled to receive, when, as and if declared by the Board of Directors of Fannie Mae, or a duly authorized committee thereof, in its sole discretion out of funds legally available therefor, non-cumulative quarterly cash dividends which will accrue from and including June 10, 2003 and will be payable on March 31, June 30, September 30 and December 31 of each year (each, a "Dividend Payment Date"), commencing September 30, 2003 at the annual rate of \$2.375 per share or 4.75% of the stated value and liquidation preference of \$50 per share (without taking into account any adjustments referred to in clause (b) below). If a Dividend Payment Date is not a Business Day, the related dividend (if declared) will be paid on the next succeeding Business Day with the same force and effect as though paid on the Dividend Payment Date, without any increase to account for the period from such Dividend Payment Date through the date of actual payment. A "Business Day" shall mean any day other than a Saturday, Sunday, or a day on which banking institutions in New York, New York are authorized by law to close. Dividends will be paid to Holders on the record date fixed by the Board of Directors or a duly authorized committee thereof, which may not be earlier than 45 days or later than 10 days prior to the applicable Dividend Payment Date. If declared, the initial dividend, which will be for the period from and including June 10, 2003 to but excluding September 30, 2003, will be \$0.7257 per share and will be payable on September 30, 2003 and, thereafter, if declared, quarterly dividends will be \$0.5938 per share. After the initial dividend, the dividend period relating to a Dividend Payment Date will be the period from and including the preceding Dividend Payment Date to but excluding the related Dividend Payment Date. If Fannie Mae redeems the Series M Preferred Stock, the dividend that would otherwise be payable for the then-current quarterly dividend period accrued to but excluding the date of redemption will be included in the redemption price of the shares redeemed and will not be separately payable. Dividends payable on the Series M Preferred Stock for any period greater or less than a full dividend period will be computed on the basis of a 360-day year consisting of twelve 30-day months. The amount of dividends per share payable at redemption will be rounded to the fourth digit after the decimal point. (If the fifth digit to the right of the decimal point is five or greater, the fourth digit will be rounded up by one.)

(b) No dividend (other than dividends or distributions paid in shares of, or options, warrants or rights to subscribe for or purchase shares of, the common stock of Fannie Mae or any other stock of Fannie Mae ranking, as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, junior to the Series M Preferred Stock) may be declared or paid or set apart for payment on Fannie Mae's common stock (or on any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Series M Preferred Stock) unless dividends have been declared and paid or set apart (or ordered to be set apart) on the Series M Preferred Stock for the then-current quarterly dividend period; provided, however, that the foregoing dividend preference shall not be cumulative and shall not in

* Plus up to 1,200,000 additional shares pursuant to the Underwriters' overallotment option.

any way create any claim or right in favor of the Holders of Series M Preferred Stock in the event that dividends have not been declared or paid or set apart (or ordered to be set apart) on the Series M Preferred Stock in respect of any prior dividend period. If the full dividend on the Series M Preferred Stock is not paid for any quarterly dividend period, the Holders of Series M Preferred Stock will have no claim in respect of the unpaid amount so long as no dividend (other than those referred to above) is paid on Fannie Mae's common stock (or any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Series M Preferred Stock) for such dividend period.

(c) The Board of Directors of Fannie Mae, or a duly authorized committee thereof, may, in its discretion, choose to pay dividends on the Series M Preferred Stock without the payment of any dividends on Fannie Mae's common stock (or any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Series M Preferred Stock).

(d) No full dividends shall be declared or paid or set apart for payment on any stock of Fannie Mae ranking, as to the payment of dividends, on a parity with the Series M Preferred Stock for any period unless full dividends have been declared and paid or set apart for payment on the Series M Preferred Stock for the then-current quarterly dividend period. When dividends are not paid in full upon the Series M Preferred Stock and all other classes or series of stock of Fannie Mae, if any, ranking, as to the payment of dividends, on a parity with the Series M Preferred Stock, all dividends declared upon shares of Series M Preferred Stock and all such other stock of Fannie Mae will be declared pro rata so that the amount of dividends declared per share of Series M Preferred Stock and all such other stock will in all cases bear to each other the same ratio that accrued dividends per share of Series M Preferred Stock (but without, in the case of any noncumulative preferred stock, accumulation of unpaid dividends for prior dividend periods) and such other stock bear to each other.

(e) No dividends may be declared or paid or set apart for payment on any shares of Series M Preferred Stock if at the same time any arrears exist or default exists in the payment of dividends on any outstanding class or series of stock of Fannie Mae ranking, as to the payment of dividends, prior to the Series M Preferred Stock.

(f) Holders of Series M Preferred Stock will not be entitled to any dividends, whether payable in cash or property, other than as herein provided and will not be entitled to interest, or any sum in lieu of interest, in respect of any dividend payment.

3. Optional Redemption.

(a) The Series M Preferred Stock shall not be redeemable prior to June 10, 2008. On or after that date, subject to the notice provisions set forth in Section 3(b) below and subject to any further limitations which may be imposed by law, Fannie Mae may redeem the Series M Preferred Stock, in whole or in part, at any time or from time to time, out of funds legally available therefor, at the redemption price of \$50 per share plus an amount equal to the amount of the dividend (whether or not declared) for the then-current quarterly dividend period accrued to but excluding the date of such redemption, but without accumulation of unpaid dividends on the Series M Preferred Stock for prior dividend periods. If less than all of the outstanding shares of Series M Preferred Stock are to be redeemed, Fannie Mae will select the shares to be redeemed from the outstanding shares not previously called for redemption by lot or pro rata (as nearly as possible) or by any other method that the Board of Directors of Fannie Mae, or a duly authorized committee thereof, in its sole discretion deems equitable.

(b) In the event Fannie Mae shall redeem any or all of the Series M Preferred Stock as aforesaid, Fannie Mae will give notice of any such redemption to Holders of Series M Preferred Stock not less than 30 days prior to the date fixed by the Board of Directors of Fannie Mae, or duly authorized committee thereof, for such redemption. Each such notice will state: (1) the number of shares of Series M Preferred Stock to be redeemed and, if fewer than all of the shares of Series M Preferred Stock held by a Holder are to be redeemed, the number of shares to be redeemed from such Holder; (2) the redemption price; (3) the redemption date; and (4) the place at which a Holder's certificate(s) representing shares of Series M Preferred Stock must be presented upon such redemption. Failure to give notice, or any defect in the notice,

to any Holder of Series M Preferred Stock shall not affect the validity of the proceedings for the redemption of shares of any other Holder of Series M Preferred Stock being redeemed.

(c) Notice having been given as herein provided, from and after the redemption date, dividends on the Series M Preferred Stock called for redemption shall cease to accrue and such Series M Preferred Stock called for redemption will no longer be deemed outstanding, and all rights of the Holders thereof as registered holders of such shares of Series M Preferred Stock will cease. Upon surrender in accordance with said notice of the certificate(s) representing shares of Series M Preferred Stock so redeemed (properly endorsed or assigned for transfer, if the Board of Directors of Fannie Mae, or a duly authorized committee thereof, shall so require and the notice shall so state), such shares shall be redeemed by Fannie Mae at the redemption price aforesaid. Any shares of Series M Preferred Stock that shall at any time have been redeemed shall, after such redemption, be cancelled and not reissued. In case fewer than all the shares represented by any such certificate are redeemed, a new certificate shall be issued representing the unredeemed shares without cost to the Holder thereof.

(d) The Series M Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. In addition, Holders of Series M Preferred Stock will have no right to require redemption of any shares of Series M Preferred Stock.

4. Liquidation Rights.

(a) Upon any voluntary or involuntary dissolution, liquidation or winding up of Fannie Mae, after payment or provision for the liabilities of Fannie Mae and the expenses of such dissolution, liquidation or winding up, the Holders of outstanding shares of the Series M Preferred Stock will be entitled to receive out of the assets of Fannie Mae or proceeds thereof available for distribution to stockholders, before any payment or distribution of assets is made to holders of Fannie Mae's common stock (or any other stock of Fannie Mae ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, junior to the Series M Preferred Stock), the amount of \$50 per share plus an amount equal to the dividend (whether or not declared) for the then-current quarterly dividend period accrued to but excluding the date of such liquidation payment, but without accumulation of unpaid dividends on the Series M Preferred Stock for prior dividend periods.

(b) If the assets of Fannie Mae available for distribution in such event are insufficient to pay in full the aggregate amount payable to Holders of Series M Preferred Stock and holders of all other classes or series of stock of Fannie Mae, if any, ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, on a parity with the Series M Preferred Stock, the assets will be distributed to the Holders of Series M Preferred Stock and holders of all such other stock pro rata, based on the full respective preferential amounts to which they are entitled (but without, in the case of any noncumulative preferred stock, accumulation of unpaid dividends for prior dividend periods).

(c) Notwithstanding the foregoing, Holders of Series M Preferred Stock will not be entitled to be paid any amount in respect of a dissolution, liquidation or winding up of Fannie Mae until holders of any classes or series of stock of Fannie Mae ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, prior to the Series M Preferred Stock have been paid all amounts to which such classes or series are entitled.

(d) Neither the sale, lease or exchange (for cash, shares of stock, securities or other consideration) of all or substantially all of the property and assets of Fannie Mae, nor the merger, consolidation or combination of Fannie Mae into or with any other corporation or the merger, consolidation or combination of any other corporation or entity into or with Fannie Mae, shall be deemed to be a dissolution, liquidation or winding up, voluntary or involuntary, for the purposes of this Section 4.

(e) After payment of the full amount of the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae to which they are entitled pursuant to paragraphs (a), (b) and (c) of this Section 4, the Holders of Series M Preferred Stock will not be entitled to any further participation in any distribution of assets by Fannie Mae.

5. No Conversion or Exchange Rights.

The Holders of shares of Series M Preferred Stock will not have any rights to convert such shares into or exchange such shares for shares of any other class or classes, or of any other series of any class or classes, of stock or obligations of Fannie Mae.

6. No Pre-Emptive Rights.

No Holder of Series M Preferred Stock shall be entitled as a matter of right to subscribe for or purchase, or have any pre-emptive right with respect to, any part of any new or additional issue of stock of any class whatsoever, or of securities convertible into any stock of any class whatsoever, or any other shares, rights, options or other securities of any class whatsoever, whether now or hereafter authorized and whether issued for cash or other consideration or by way of dividend.

7. Voting Rights; Amendments.

(a) Except as provided below, the Holders of Series M Preferred Stock will not be entitled to any voting rights, either general or special.

(b) Without the consent of the Holders of Series M Preferred Stock, Fannie Mae will have the right to amend, alter, supplement or repeal any terms of this Certificate or the Series M Preferred Stock (1) to cure any ambiguity, or to cure, correct or supplement any provision contained in this Certificate of Designation that may be defective or inconsistent with any other provision herein or (2) to make any other provision with respect to matters or questions arising with respect to the Series M Preferred Stock that is not inconsistent with the provisions of this Certificate of Designation so long as such action does not materially and adversely affect the interests of the Holders of Series M Preferred Stock; provided, however, that any increase in the amount of authorized or issued Series M Preferred Stock or the creation and issuance, or an increase in the authorized or issued amount, of any other class or series of stock of Fannie Mae, whether ranking prior to, on a parity with or junior to the Series M Preferred Stock, as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, or otherwise, will not be deemed to materially and adversely affect the interests of the Holders of Series M Preferred Stock.

(c) Except as set forth in paragraph (b) of this Section 7, the terms of this Certificate or the Series M Preferred Stock may be amended, altered, supplemented, or repealed only with the consent of the Holders of at least two-thirds of the shares of Series M Preferred Stock then outstanding, given in person or by proxy, either in writing or at a meeting of stockholders at which the Holders of Series M Preferred Stock shall vote separately as a class. On matters requiring their consent, Holders of Series M Preferred Stock will be entitled to one vote per share.

(d) The rules and procedures for calling and conducting any meeting of Holders (including, without limitation, the fixing of a record date in connection therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents, and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules that the Board of Directors of Fannie Mae, or a duly authorized committee thereof, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of any national securities exchange on which the Series M Preferred Stock are listed at the time.

8. Additional Classes or Series of Stock.

The Board of Directors of Fannie Mae, or a duly authorized committee thereof, shall have the right at any time in the future to authorize, create and issue, by resolution or resolutions, one or more additional classes or series of stock of Fannie Mae, and to determine and fix the distinguishing characteristics and the relative rights, preferences, privileges and other terms of the shares thereof. Any such class or series of

stock may rank prior to, on a parity with or junior to the Series M Preferred Stock as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, or otherwise.

9. Priority.

For purposes of this Certificate of Designation, any stock of any class or series of Fannie Mae shall be deemed to rank:

(a) Prior to the shares of Series M Preferred Stock, either as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, if the holders of such class or series shall be entitled to the receipt of dividends or of amounts distributable upon dissolution, liquidation or winding up of Fannie Mae, as the case may be, in preference or priority to the Holders of shares of Series M Preferred Stock.

(b) On a parity with shares of Series M Preferred Stock, either as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, whether or not the dividend rates or amounts, dividend payment dates or redemption or liquidation prices per share, if any, be different from those of the Series M Preferred Stock, if the holders of such class or series shall be entitled to the receipt of dividends or of amounts distributable upon dissolution, liquidation or winding up of Fannie Mae, as the case may be, in proportion to their respective dividend rates or amounts or liquidation prices, without preference or priority, one over the other, as between the holders of such class or series and the Holders of shares of Series M Preferred Stock.

(c) Junior to shares of Series M Preferred Stock, either as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, if such class shall be common stock of Fannie Mae or if the Holders of shares of Series M Preferred Stock shall be entitled to the receipt of dividends or of amounts distributable upon dissolution, liquidation or winding up of Fannie Mae, as the case may be, in preference or priority over the holders of such class or series.

(d) The shares of Preferred Stock of Fannie Mae designated “5.25% Non-Cumulative Preferred Stock, Series D” (the “Series D Preferred Stock”), “5.10% Non-Cumulative Preferred Stock, Series E” (the “Series E Preferred Stock”), “Variable Rate Non-Cumulative Preferred Stock, Series F” (the “Series F Preferred Stock”), “Variable Rate Non-Cumulative Preferred Stock, Series G” (the “Series G Preferred Stock”), “5.81% Non-Cumulative Preferred Stock, Series H” (the “Series H Preferred Stock”), “5.375% Non-Cumulative Preferred Stock, Series I” (the “Series I Preferred Stock”), “Variable Rate Non-Cumulative Preferred Stock, Series J (the “Series J Preferred Stock”), “Variable Rate Non-Cumulative Preferred Stock, Series K” (the “Series K Preferred Stock”) and “5.125% Non-Cumulative Preferred Stock, Series L” (the “Series L Preferred Stock”) shall be deemed to rank on a parity with shares of Series M Preferred Stock as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae. Accordingly, the holders of record of Series D Preferred Stock, the holders of record of Series E Preferred Stock, the holders of record of Series F Preferred Stock, the holders of record of Series G Preferred Stock, the holders of record of Series H Preferred Stock, the holders of record of Series I Preferred Stock, the holders of record of Series J Preferred Stock, the holders of record of Series K Preferred Stock, the holders of record of Series L Preferred Stock and the holders of record of Series M Preferred Stock shall be entitled to the receipt of dividends and of amounts distributable upon dissolution, liquidation or winding up of Fannie Mae, as the case may be, in proportion to their respective dividend rates or amounts or liquidation prices, without preference or priority, one over the other.

10. Transfer Agent, Dividend Disbursing Agent and Registrar.

Fannie Mae hereby appoints EquiServe Trust Company, N.A., as its initial transfer agent, dividend disbursing agent and registrar for the Series M Preferred Stock. Fannie Mae may at any time designate an additional or substitute transfer agent, dividend disbursing agent and registrar for the Series M Preferred Stock.

11. Notices.

Any notice provided or permitted by this Certificate of Designation to be made upon, or given or furnished to, the Holders of Series M Preferred Stock by Fannie Mae shall be made by first-class mail, postage prepaid, to the addresses of such Holders as they appear on the books and records of Fannie Mae. Such notice shall be deemed to have been sufficiently made upon deposit thereof in the United States mail. Notwithstanding anything to the contrary contained herein, in the case of the suspension of regular mail service or by reason of any other cause it shall be impracticable, in Fannie Mae's judgment, to give notice by mail, then such notification may be made, in Fannie Mae's discretion, by publication in a newspaper of general circulation in The City of New York or by hand delivery to the addresses of Holders as they appear on the books and records of Fannie Mae.

Receipt and acceptance of a share or shares of the Series M Preferred Stock by or on behalf of a Holder shall constitute the unconditional acceptance by such Holder (and all others having beneficial ownership of such share or shares) of all of the terms and provisions of this Certificate of Designation. No signature or other further manifestation of assent to the terms and provisions of this Certificate of Designation shall be necessary for its operation or effect as between Fannie Mae and the Holder (and all such others).

EMPLOYMENT AGREEMENT
between
FANNIE MAE
and
FRANKLIN D. RAINES

INCLUDING ALL AMENDMENTS
THROUGH JULY 1, 2003

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EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT, effective as of the 21st day of May, 1998, is by and between FANNIE MAE (the "Corporation") and FRANKLIN D. RAINES ("Employee").

WITNESSETH THAT:

WHEREAS, the Corporation desires to employ Employee, from the date of this Agreement through December 31, 1998, as Chairman of the Board-Designate and Chief Executive Officer-Designate of the Corporation and, commencing on January 1, 1999, as Chief Executive Officer and Chairman of the Board, and Employee desires to serve in such capacities;

WHEREAS, the Corporation and Employee desire to set forth the terms and conditions of such employment; and

WHEREAS, the Board of Directors of the Corporation (the "Board") duly approved and authorized the terms of this Agreement for and on behalf of the Corporation at a meeting held on July 21, 1998, at which meeting a quorum was present, and the Board authorized the Chairman of the

Board to finalize and enter into this Agreement with Employee on behalf of the Corporation;

NOW, THEREFORE, in consideration of the foregoing and of the mutual promises and covenants herein contained, the parties hereto agree as follows:

A. EMPLOYMENT TERM

1. Term and Duties

(a) The Corporation hereby agrees to employ Employee, and Employee hereby agrees to serve, as Chairman of the Board-Designate and Chief Executive Officer-Designate of the Corporation, upon the terms and conditions herein contained, for a term commencing on May 21, 1998 (the "Effective Date") and, subject to the terms hereof, terminating on December 31, 1998, and, as Chairman of the Board and Chief Executive Officer of the Corporation, upon the terms and conditions herein contained, for a term commencing on January 1, 1999 and, subject to the terms hereof, terminating on June 30, 2004 (the "Termination Date"). As used in this Agreement, "Employment Term" shall mean the period from the Effective Date through the Termination Date, plus any extension of such period pursuant to the written agreement of the parties.

(b) During the Employment Term, Employee shall be nominated for election to the Board, and shall be identified as a nominee recommended for election by the Board, at each annual meeting of the stockholders of the Corporation, beginning with the annual meeting held in 1998.

(c) While serving as Chairman of the Board-Designate and Chief Executive Officer-Designate, Employee shall perform such duties for the Corporation as may be determined from time to time by the Chairman of the Board, provided that such duties are reasonable and customary for a chairman of the board-designate and chief executive officer-designate. While serving as Chairman of the Board and Chief Executive Officer, Employee shall perform such duties for the Corporation as may be determined from time to time by the Board, provided that such duties are reasonable and customary for a chairman of the board and chief executive officer.

(d) The Corporation and Employee acknowledge that the Employment Term may be extended for an additional period by mutual written agreement entered into at any time prior to the expiration of the Employment Term.

2. Annual Salary.

(a) Commencing on the Effective Date and, subject to Paragraphs 4, 5, 7 and 8 below, during the remainder of the Employment Term, the Corporation shall pay to Employee an annual base salary of not less than \$900,000 (such amount to be prorated for 1998), payable in equal biweekly installments on the same dates the other senior officers of the Corporation are paid. Employee's annual base salary payable pursuant to this Paragraph 2 (including any increases in such salary approved by the Board pursuant to this Paragraph 2) is hereinafter referred to as "Employee's Basic Compensation."

(b) The Board shall, from time to time, review Employee's Basic Compensation and may increase (but in no event decrease) such compensation for any year after 1999 by such amounts as the Board deems proper. The criteria that the Board may take into consideration in providing for any such increases are the base compensation payable to chairmen and chief executive officers and other comparable officers of comparable financial institutions and corporations, Employee's ability and performance, any increases in the responsibilities assumed by Employee, the success achieved by the Corporation, any increase or change

in the volume, character or variety of the business of the Corporation, increases in the cost of living and any other criteria the Board may deem relevant.

3. Employee's Rights Under Certain Plans and Other Benefits

(a) Executive Pension Plan. Employee and the Corporation acknowledge that the Corporation has previously designated Employee as a participant in the Executive Pension Plan of the Federal National Mortgage Association (the "Executive Pension Plan"). Notwithstanding any of the provisions of the Executive Pension Plan to the contrary, the following provisions shall apply to Employee:

- (i) Employee's Pension Goal under the Executive Pension Plan shall at all times be equal to at least 60% of his High-Three Total Compensation (as such terms are defined in the Executive Pension Plan as modified in this Agreement);
- (ii) Employee's Total Compensation and High-Three Total Compensation shall be determined solely by reference to Employee's Employment Term;

- (iii) As of the Effective Date, Employee shall be 60% vested in his Pension Goal in recognition of his prior service as Vice-Chairman and in recognition of his agreement to serve in the positions described in this Agreement. Employee's vesting in his Pension Goal shall be increased an additional 10% per year in accordance with the provisions of the Executive Pension Plan, calculated on the basis of Employee's Hours of Service in each year, starting in 1998, so that, assuming that Employee's employment under this Agreement has not been terminated for any reason, Employee would become 100% vested in his Pension Goal in 2001.
- (iv) At termination of his employment with the Corporation for any reason (including non-extension of the Employment Term) upon and after reaching the age of 55, Employee shall commence to receive, within 30 days after the date his employment terminates, his vested normal

retirement benefit (as determined under the Executive Pension Plan as modified in this Agreement and in the form provided in the Executive Pension Plan). If Employee's employment with the Corporation is terminated for any reason (including non-extension of the Employment Term) prior to Employee's reaching the age of 55, then, within 30 days after Employee's reaching the age of 55, he shall commence to receive his vested normal retirement benefit (as determined under the Executive Pension Plan as modified in this Agreement and in the form provided in the Executive Pension Plan). There shall be no actuarial adjustment to any benefits payable under this Paragraph 3(a)(iv) by reason of the commencement of benefit payments prior to age 60.

- (v) If Employee dies after the commencement of payments to him under the Executive Pension Plan, his Surviving Spouse, as

such term is defined in such plan, shall receive (regardless of her age at the time of Employee's death) monthly payments, commencing on the first day of the month coincident with or next following the date of Employee's death and continuing for her lifetime, equal to 100% of the monthly amount which was being paid to Employee at the time of his death.

- (vi) If Employee dies before the commencement of payments to him under the Executive Pension Plan, his Surviving Spouse, as such term is defined in such plan, shall receive (regardless of her age at the time of Employee's death) a monthly preretirement surviving spouse's benefit, commencing within 30 days of Employee's death and continuing for her lifetime, equal to the monthly normal retirement benefit that Employee would have received (under the Executive Pension Plan as modified in this Agreement) had he

terminated employment on the day prior to the date of his death and had he attained at least age 55 prior to his death. There shall be no age-based actuarial reduction in the preretirement surviving spouse's benefit, except that, where Employee dies before reaching the age of 55, there shall be an age-based actuarial reduction based solely on the number of years, if any, that Employee's age at the date of his death is less than 55.

- (vii) The Corporation may amend the Executive Pension Plan from time to time; provided, however, that no such amendment shall adversely modify the vesting schedule or decrease Employee's Pension Goal or the vested benefits to which Employee or his Surviving Spouse, if any, would have been entitled under such plan, as modified in this Agreement, as in effect on the date hereof or, if benefits are improved, as of the date of such improvement.

(b) Stock Options. The Corporation has granted to Employee, as of May 21, 1998, a Nonqualified Stock Option (the "May 1998 Option"), pursuant to the Fannie Mae Stock Compensation Plan of 1993 (the "1993 Stock Compensation Plan"), to purchase 358,830 shares of common stock of the Corporation (the "Stock") for a price equal to the Fair Market Value (as defined in the 1993 Stock Compensation Plan) of the Stock on the date of such grant. The Corporation shall also grant to Employee, as of January 4, 1999 (the first business day following January 1, 1999), a Nonqualified Stock Option (the "January 1999 Option"), pursuant to the 1993 Stock Compensation Plan, to purchase 195,000 shares of Stock for a price equal to the Fair Market Value (as defined in the 1993 Stock Compensation Plan) of the Stock on the date of such grant. Employee shall be considered for additional grants of Nonqualified Stock Options or Incentive Stock Options at any time the Corporation grants Nonqualified Stock Options or Incentive Stock Options to other officers. Notwithstanding the foregoing or any provision of the 1993 Stock Compensation Plan or any successor plan, the following provisions shall apply to Employee:

- (i) The May 1998 Option shall expire on May 21, 2008 and shall become exercisable with respect to 25% of the Stock covered thereby on May 21 of each of 1999, 2000, 2001 and 2002, or earlier as provided in (iv) below, provided, however, that in the case of termination pursuant to Paragraph 5(a) or 5(b) below, any portion of the May 1998 Option not exercisable on the date of such termination shall become exercisable from and after the date of such termination only as provided in the 1993 Stock Compensation Plan.
- (ii) The January 1999 Option shall expire on January 2, 2009 and shall become exercisable with respect to 25% of the Stock covered thereby on January 4 of each of 2000, 2001, 2002, and 2003, or earlier as provided in (iv) below, provided, however, that in the case of termination pursuant to Paragraph 5(a) or 5(b) below, any portion of the January 1999 Option not exercisable on the date of such termination shall become

exercisable from and after the date of such termination only as provided in the 1993 Stock Compensation Plan.

- (iii) Any additional Nonqualified Stock Option or any Incentive Stock Option granted to Employee shall become exercisable as provided in the 1993 Stock Compensation Plan or any successor plan, or earlier as provided in (iv) below, provided, however, that in the case of termination pursuant to Paragraph 5(a) or 5(b) below, any portion of such Nonqualified Stock Option or Incentive Stock Option not exercisable on the date of such termination shall become exercisable from and after the date of such termination only as provided in the 1993 Stock Compensation Plan or any successor plan.
- (iv) In the event that (v) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (w) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below), (x) the Employment Term expires

because of the failure of the Corporation to extend this Agreement as set forth in Paragraph 4(a) below, (y) Employee is terminated by reason of serious illness or disability pursuant to Paragraph 7(a) below, or (z) Employee dies while employed under this Agreement, all of Employee's Incentive Stock Options and Nonqualified Stock Options, including the May 1998 Option and the January 1999 Option specified above in this Paragraph 3(b), shall become immediately exercisable.

- (v) Employee (or, in the case of serious illness, disability or death, the person or persons to whom Employee's rights under any Incentive Stock Option or any Nonqualified Stock Option pass by will or applicable law or, if no such person has such rights, Employee's executors or administrators) shall have the right to exercise any exercisable Incentive Stock Option and any exercisable Nonqualified Stock Option, until it expires by its terms, regardless of

whether Employee is employed by the Corporation at the time of such exercise, provided, however, that in the case of a termination pursuant to Paragraph 5(a) or 5(b) below, all stock options, including the May 1998 Option and the January 1999 Option specified above in this Paragraph 3(b), may be exercised from and after the date of such termination only as provided in the 1993 Stock Compensation Plan or any successor plan.

(c) Annual Incentive Plan. Employee's Maximum Potential Award (as defined in the Federal National Mortgage Association Annual Incentive Plan (the "Annual Incentive Plan")) for each year during the Employment Term shall be at least 200% of Employee's Basic Compensation. The amount to be paid with respect to such award for each such year shall be determined by the extent to which any Corporate Goals (as defined in the Annual Incentive Plan) are attained. Employee shall be entitled to participate in the Annual Incentive Plan for 1998 on a pro rata basis. Notwithstanding any provision of the

Annual Incentive Plan to the contrary, the following provisions shall apply to Employee:

- (i) In the event that (w) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (x) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below), (y) Employee is terminated by reason of serious illness or disability pursuant to Paragraph 7(a) below or (z) Employee dies while employed under this Agreement, the Corporation shall pay to Employee at the time of payment of awards to other participants in the Annual Incentive Plan (regardless of whether Employee is employed by the Corporation on the date of payment) (A) the amount of any bonus earned by and payable to Employee pursuant to the Annual Incentive Plan for a completed calendar year (with the period May 21-December 31, 1998 being considered a completed calendar year for

such purposes) but not yet paid by the Corporation for such year and (B) a pro rata award calculated assuming 100% attainment of the target Corporate Goal specified by the Board for the Annual Incentive Plan for the year in which such termination or resignation occurred.

(ii) In the event that the Employment Term expires because of the failure of the Corporation to extend this Agreement, the Corporation shall pay to Employee the amount of any bonus earned by and payable to Employee pursuant to the Annual Incentive Plan for a completed calendar year (with the period May 21-December 31, 1998 being considered a completed calendar year for such purposes) but not yet paid by the Corporation for such year.

(d) Performance Shares. The Corporation has granted to Employee, as of May 21, 1998, Performance Shares pursuant to the 1993 Stock Compensation Plan for the 1996-1998, 1997-1999 and 1998-2000 Award Periods (as defined in

the 1993 Stock Compensation Plan) in amounts equal to 14,973, 20,251 and 55,132 Performance Shares, respectively. The Corporation shall also grant to Employee, as of January 4, 1999 (the first business day following January 1, 1999), Performance Shares pursuant to the 1993 Stock Compensation Plan for the 1997-1999 and 1998-2000 Award Periods (as defined in the 1993 Stock Compensation Plan) in amounts equal to 938 and 3,162 Performance Shares, respectively. The Employee shall be considered for additional grants of Performance Shares at any time the Corporation grants Performance Shares to other employees. Notwithstanding any provision of the 1993 Stock Compensation Plan to the contrary, the following provisions shall apply to Employee:

- (i) In the event that (w) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (x) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below), (y) the Employment Term expires because of the failure of the Corporation to extend this Agreement or (z) Employee is terminated

by reason of serious illness or disability pursuant to Paragraph 7(a) below, the Corporation shall pay to Employee, after the end of each such Award Period, Actual Awards with respect to Performance Shares awarded for each Award Period of the Performance Share Plan in which Employee has completed at least 18 months of service, in each case on a pro rata basis reflecting Employee's completed months of service in the Award Period, based on the actual achievement of Program Targets for the Award Period and using as the Valuation Date (as defined in the 1993 Stock Compensation Plan) (A) in the case of a termination upon a Change in Control, the date of such Change in Control, and (B) in the case of a termination without Cause, the failure of the Corporation to extend the Employment Term or a termination because of serious illness or disability, the last day of the Award Period.

(ii) In the event that Employee dies while employed under this Agreement, the Corporation shall pay to Employee's designated beneficiary or, if none, Employee's estate as soon as is practicable after the date of Employee's death, Actual Awards with respect to Performance Shares awarded for each Award Period of the Performance Share Plan, in each case on a pro rata basis reflecting the Board's determination of the likelihood of the Corporation's achievement of Program Targets for the Award Period and using the date of death as the Valuation Date (as defined in the 1993 Stock Compensation Plan).

(e) Restricted Stock. In the event that (i) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (ii) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below), (iii) the Employment Term expires because of the failure of the Corporation to extend this Agreement or (iv) Employee is terminated by reason of

serious illness or disability pursuant to Paragraph 7(a) below, any grants of restricted stock made to Employee shall continue to vest in accordance with the schedule included in each such grant through the end of the Employment Term, but any unvested shares at the end of the Employment Term shall be forfeited. Upon the death of Employee, all grants of restricted stock made to Employee, not previously forfeited, but not yet vested on the date of death, shall immediately vest. In the case of a termination pursuant to Paragraph 5(a) or 5(b) below, Employee shall receive any restricted stock vested on or prior to the date of such termination, but shall forfeit any restricted stock not vested on the date of such termination.

(f) Other Benefits. The Corporation shall also provide Employee with the following benefits:

- (i) The Corporation shall reimburse Employee for actual expenses incurred by Employee while Employee is employed under this Agreement in obtaining tax and investment assistance and advice.
- (ii) The Corporation shall pay the legal expenses incurred by Employee in

connection with the negotiation of this Agreement.

- (iii) The Corporation shall provide Employee with access to a car and driver for transportation relating to business purposes while Employee is employed under this Agreement.
- (iv) The Corporation shall, on no more than a yearly basis, pay or reimburse Employee for actual expenses incurred by Employee while Employee is employed under this Agreement for a complete physical examination at a medical facility of his choice.
- (v) The Corporation shall pay or reimburse Employee for all reasonable travel expenses incurred by Employee's spouse in accompanying Employee on his trips made on behalf of the Corporation while Employee is employed under this Agreement.
- (vi) While Employee is employed under this Agreement, the Corporation shall provide

Employee, at its own expense, term life insurance in the face amount of \$900,000.

- (vii) If Employee incurs a Reimbursable Expense, as described below, and the Corporation includes the amount of any reimbursement for that expense on Employee's Wage and Tax Statement, the Corporation agrees to pay to Employee, in addition to reimbursement for the amount of the expense, any additional amount necessary to make Employee whole on an after-tax basis. Reimbursable Expense means any expense for travel (including travel expenses of Employee's spouse as described in this Paragraph 3(f)), entertainment or other activity undertaken in connection with the performance of Employee's duties for the Corporation.
- (viii) In the event that (w) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (x) Employee is terminated or resigns within six (6)

months following a Change of Control (as defined in Paragraph 4(d) below), (y) the Employment Term expires because of the failure of the Corporation to extend this Agreement or (z) Employee is terminated by reason of serious illness or disability pursuant to Paragraph 7(a) below, the Corporation shall continue to provide to Employee, until the later of (A) the expiration of the Employment Term or (B) one year following the date of such termination, resignation or expiration, an office and secretary and job assistance services, as appropriate to his position held on the last date of his employment under this Agreement.

(g) General Rights Under Benefit Plans. Nothing contained herein is intended to or shall be deemed to affect adversely any of Employee's rights as a participant under any long- or short-term bonus, stock option, restricted stock or other executive compensation plans, or under any program of perquisites or disability, retirement, stock purchase, retirement savings, health, medical, life

insurance, expense reimbursement or similar plans of the Corporation now or hereafter in effect. Employee shall at all times during the Employment Term be entitled to participate in all long- or short-term bonus, stock option, restricted stock, and other executive compensation plans, and in all perquisite programs and disability, retirement, stock purchase, thrift and savings, health, medical, life insurance, expense reimbursement and similar plans of the Corporation which are from time to time in effect and in which other senior officers of the Corporation generally are entitled to participate. Except as otherwise provided in this Agreement, Employee's participation in such plans and programs shall be in accordance with the provisions of such plans and programs applicable from time to time, it being the intent of the parties hereto that nothing in this Agreement shall decrease the rights and benefits of Employee under any such plans and programs as may be in effect from time to time. Except as specifically set forth in this Agreement, or as specifically permitted by the terms of any such plan or program, no right or benefit under any such plan or program shall become vested or exercisable after the termination of Employee's employment by the Corporation. If for any reason any benefits payable

pursuant to this Agreement cannot be paid under the Corporation's employee benefit or executive compensation plans, such payments shall be made out of the general assets of the Corporation.

4. Termination Without Cause, Termination or Resignation Upon a Change of Control or Failure to Extend

(a) Notwithstanding any other provision hereunder, the Corporation shall have the right to terminate Employee's employment hereunder without Cause (as defined in Paragraph 5(b) below) at any time for any reason in its sole discretion on not less than thirty (30) days' prior written notice to Employee. In the event that (i) the Corporation terminates Employee's employment pursuant to the immediately preceding sentence, (ii) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below) or (iii) the Employment Term expires because of the failure of the Corporation to extend this Agreement, the Corporation shall, subject to Paragraph 4(b) below, continue to pay Employee's Basic Compensation to Employee at the rate in effect at the time of such termination, resignation or expiration until the later of (A) the expiration of the Employment Term or (B) one year following the date of such

termination, resignation or expiration. Employee shall, subject to Paragraph 4(b) below, continue to participate in all Employee Welfare Benefit Plans (as such term is defined in Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended, and the regulations promulgated thereunder) maintained by the Corporation during the remainder of the Employment Term or until such later date as may be expressly provided under the terms of any such plan.

(b) Following a termination or resignation pursuant to Paragraph 4(a) above or the expiration of the Employment Term because of the failure of the Corporation to extend this Agreement, Employee shall have the duty, commencing on the date six (6) months after the date of such termination, resignation or expiration, to seek other employment or to become self-employed; provided, however, that Employee shall not be required to accept other employment or to become self-employed in any position not at least substantially equivalent (in terms of importance, dignity and responsibilities) to his position last held pursuant to this Agreement. Any income received from such employment (including self-employment but excluding service on boards of directors) after such six-month period shall reduce, on

a dollar-for-dollar basis (but not below zero), the Corporation's obligation to pay Employee's Basic Compensation. Any employee benefits provided to Employee in consideration of such employment after such six (6) month period shall relieve the Corporation of its obligation to provide comparable benefits hereunder to the extent of the benefits so provided; provided, however, that Employee's retirement benefit, if any, pursuant to Paragraph 3(a) above shall not be reduced on account of any such income or benefits resulting from such employment.

(c) If at any time during the Employment Term, (i) there is a material reduction of Employee's authority or any material change in Employee's functions, duties or responsibilities which would in any material way cause Employee's position to become less important, (ii) the Corporation shall require Employee to relocate his office outside the Washington, D.C. area, or (iii) the Corporation shall breach materially any other material obligation under this Agreement, Employee shall have the right, upon not less than thirty (30) days' written notice to the Corporation, which notice must be given within four calendar months after the event giving rise to said right, to treat such event as a termination by the Corporation of

his employment without Cause pursuant to Paragraph 4(a) above for all purposes under this Agreement, and all of the provisions of this Agreement applicable to such a termination without Cause shall be operative with respect to such termination.

(d) A “Change of Control” shall have occurred if there is a change in the composition of a majority of the Board of Directors elected by the stockholders within twelve (12) months after any “person” (as defined in Sections 3(a)(9) and 13(d)(3) of the Securities Exchange Act of 1934 (the “Exchange Act”), as such sections are in effect on the Effective Date) is or becomes the “beneficial owner” (as defined in Rule 13d-3 under the Exchange Act, as such rule is in effect on the Effective Date) of securities representing 25% or more of the combined voting power of the then outstanding securities of the Corporation.

5. Termination by Employee; Breach by Employee

(a) Notwithstanding any other provision hereunder, Employee shall have the right to terminate his employment by the Corporation at any time for any reason in his sole discretion on not less than thirty (30) days’ prior written notice to the Corporation. Upon receipt of any such notice from Employee, the Corporation shall have the option,

exercisable by giving Employee written notice within thirty (30) days of such receipt, to designate any date after the date of such notice to Employee and prior to the expiration of the aforesaid notice period as the date on which Employee shall cease to be an officer and employee of the Corporation, and the effective date of termination hereunder shall be any such earlier date so designated by the Corporation. In no event shall the termination of Employee's employment by the Corporation without Cause pursuant to Paragraph 4(a) above, Employee's termination or resignation within six (6) months following a Change of Control pursuant to Paragraph 4(a) above or the expiration of the Employment Term because of the failure of the Corporation to extend this Agreement be deemed to be a termination by Employee pursuant to this Paragraph 5(a).

(b) Notwithstanding any other provision hereunder, the Corporation may terminate Employee's employment hereunder for "Cause," which shall mean that Employee has materially harmed the Corporation by, in connection with his service under this Agreement, engaging in dishonest or fraudulent actions or willful misconduct, or performing his duties in a negligent manner. Notwithstanding the foregoing, Employee shall not be deemed to have been

terminated for Cause unless the Corporation shall have provided (i) reasonable notice to Employee setting forth the reasons for the Corporation's intention to terminate for Cause, (ii) where remedial action is feasible, a reasonable opportunity for such action, (iii) an opportunity for Employee, together with his counsel, to be heard before the Board and (iv) Employee with a notice of termination stating that Employee was guilty of the conduct set forth in this Paragraph 5(b) and specifying the particulars thereof in detail. No act or failure to act will be considered "willful" unless it is done, or omitted to be done, by Employee in bad faith or without reasonable belief that his action or omission was in the best interests of the Corporation.

(c) In the event of a termination pursuant to Paragraph 5(a) or 5(b) above, Employee shall be entitled to all of Employee's Basic Compensation which has accrued to the date of termination and any benefits or awards (whether of options, stock or other property) which have vested prior to such date. The Corporation shall have no further obligations to Employee.

(d) In the event of a termination by Employee pursuant to Paragraph 5(a) above, during the period from

the effective date of termination to the earlier of (i) the first anniversary thereof and (ii) the expiration of the Employment Term, Employee shall not, directly or indirectly (x) Compete with the Corporation in the United States, (y) solicit any officer or employee of the Corporation or any of its affiliates to engage in any conduct prohibited hereby for Employee or to terminate any existing relationship with the Corporation or such affiliate or (z) assist any other person to engage in any activity in any manner prohibited hereby to Employee. As used herein, "Compete" shall mean to engage directly or indirectly in any business, or to become connected directly or indirectly with any business or firm, if a substantial part of such business or the business of any such firm involves transactions in what is commonly known as the secondary market in residential mortgages; provided, however, that Employee shall not be deemed, directly or indirectly, to Compete with the Corporation solely by virtue of Employee's employment with any corporation or firm involved in transactions in what is commonly known as the secondary market in residential mortgages so long as Employee himself does not participate in such corporation's or firm's involvement in such transactions.

(e) The need to protect the Corporation against Employee's competition, as well as the nature and scope of such protection, has been carefully considered by the parties hereto in light of the uniqueness of Employee's talent and his importance to the Corporation. Accordingly, Employee agrees that, in addition to any other relief to which the Corporation may be entitled, the Corporation shall be entitled to seek and obtain injunctive relief (without the requirement of a bond) from a court of competent jurisdiction for the purpose of restraining Employee from any actual or threatened breach of the covenant contained in Paragraph 5(d) above. If for any reason a final decision of any court determines that the restrictions under Paragraph 5(d) above are not reasonable or that consideration therefor is inadequate, such restrictions shall be interpreted, modified or rewritten by such court to include as much of the duration, scope and geographic area identified in Paragraph 5(d) above as will render such restrictions valid and enforceable.

6. Resignation as Board Member

In the event Employee ceases to be employed by the Corporation and Employee is then a member of the Board, Employee hereby agrees that, unless otherwise requested by

the Board, he shall submit his resignation as a member of the Board and of the Fannie Mae Foundation in writing on or before the date he ceases to be an officer of the Corporation. If Employee fails or neglects to submit such resignations in writing, this Paragraph 6 may be deemed by the Corporation to constitute Employee's written resignation as a member of the Board and of the Fannie Mae Foundation effective on the same date that Employee ceases to be employed by the Corporation.

B. DISABILITY

7. Disability

(a) In the event that, while employed under this Agreement, Employee is prevented from performing his duties hereunder by reason of serious illness or disability, the Corporation may, on sixty (60) days' prior written notice to Employee, terminate Employee's employment. If, within sixty (60) days of such notice, Employee recovers and is again able to perform his duties hereunder, such notice shall be void, and the Employee's employment shall not be terminated thereby. Upon the termination of Employee's employment pursuant to this Paragraph 7(a), the Corporation shall, subject to Paragraphs 7(b) and (c) below, continue

to pay Employee's Basic Compensation at the rate in effect at the time of such termination until the later of (A) the expiration of the Employment Term or (B) one year following the date of such termination. Employee shall, subject to Paragraph 7(b) below, continue to participate in all Employee Welfare Benefit Plans maintained by the Corporation and receive benefits to which he is entitled under such plans during the remainder of the Employment Term or until such later date as may be expressly provided under the terms of any such plan.

(b) Employee may, in his sole discretion, after the date he ceases to be employed by the Corporation pursuant to Paragraph 7(a) above, engage in regular employment (whether as the employee of another or as a self-employed person). Any income received from such employment, including self-employment, shall reduce, on a dollar-for-dollar basis (but not below zero), the Corporation's obligation to pay Employee's Basic Compensation under Paragraph 7(a) above. Any employee benefits provided to Employee in consideration of such employment shall relieve the Corporation of its obligation to provide comparable benefits hereunder to the extent of the benefits so provided; provided, however, that Employee's retirement

benefits, if any, pursuant to Paragraph 3(a) above shall not be reduced on account of any such income or benefits resulting from such employment.

(c) If Employee becomes entitled to and receives disability benefits under any disability payment plan, including disability insurance, the amount of Employee's Basic Compensation otherwise payable by the Corporation to Employee pursuant to Paragraph 7(a) above shall be reduced, on a dollar-for-dollar basis (but not below zero), by the amount of any such disability benefits received by him, but only to the extent such benefits are attributable to premium payments made by the Corporation.

C. DEATH

8. Death

(a) In the event Employee dies while employed under this Agreement, the Corporation shall pay Employee's designated beneficiary or, if none, Employee's estate, in one cash payment an amount equal to 200% of Employee's Basic Compensation in effect on the date of his death.

(b) At all times while employed under this Agreement, Employee shall be covered at the Corporation's expense under the Corporation's Executive Insurance Plan by

a whole life insurance policy in a face amount equal to 200% of Employee's Basic Compensation. In order to eliminate the income tax burden on Employee by reason of the imputation of income as a result of such insurance coverage, the Corporation shall pay to Employee an amount equal to the income taxes imposed on such imputed income plus the income taxes imposed on such payment. In the event this Agreement terminates or expires other than pursuant to Paragraph 5(a) or 5(b) above, Employee may, pursuant to the terms of the insurance policy through which such benefits are provided and the agreement between the Corporation and Employee entered into thereunder, acquire such insurance policy by paying the Corporation an amount equal to the sum of all premium payments made by the Corporation on such policy, and the Corporation shall pay to Employee an amount equal to the income taxes imposed on Employee with respect to such acquisition plus the income taxes imposed on such payment. In the event Employee completes thirteen (13) years of service with the Corporation pursuant to this Agreement, such insurance policy shall automatically be transferred to Employee pursuant to the terms of such policy and the agreement between the Corporation and Employee entered into

thereunder. In the event of any such transfer, in order to eliminate the income tax burden on Employee by reason of the income arising from such transfer, the Corporation shall pay to Employee an amount equal to the income taxes imposed on such income plus the income taxes imposed on such payment. Nothing contained herein shall reduce any benefit payable pursuant to Paragraph 3(a) above or under the terms of any other qualified or nonqualified pension, executive compensation or welfare plan of the Corporation.

(c) Unless Employee's employment shall have terminated pursuant to Paragraph 5(a) or 5(b) above, after Employee's death at any time during or after the expiration of the Employment Term, the Corporation shall continue the health and medical coverage elected by the Employee, without direct premium payments by Employee's family, for Employee's surviving spouse for her life, and for his other dependents so long as they remain dependents as defined in said health and medical plan.

D. MISCELLANEOUS

9. Payment of Certain Expenses

The Corporation agrees to pay promptly as incurred, to the fullest extent permitted by law, all legal fees and

expenses which Employee may reasonably incur as a result of any contest by the Corporation, Employee or others of the validity or enforceability of, or liability under, any provision of this Agreement (including as a result of any contest initiated by Employee about the amount of any payment due pursuant to this Agreement), plus in each case interest on any delayed payment at the applicable federal rate provided for in Section 7872(f)(2)(A) of the Internal Revenue Code of 1986, as amended; provided, however, that the Corporation shall not be obligated to make such payment with respect to any contest in which the Corporation prevails over Employee.

10. Secretary and Office

If Employee's employment under this Agreement is terminated on or after his reaching age fifty-five (55), other than pursuant to Paragraph 5(a) or 5(b) above, the Corporation shall provide to Employee, at any time Employee is not employed by any person on a full-time basis, an office and secretary.

11. Assignment by Employee

Except as otherwise expressly provided in this Agreement, the rights and benefits of Employee pursuant hereto are personal to him, and no such right or benefit shall be subject to voluntary or involuntary alienation, assignment or transfer.

12. Funding Prohibitions

All payments to be made under this Agreement shall be paid from the general funds of the Corporation or from the funds set aside or reserved for payment of the Corporation's obligations under its employee benefit or executive compensation plans, if any. Employee shall have no right, title or interest in or to any investments which the Corporation may make to aid it in meeting its obligations under this Agreement. All such assets shall be the property solely of the Corporation and shall be subject to the claims of the Corporation's unsecured general creditors. To the extent Employee or any other person acquires a right to receive payments from the Corporation under this Agreement, such right shall be no greater than the right of any unsecured general creditor of the Corporation and such person shall have only the unsecured

contractual agreement of the Corporation that such payments shall be made.

13. Disclosure of Information to the Corporation

In the event Paragraph 4 or 7 above becomes applicable, Employee or, in the event of Employee's incapacity or death, his personal representative shall make available to the Corporation on a confidential basis such records, documents and other information reasonably necessary to enable the Corporation to verify the amount of income available to offset the payments otherwise due Employee pursuant to Paragraph 4 or 7 above.

14. Nondisclosure of Confidential Information

Employee shall not, without the prior written consent of the Corporation, divulge, disclose or make accessible to any other person, firm, partnership, corporation or other entity any Confidential Information pertaining to the business of the Corporation, except (i) while employed by the Corporation, in the business of and for the benefit of the Corporation, or (ii) when required to do so by a court of competent jurisdiction, by any governmental agency having supervisory authority over the

business of the Corporation, or by any administrative body or legislative body (including a committee thereof) with purported or apparent jurisdiction to order Employee to divulge, disclose or make accessible such information. For purposes of this Paragraph 14, "Confidential Information" shall mean nonpublic information concerning the Corporation's financial data, strategic business plans, product development (or other proprietary product data), marketing plans and other nonpublic, proprietary and confidential information of the Corporation that is not otherwise available to the public. Confidential Information, however, shall not include information the disclosure of which cannot reasonably be expected to affect adversely the business of the Corporation to a material degree.

15. Waiver

The failure of either party hereto to insist upon strict compliance by the other party with any term, covenant or condition hereof shall not be deemed a waiver of such term, covenant or condition, nor shall any waiver or relinquishment or failure to insist upon strict compliance of any right or power hereunder at any one time

or more times be deemed a waiver or relinquishment of such right or power at any other time or times.

16. Notice

Any notice required or desired to be given pursuant to this Agreement shall be sufficient if in writing transmitted by hand delivery or sent by prepaid courier or registered or certified mail, postage prepaid, to the addresses hereinafter set forth or to such other address as any party hereto may designate in writing and transmit in such manner. Any such notice shall be deemed given when delivered, if transmitted by hand delivery, 24 hours after deposit with a prepaid courier service or 72 hours after deposit in the United States mail, if sent by registered or certified mail.

17. Applicable Law

This Agreement shall be governed by the laws of the District of Columbia without regard to any otherwise applicable conflict of laws principles.

18. Taxes

The Corporation shall deduct from all amounts payable under this Agreement all federal, state, local and other taxes required by law to be withheld with respect to such payments.

19. Benefit

Except as is otherwise herein expressly provided, this Agreement shall inure to the benefit of and be binding upon the Corporation, its successors and assigns, and upon Employee, his spouse, heirs, executors and administrators; provided, however, that the obligations of Employee hereunder shall not be delegated. The Corporation shall require any successor (whether direct or indirect, by purchase, merger, reorganization, consolidation, acquisition of property or stock, liquidation, or otherwise) to all or a substantial portion of its assets, by agreement in form and substance reasonably satisfactory to Employee, expressly to assume and agree to perform this Agreement in the same manner and to the same extent that the Corporation would be required to perform this Agreement if no such succession had taken place. Regardless of whether such an agreement is executed, this Agreement shall

be binding upon any successor of the Corporation in accordance with the operation of law, and such successor shall be deemed the "Corporation" for purposes of this Agreement.

20. Entire Agreement

The parties hereto agree that this Agreement contains the entire understanding and agreement between them and cannot be amended, modified or supplemented in any respect except by an agreement in writing signed by both parties.

21. Arbitration

Except as to any controversy or claim which Employee elects, by written notice to the Corporation, to have adjudicated by a court of competent jurisdiction, any controversy or claim arising out of or relating to this Agreement or the breach hereof shall be settled by arbitration in the District of Columbia in accordance with the laws of the District of Columbia. The arbitration shall be conducted in accordance with the rules of the American Arbitration Association. The costs and expenses of the arbitrator(s) shall be borne by the Corporation.

The award of the arbitrator(s) shall be binding upon the parties. Judgment upon the award rendered by the arbitrator(s) may be entered in any court having jurisdiction.

22. Interpretation

Wherever reference is made herein to the “failure of the Corporation to extend this Agreement,” such a failure shall be deemed to have occurred if and only if the Corporation either notifies Employee that it does not desire to extend this Agreement or that it desires to do so only on terms in the aggregate materially less favorable to Employee than those contained herein. If the Corporation notifies Employee it desires to extend this Agreement on terms that are in the aggregate substantially equivalent to or more favorable to Employee than those contained herein, any nonextension shall not be deemed to be a “failure of the Corporation to extend this Agreement.”

23. Severability

It is the intent and understanding of each party hereto that, if any term, restriction, covenant, or promise is found to be invalid or otherwise unenforceable, then

such term, restriction, covenant, or promise shall not thereby be terminated but shall be deemed modified to the extent necessary to make it enforceable and, if it cannot be so modified, shall be deemed amended to delete therefrom such provision or portion found to be invalid or unenforceable, such modification or amendment in any event to apply only with respect to the operation of this Agreement in the particular jurisdiction in which such finding is made.

IN WITNESS WHEREOF, the Corporation has caused its name to be ascribed to this Agreement by its duly authorized representative and Employee has executed this Agreement, each as of the day and the year first above written.

Attest:

FANNIE MAE
3900 Wisconsin Avenue, N.W.
Washington, D.C. 20016

/s/ Elizabeth Berg

By: /s/James A. Johnson

Chairman of the Board
of Directors

Witness:

/s/ Equilla Ford

/s/ Franklin D. Raines

FRANKLIN D. RAINES

EMPLOYMENT AGREEMENT
between
FANNIE MAE
and
DANIEL H. MUDD

INCLUDING ALL AMENDMENTS
THROUGH JULY 1, 2003

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EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT, effective as of the 23rd day of February, 2000, is by and between FANNIE MAE (the "Corporation") and DANIEL H. MUDD ("Employee").

WITNESSETH THAT:

WHEREAS, the Corporation desires to employ Employee as Vice Chairman of the Board and Chief Operating Officer of the Corporation, and Employee desires to serve in such capacity;

WHEREAS, the Corporation and Employee desire to set forth the terms and conditions of such employment; and

WHEREAS, the Board of Directors of the Corporation (the "Board") duly approved and authorized the terms of this Agreement for and on behalf of the Corporation at a meeting held on February 23, 2000, at which meeting a quorum was present, and the Board authorized the Chairman of the Board to finalize and enter into this Agreement with Employee on behalf of the Corporation;

NOW, THEREFORE, in consideration of the foregoing and of the mutual promises and covenants herein contained, the parties hereto agree as follows:

A. EMPLOYMENT TERM

1. Term and Duties

(a) The Corporation hereby agrees to employ Employee, and Employee hereby agrees to serve, as Vice Chairman of the Board and Chief Operating Officer of the Corporation, upon the terms and conditions herein contained, for a term commencing on February 23, 2000 (the "Effective Date") and, subject to the terms hereof, terminating on June 30, 2004 (the "Termination Date"). As used in this Agreement, "Employment Term" shall mean the period from the Effective Date until the Termination Date, plus any extension of such period pursuant to the written agreement of the parties.

(b) The Corporation hereby agrees that, as of February 23, 2000, Employee shall become a member of the Board. During the Employment Term (including any extension thereof), Employee shall be nominated for election to the Board, and shall be identified as a nominee recommended for election by the Board, at each annual meeting of the stockholders of the Corporation, beginning with the annual meeting held in 2000.

(c) Employee shall perform such duties for the Corporation as may be determined from time to time by the Chairman of the Board, provided that such duties are reasonable and customary for a corporate vice chairman and chief operating officer.

(d) The Corporation and Employee acknowledge that the Employment Term may be extended for an additional period by mutual written agreement entered into at any time prior to the expiration of the Employment Term.

2. Annual Salary; Certain Reimbursements and Fringe Benefits

(a) Commencing on the Effective Date and, subject to Paragraphs 4, 5, 7 and 8 below, during the remainder of the Employment Term, the Corporation shall pay to Employee an annual base salary of not less than \$625,170 (such amount being prorated for 2000), payable in equal biweekly installments on the same dates the other senior officers of the Corporation are paid. Employee's annual base salary payable pursuant to this Paragraph 2 (including any increases in such salary approved by the Board pursuant to this Paragraph 2) is hereinafter referred to as "Employee's Basic Compensation."

(b) The Board shall, from time to time, review Employee's Basic Compensation and may increase (but in no event decrease) such compensation for any year after 2000 by such amounts as the Board deems proper. The criteria that the Board may take into consideration in providing for any such increases are the recommendation of the Chairman of the Board, the base compensation payable to vice chairmen or chief operating officers and other comparable officers of comparable financial institutions and corporations, Employee's ability and performance, any increases in the responsibilities assumed by Employee, the success achieved by the Corporation, any increase or change in the volume, character or variety of the business of the Corporation, increases in the cost of living and any other criteria the Board may deem relevant.

(c) The Corporation shall reimburse Employee for actual expenses incurred by Employee while Employee is employed under this Agreement or any successor agreement in obtaining tax and investment assistance and advice; provided, however, that in no event shall the Corporation be obligated to reimburse Employee under this Paragraph 2(c) for more than \$25,000 for expenses incurred in any calendar year.

(d) The Corporation shall provide Employee with access to a car and driver for transportation relating to business purposes while Employee is employed under this Agreement or any successor agreement on the same terms as the other members of the Office of the Chairman.

3. Employee's Rights Under Certain Plans

(a) Executive Pension Plan. The Corporation hereby designates Employee as a participant in the Executive Pension Plan of the Federal National Mortgage Association (the "Executive Pension Plan") with a Pension Goal at all times equal to no less than 50% of his High-Three Total Compensation (as such terms are defined in the Executive Pension Plan), as of the Effective Date. The Corporation may amend the Executive Pension Plan from time to time; provided, however, that no such amendment shall adversely modify the vesting schedule or decrease Employee's Pension Goal or the vested benefits to which Employee or his surviving spouse, if any, would have been entitled under such plan as in effect on the date hereof or, if benefits are improved, as of the date of such improvement.

(b) Stock Options. The Corporation shall grant the following stock options to Employee.

- (i) The Corporation shall grant to Employee, as of February 23, 2000, a Nonqualified Stock Option (the "Option"), pursuant to the Federal National Mortgage Association Stock Compensation Plan of 1993 (the "1993 Stock Compensation Plan"), to purchase 114,855 shares of common stock of the Corporation (the "Stock")

for a price equal to the Fair Market Value (as defined in such plan) of the Stock on the date of such grant. The Option shall expire on February 23, 2010 and shall become exercisable with respect to 25% of the Stock covered thereby on February 23, of each of 2001, 2002, 2003 and 2004; provided, in each case, that Employee is still employed by the Corporation on such date. Notwithstanding the foregoing or any provision of the 1993 Stock Compensation Plan to the contrary, in the event that (v) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (w) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below), (x) the Employment Term expires because of the failure of the Corporation to extend this Agreement or any successor agreement, (y) Employee is terminated by reason of serious illness or disability pursuant to Paragraph 7(a) below or (z) Employee dies while employed under this Agreement or any successor agreement, Employee (or, in the case of serious illness, disability or death, the person or persons to whom Employee's rights under the Option pass by will or applicable law or, if no such person has such rights, Employee's executors or administrators) shall be entitled to exercise the Option with respect to 100% of the Stock covered thereby until February 23, 2010.

(ii) The Corporation shall grant to Employee, as of February 23, 2000, an Earnings Per Share Challenge Option ("EPS Option"), pursuant to the 1993 Stock Compensation Plan, to purchase 116,710 shares of stock for a price equal to the Fair Market Value (as defined in such plan) of the Stock on the date of such grant. The EPS Option shall expire on January 18, 2010. If the Corporation's earnings per share for 2003 is \$6.46 or greater, the EPS Option shall become exercisable with respect to all of the Stock covered thereby on the date of the Corporation's January 2004 Board meeting; however, if the Corporation's earnings per share for 2003 is less than \$6.46, the EPS Option shall become exercisable with respect to 25% of the Stock covered thereby on January 18 of each 2005, 2006, 2007 and 2008; provided, in each case, that Employee is still employed by the Corporation on such date. Notwithstanding the foregoing or any provision of the 1993 Stock Compensation Plan to the contrary, in the event that (v) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (w) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below), (x) the Employment Term expires because of the failure of the Corporation to extend this Agreement or any successor agreement, (y) Employee is terminated by reason of serious illness or disability pursuant to Paragraph 7(a) below or (z) Employee dies while employed under

this Agreement or any successor agreement, Employee (or, in the case of serious illness, disability or death, the person or persons to whom Employee's rights under the EPS Option pass by will or applicable law or, if no such person has such rights, Employee's executors or administrators) shall be entitled to exercise the EPS Option with respect to 100% of the Stock covered thereby until January 18, 2010.

(c) Annual Incentive Plan. Employee's Maximum Potential Award (as defined in the Federal National Mortgage Association Annual Incentive Plan (the "Annual Incentive Plan")) for each year during the Employment Term shall be 137.5% of Employee's Basic Compensation. The amount to be paid with respect to such award for each such year shall be determined by the extent to which any Corporate Goals (as defined in the Annual Incentive Plan) are attained. Employee shall be entitled to participate in the Annual Incentive Plan for 2000 on a pro rata basis. Notwithstanding any provision of the Annual Incentive Plan to the contrary, the following provisions shall apply to Employee:

- (i) In the event that (x) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (y) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below) or (z) Employee is terminated by reason of serious illness, disability pursuant to Paragraph 7(a) below, or death, the Corporation shall pay to Employee at the time of payment of awards to other participants in the Plan (A) the amount of any bonus earned by and payable to Employee pursuant

to the Annual Incentive Plan for a completed calendar year (with the period February 23-December 31, 2000 being considered a completed calendar year for such purposes) but not yet paid by the Corporation for such year and (B) an award calculated assuming 100% attainment of the target corporate goal specified by the Board for the Annual Incentive Plan for the year in which such termination or resignation occurred.

- (ii) In the event that the Employment Term expires because of the failure of the Corporation to extend this Agreement or any successor agreement, the Corporation shall pay to Employee the amount of any bonus earned by and payable to Employee pursuant to the Annual Incentive Plan for a completed calendar year (with the period February 23-December 31, 2000 being considered a completed calendar year for such purposes) but not yet paid by the Corporation for such year.

(d) Restricted Stock. The Corporation shall grant to Employee, as of February 23, 2000, 25,000 shares of Restricted Common Stock ("Restricted Stock") pursuant to the 1993 Stock Compensation Plan. Twenty percent (20%) of such shares of Restricted Stock shall vest, and the Restricted Period applicable to such shares shall end, on February 23 in each of 2001, 2002, 2003, 2004 and 2005; provided, in each case, that Employee is still employed by the Corporation under this Agreement or any successor agreement on such date. Notwithstanding the foregoing or any provision of the 1993

Stock Compensation Plan to the contrary, the following provisions shall apply to Employee:

- (i) In the event that (w) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (x) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below), (y) the Employment Term expires because of the failure of the Corporation to extend this Agreement or any successor agreement or (z) Employee is terminated by reason of serious illness or disability pursuant to Paragraph 7(a) below, Employee's rights with respect to (A) shares of Restricted Stock awarded on February 23, 2000 shall become immediately vested and the Restricted Period applicable to all such shares shall end in accordance with the terms of the 1993 Stock Compensation Plan and (B) shares of Restricted Stock awarded after February 23, 2000 shall continue to vest and the Restricted Period applicable to such shares shall end in accordance with the schedule included in each such grant through the end of the Employment Term.
- (ii) In the event that Employee dies while employed under this Agreement or any successor agreement, Employee's rights with respect to all shares of Restricted Stock shall become immediately vested and the Restricted Period applicable to such shares shall end

in accordance with the terms of the 1993 Stock Compensation Plan.

(e) Performance Shares. The Corporation shall grant to Employee, as of February 23, 2000, Performance Shares pursuant to the 1993 Stock Compensation Plan for the 1998-2000, 1999-2001 and 2000-2002 Award Periods (as defined in the 1993 Stock Compensation Plan) in amounts equal to 7,028, 16,152 and 34,620 Performance Shares, respectively. The 7,028 Performance Shares represent a proration of a full 24,610 Performance Share Grant for the 1998-2000 Award Period, prorated to reflect Employee's employment by the Corporation for a portion (313 days) of such three-year Award Period. The 16,152 Performance Shares represent a proration of a full 26,110 Performance Share grant for the 1999-2001 Award Period, prorated to reflect Employee's employment by the Corporation for a portion (678 days) of such three-year Award Period. The grant of 34,620 Performance Shares for the 2000-2002 Award Period has not been prorated. If grants are made to other Participants for future Award Periods, Employee shall likewise be awarded a grant for each such future Award Period. Notwithstanding any provision of the 1993 Stock Compensation Plan to the contrary, the following provisions shall apply to Employee:

- (i) In the event that (w) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (x) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below), (y) the Employment Term expires because of the failure of the Corporation to extend this Agreement or any successor agreement or (z) Employee is

terminated by reason of serious illness or disability pursuant to Paragraph 7(a) below, the Corporation shall pay to Employee, after the end of each such Award Period, Actual Awards with respect to Performance Shares previously awarded for each Award Period of the Performance Share Plan in which Employee has completed at least 18 months of service, in each case on a pro rata basis reflecting Employee's completed months of service in the Award Period, based on the actual achievement of Program Targets for the Award Period and using as the Valuation Date (as defined in the 1993 Stock Compensation Plan) (A) in the case of a termination upon a Change in Control, the date of such Change in Control, and (B) in the case of a termination without Cause, the failure of the Corporation to extend the Employment Term or a termination because of serious illness or disability, the last day of the Award Period.

- (ii) In the event that Employee dies while employed under this Agreement or any successor agreement, the Corporation shall pay to Employee's designated beneficiary or, if none, Employee's estate as soon as is practicable after the date of Employee's death, Actual Awards with respect to Performance Shares previously awarded for (x) the 1999-2001 Award Period, if Employee's death occurs after February 22, 2001, and (y) each other Award Period of the Performance Share Plan in which Employee has completed at least

18 months of service, in each case on a pro rata basis reflecting Employee's completed months of service in the Award Period, based on the Board's determination of the likelihood of the Corporation's achievement of Program Targets for the Award Period and using the date of death as the Valuation Date (as defined in the 1993 Stock Compensation Plan).

(f) General Rights Under Benefit Plans. Nothing contained herein is intended to or shall be deemed to affect adversely any of Employee's rights as a participant under any long- or short-term bonus, stock option, restricted stock or other executive compensation plans, or under any program of perquisites or disability, retirement, stock purchase, retirement savings, health, medical, life insurance, or similar plans of the Corporation now or hereafter in effect. Employee shall at all times during the Employment Term be entitled to participate in all long- or short-term bonus, stock option, restricted stock, and other executive compensation plans, and in all perquisite programs and disability, retirement stock purchase, thrift and savings, health, medical, life insurance, and similar plans of the Corporation which are from time to time in effect and in which other senior officers of the Corporation generally are entitled to participate. Except as otherwise provided in this Agreement, Employee's participation in such plans and programs shall be in accordance with the provisions of such plans and programs applicable from time to time, it being the intent of the parties hereto that nothing in this Agreement shall decrease the rights and benefits of Employee under any such plans and programs as may be in effect from time to time. Except as specifically set forth in this Agreement, or as specifically permitted by the terms of any such plan or program, no

right or benefit under any such plan or program shall become vested or exercisable after the termination of Employee's employment by the Corporation. If for any reason any benefits payable pursuant to this Agreement cannot be paid under the Corporation's employee benefit or executive compensation plans, such payments shall be made out of the general assets of the Corporation.

4. Termination Without Cause, Termination or Resignation Upon a Change of Control or Failure to Extend

(a) Notwithstanding any other provision hereunder, the Corporation shall have the right to terminate Employee's employment hereunder without Cause (as defined in Paragraph 5(b) below) at any time for any reason in its sole discretion on not less than ninety (90) days' prior written notice to Employee. In the event that (i) the Corporation terminates Employee's employment pursuant to the immediately preceding sentence, (ii) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below) or (iii) the Employment Term expires because of the failure of the Corporation to extend this Agreement or any successor agreement, the Corporation shall, subject to Paragraph 4(b) below, continue to pay Employee's Basic Compensation to Employee at the rate in effect at the time of such termination, resignation or expiration until the later of (A) the expiration of the Employment Term or (B) one year following the date of such termination or resignation or notification to Employee of such failure to extend. Employee shall, subject to Paragraph 4(b) below, continue to participate in all Employee Welfare Benefit Plans (as such term is defined in Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended, and

the regulations promulgated thereunder) maintained by the Corporation during the remainder of the Employment Term or until such later date as may be expressly provided under the terms of any such plan.

(b) Following a termination or resignation pursuant to Paragraph 4(a) above or the expiration of the Employment Term because of the failure of the Corporation to extend this Agreement or any successor agreement, Employee shall have the duty, commencing on the date six (6) months after the date of such termination, resignation or expiration, to seek other employment or to become self-employed; provided, however, that Employee shall not be required to accept other employment or to become self-employed in any position not at least substantially equivalent (in terms of importance, dignity and responsibilities) to his position as Vice Chairman of the Board and Chief Operating Officer of the Corporation pursuant to this Agreement. Any income received from such employment (including self-employment but excluding service on boards of directors) after such six-month period shall reduce, on a dollar-for-dollar basis (but not below zero), the Corporation's obligation to pay Employee's Basic Compensation. Any employee benefits received by Employee in consideration of such employment after such six (6) month period shall relieve the Corporation of its obligation to provide comparable benefits hereunder to the extent of the benefits so received; provided, however, that Employee's retirement benefit, if any, pursuant to Paragraph 3(a) above shall not be reduced on account of any such income or benefits received from such employment.

(c) If at any time during the Employment Term, there is a material reduction of Employee's authority as Vice Chairman of the Board and Chief Operating Officer of

the Corporation, or any material change in Employee's functions, duties or responsibilities which would in any material way cause Employee's position to become less important or if Employee reports to anyone other than the Chairman of the Board or if the Corporation appoints a person other than Employee to the position of President, Deputy Chairman or a similar position superior to Employee's position and inferior to the position of Chairman of Fannie Mae, with the understanding that a change in the functions reporting to him is not per se material, or if the Corporation shall require Employee to relocate outside the Washington, D.C. area, Employee shall have the right, upon not less than ninety (90) days' written notice to the Corporation, which notice must be given within four calendar months after the event giving rise to said right, to treat such event as a termination by the Corporation of his employment without Cause pursuant to Paragraph 4(a) above for all purposes under this Agreement, and all of the provisions of this Agreement applicable to such a termination without Cause shall be operative with respect to such termination.

(d) "Change of Control" shall have occurred if there is a change in the composition of a majority of the Board of Directors elected by the stockholders within twelve (12) months after any "person" (as defined in Sections 3(a)(9) and 13(d)(3) of the Securities Exchange Act of 1934 (the "Exchange Act"), as such sections are in effect on the Effective Date) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act, as such rule is in effect on the Effective Date) of securities representing 25% or more of the combined voting power of the then outstanding securities of the Corporation.

5. Termination by Employee; Breach by Employee

(a) Notwithstanding any other provision hereunder, Employee shall have the right to terminate his employment by the Corporation at any time for any reason in his sole discretion on not less than ninety (90) days' prior written notice to the Corporation. Upon receipt of any such notice from Employee, the Corporation shall have the option, exercisable by giving Employee written notice within thirty (30) days of such receipt, to designate any date after the date of such notice to Employee and prior to the expiration of the aforesaid notice period as the date on which Employee shall cease to be an officer and employee of the Corporation, and the effective date of termination hereunder shall be any such earlier date so designated by the Corporation. In no event shall the termination of Employee's employment by the Corporation without Cause pursuant to Paragraph 4(a) above, Employee's termination or resignation within six (6) months following a Change of Control pursuant to Paragraph 4(a) above or the expiration of the Employment Term because of the failure of the Corporation to extend this Agreement or any successor agreement be deemed to be a termination by Employee pursuant to this Paragraph 5(a).

(b) Notwithstanding any other provision hereunder, the Corporation may terminate Employee's employment hereunder for "Cause," which shall mean that Employee has materially breached this Agreement by engaging in dishonest or fraudulent actions or willful misconduct or has materially harmed the Corporation by performing his duties in a negligent manner. Notwithstanding the foregoing, Employee shall not be deemed to have been terminated for Cause unless the Corporation shall have provided (i) reasonable notice to Employee setting forth the reasons for the Corporation's intention to terminate for Cause, (ii) an opportunity for Employee, together with his counsel, to be

heard before the Board and (iii) Employee with a notice of termination stating that Employee was guilty of the conduct set forth in this Paragraph 5(b) and specifying the particulars thereof in detail.

(c) In the event of a termination pursuant to Paragraph 5(a) or 5(b) above, Employee shall be entitled to all of Employee's Basic Compensation which has accrued to the date of termination and any benefits or awards (whether of options, stock or other property) which have vested prior to such date. The Corporation shall have no further obligations to Employee.

(d) In the event of a termination by Employee pursuant to Paragraph 5(a) above, during the period from the effective date of termination to the earlier of (i) the first anniversary thereof and (ii) the expiration of the Employment Term, Employee shall not, directly or indirectly (x) Compete with the Corporation in the United States of America, (y) solicit any officer or employee of the Corporation or any of its affiliates to engage in any conduct prohibited hereby for Employee or to terminate any existing relationship with the Corporation or such affiliate or (z) assist any other person to engage in any activity in any manner prohibited hereby to Employee. As used herein, "Compete" shall mean to engage directly or indirectly in any business, or to become connected directly or indirectly with any business or firm, if a substantial part of such business or the business of any such firm involves transactions in what is commonly known as the secondary market in residential mortgages; provided, however, that Employee shall not be deemed, directly or indirectly, to Compete with the Corporation solely by virtue of Employee's employment with any corporation or firm involved in transactions in what is commonly

known as the secondary market in residential mortgages so long as Employee himself does not participate in such corporation's or firm's involvement in such transactions.

(e) The need to protect the Corporation against Employee's competition, as well as the nature and scope of such protection, has been carefully considered by the parties hereto in light of the uniqueness of Employee's talent and his importance to the Corporation. Accordingly, Employee agrees that, in addition to any other relief to which the Corporation may be entitled, the Corporation shall be entitled to seek and obtain injunctive relief (without the requirement of a bond) from a court of competent jurisdiction for the purpose of restraining Employee from any actual or threatened breach of the covenant contained in Paragraph 5(d) above. If for any reason a final decision of any court determines that the restrictions under Paragraph 5(d) above are not reasonable or that consideration therefor is inadequate, such restrictions shall be interpreted, modified or rewritten by such court to include as much of the duration, scope and geographic area identified in Paragraph 5(d) above as will render such restrictions valid and enforceable.

6. Resignation as Board Member

In the event Employee ceases to be employed by the Corporation and Employee is then a member of the Board, Employee hereby agrees that, unless otherwise requested by the Board, he shall submit his resignation as a member of the Board and of the Fannie Mae Foundation in writing on or before the date he ceases to be an officer of the Corporation. If Employee fails or neglects to submit such resignations in writing, this Paragraph 6 may be deemed by the Corporation to constitute Employee's written

resignation as a member of the Board and of the Fannie Mae Foundation effective on the same date that Employee ceases to be an officer of the Corporation.

B. DISABILITY

7. Disability

(a) In the event that, while employed under this Agreement or any successor agreement, Employee is prevented from performing his duties hereunder by reason of serious illness or disability, the Corporation may, on sixty (60) days' prior written notice to Employee, terminate Employee's employment. Upon the termination of Employee's employment pursuant to this Paragraph 7(a), the Corporation shall, subject to Paragraphs 7(b) and (c) below, continue to pay Employee's Basic Compensation at the rate in effect at the time of such termination until the later of (A) the expiration of the Employment Term or (B) one year following the date of such termination. Employee shall, subject to Paragraph 7(b) below, continue to participate in all Employee Welfare Benefit Plans maintained by the Corporation during the remainder of the Employment Term or until such later date as may be expressly provided under the terms of any such plan.

(b) Employee may, in his sole discretion, after the date he ceases to be employed by the Corporation pursuant to Paragraph 7(a) above, engage in regular employment (whether as the employee of another or as a self-employed person). Any income received from such employment, including self-employment, shall reduce, on a dollar-for-dollar basis (but not below zero), the Corporation's obligation to pay Employee's Basic Compensation under Paragraph 7(a) above. Any employee benefits received by Employee in consideration of such employment shall relieve the Corporation

of its obligation to provide comparable benefits hereunder to the extent of the benefits so received; provided, however, that Employee's retirement benefits, if any, pursuant to Paragraph 3(a) above shall not be reduced on account of any such income or benefits resulting from such employment.

(c) If Employee becomes entitled to and receives disability benefits under any disability payment plan, including disability insurance, the amount of Employee's Basic Compensation otherwise payable by the Corporation to Employee pursuant to Paragraph 7(a) above shall be reduced, on a dollar-for-dollar basis (but not below zero), by the amount of any such disability benefits received by him, but only to the extent such benefits are attributable to premium payments made by the Corporation.

C. DEATH

8. Death

(a) In the event Employee dies while employed under this Agreement or any successor agreement, the Corporation shall pay Employee's designated beneficiary or, if none, Employee's estate, in one cash payment an amount equal to 100% of Employee's Basic Compensation at the rate in effect on the date of his death.

(b) At all times while employed under this Agreement or any successor agreement, Employee shall be covered at the Corporation's expense under the Corporation's Executive Insurance Plan by a whole life insurance policy in a face amount equal to 200% of Employee's Basic Compensation. In order to eliminate the income tax burden on Employee by reason of the imputation of income as a result of such insurance coverage, the Corporation shall pay to Employee an amount equal to the income taxes

imposed on such imputed income plus the income taxes imposed on such payment. In the event this Agreement or any successor agreement expires because of the failure of the Corporation to extend such agreement, Employee may, pursuant to the terms of the insurance policy through which such benefits are provided and the agreement between the Corporation and Employee entered into thereunder, acquire such insurance policy by paying the Corporation an amount equal to the sum of all premium payments made by the Corporation on such policy. In the event Employee completes sixteen (16) years of service with the Corporation pursuant to this Agreement or any successor agreement, such insurance policy shall automatically be transferred to Employee pursuant to the terms of such policy and the agreement between the Corporation and Employee entered into thereunder. In the event of any such transfer, in order to eliminate the income tax burden on Employee by reason of the income arising from such transfer, the Corporation shall pay to Employee an amount equal to the income taxes imposed on such income plus the income taxes imposed on such payment. Nothing contained herein shall reduce any benefit payable pursuant to Paragraph 3(a) above or under the terms of any other qualified or nonqualified pension, executive compensation or welfare plan of the Corporation.

D. MISCELLANEOUS

9. Assignment by Employee

Except as otherwise expressly provided in this Agreement, the rights and benefits of Employee pursuant hereto are personal to him and no such right or benefit shall be subject to voluntary or involuntary alienation, assignment or transfer.

10. Funding Prohibitions

All payments to be made under this Agreement shall be paid from the general funds of the Corporation or from the funds set aside or reserved for payment of the Corporation's obligations under its employee benefit or executive compensation plans, if any. Employee shall have no right, title or interest in or to any investments which the Corporation may make to aid it in meeting its obligations under this Agreement. All such assets shall be the property solely of the Corporation and shall be subject to the claims of the Corporation's unsecured general creditors. To the extent Employee or any other person acquires a right to receive payments from the Corporation under this Agreement, such right shall be no greater than the right of any unsecured general creditor of the Corporation and such person shall have only the unsecured contractual agreement of the Corporation that such payments shall be made.

11. Disclosure of Information to the Corporation

In the event Paragraph 4 or 7 above becomes applicable, Employee or, in the event of Employee's incapacity or death, his personal representative shall make available to the Corporation on a confidential basis such records, documents and other information reasonably necessary to enable the Corporation to verify the amount of income available to offset the payments otherwise due Employee pursuant to Paragraph 4 or 7 above.

12. Nondisclosure of Confidential Information

Employee shall not, without the prior written consent of the Corporation, divulge, disclose or make accessible to any other person, firm, partnership, corporation or other entity any Confidential Information pertaining to the business of the Corporation, except (i) while employed by the Corporation, in the business of and for the benefit of the Corporation, or (ii) when required to do so by a court of competent jurisdiction, by any governmental agency having supervisory authority over the business of the Corporation, or by any administrative body or legislative body (including a committee thereof) with purported or apparent jurisdiction to order Employee to divulge, disclose or make accessible such information. For purposes of this Paragraph 12, "Confidential Information" shall mean nonpublic information concerning the Corporation's financial data, strategic business plans, product development (or other proprietary product data), marketing plans and other nonpublic, proprietary and confidential information of the Corporation that is not otherwise available to the public. Confidential Information, however, shall not include information the disclosure of which cannot reasonably be expected to affect adversely the business of the Corporation to a material degree.

13. Waiver

The failure of either party hereto to insist upon strict compliance by the other party with any term, covenant or condition hereof shall not be deemed a waiver of such term, covenant or condition, nor shall any waiver or relinquishment or failure to insist upon strict compliance of any right or power hereunder at any one time or more times be deemed a waiver or relinquishment of such right or power at any other time or times.

14. Notice

Any notice required or desired to be given pursuant to this Agreement shall be sufficient if in writing transmitted by hand delivery or sent by prepaid courier or registered or certified mail, postage prepaid, to the addresses hereinafter set forth or to such other address as any party hereto may designate in writing and transmit in such manner. Any such notice shall be deemed given when delivered, if transmitted by hand delivery, 24 hours after deposit with a prepaid courier service or 72 hours after deposit in the United States mail, if sent by registered or certified mail.

15. Applicable Law

This Agreement shall be governed by the laws of the District of Columbia without regard to any otherwise applicable conflict of laws principles.

16. Taxes

The Corporation shall deduct from all amounts payable under this Agreement all federal, state, local and other taxes required by law to be withheld with respect to such payments.

17. Benefit

Except as is otherwise herein expressly provided, this Agreement shall inure to the benefit of and be binding upon the Corporation, its successors and assigns, and upon

Employee, his spouse, heirs, executors and administrators; provided, however, that the obligations of Employee hereunder shall not be delegated.

18. Entire Agreement

The parties hereto agree that this Agreement contains the entire understanding and agreement between them and cannot be amended, modified or supplemented in any respect except by an agreement in writing signed by both parties.

19. Interpretation

Wherever reference is made herein to the “failure of the Corporation to extend this Agreement or any successor agreement,” such a failure shall be deemed to have occurred if and only if the Corporation either notifies Employee that it does not desire to extend this Agreement or any successor agreement or that it desires to do so only on terms in the aggregate that are materially less favorable to Employee than those applicable to Employee at the time of said notice. If the Corporation notifies Employee it desires to extend this Agreement or any successor agreement on terms that are in the aggregate substantially similar to or more favorable than those applicable to Employee at the time of said notice, any nonextension shall not be deemed to be a “failure of the Corporation to extend this Agreement or any successor agreement.”

20. Severability

Except as provided in Section 21, it is the intent and understanding of each party hereto that, if any term, restriction, covenant, or promise is found to be invalid or

otherwise unenforceable, then such term, restriction, covenant, or promise shall not thereby be terminated but shall be deemed modified to the extent necessary to make it enforceable and, if it cannot be so modified, shall be deemed amended to delete therefrom such provision or portion found to be invalid or unenforceable, such modification or amendment in any event to apply only with respect to the operation of this Agreement in the particular jurisdiction in which such finding is made.

21. Regulatory Approved

The parties hereto acknowledge and agree that pursuant to Section 309(d) of the Federal National Mortgage Association Charter Act, as amended by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (as so amended, the "Act"), 12 U.S.C. 1723a(d), no provision of this Agreement relating to the terms of Employee's termination of employment shall be effective unless and until such provision has been reviewed and approved by the Director (the "Director") of the Office of Federal Housing Enterprise Oversight ("OFHEO"). The parties therefore agree as follows:

(a) The Corporation shall promptly hereafter submit this Agreement to the Director for his review and approval of those terms hereof relating to termination of employment and shall seek diligently to obtain such approval;

(b) No such provisions shall become effective unless and until the Director's approval thereof shall have been obtained; and

(c) The Director's approval of all such provisions shall be a condition subsequent to the continued effectiveness of this Agreement such that, in the event that the Director shall reject or otherwise refuse to approve any such provision in a timely

manner, this Agreement shall thereafter be voidable by Employee on thirty (30) days notice to the Corporation.

IN WITNESS WHEREOF, the Corporation has caused its name to be ascribed to this Agreement by its duly authorized representative, and Employee has executed this Agreement, each as of the day and the year first above written.

Attest:

FANNIE MAE
3900 Wisconsin Avenue, N.W.
Washington, D.C. 20016

/s/ Rebecca Culverson

By: /s/ Franklin D. Raines
Chairman of the Board of
Directors

Witness:

/s/ Thomas R. Nides

/s/ Daniel H. Mudd
DANIEL H. MUDD

EMPLOYMENT AGREEMENT
between
FANNIE MAE
and
J. TIMOTHY HOWARD

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EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT, effective as of the 1st day of July, 2003, is by and between FANNIE MAE (the "Corporation") and J. TIMOTHY HOWARD ("Employee").

WITNESSETH THAT:

WHEREAS, the Corporation desires to employ Employee as Vice Chairman of the Board and Chief Financial Officer of the Corporation, and Employee desires to serve in such capacity;

WHEREAS, the Corporation and Employee desire to set forth the terms and conditions of such employment; and

WHEREAS, the Board of Directors of the Corporation (the "Board") duly approved and authorized the terms of this Agreement for and on behalf of the Corporation at a meeting held on June 27, 2003, at which meeting a quorum was present, and the Board authorized the Chairman of the Board to finalize and enter into this Agreement with Employee on behalf of the Corporation;

NOW, THEREFORE, in consideration of the foregoing and of the mutual promises and covenants herein contained, the parties hereto agree as follows:

A. EMPLOYMENT TERM

1. Term and Duties

(a) The Corporation hereby agrees to continue to employ Employee, and Employee hereby agrees to continue to serve, as Vice Chairman of the Board and Chief Financial Officer of the Corporation, upon the terms and conditions herein contained, for a term commencing on July 1, 2003 (the "Effective Date") and, subject to the terms hereof, terminating on June 30, 2004 (the "Termination Date"). As used in this Agreement, "Employment Term" shall mean the period from the Effective Date until the Termination Date, plus any extension of such period pursuant to the written agreement of the parties.

(b) Employee is currently a member of the Board. During the Employment Term (including any extension thereof), Employee shall be nominated for election to the Board, and shall be identified as a nominee recommended for election by the Board, at each annual meeting of the stockholders of the Corporation, beginning with the annual meeting held in 2004.

(c) Employee shall perform such duties for the Corporation as may be determined from time to time by the Chairman of the Board, provided that such duties are reasonable and customary for a corporate vice chairman and chief financial officer.

(d) The Corporation and Employee acknowledge that the Employment Term may be extended for an additional period by mutual written agreement entered into at any time prior to the expiration of the Employment Term.

2. Annual Salary; Certain Reimbursements and Fringe Benefits

(a) Commencing with 2003 and, subject to Paragraphs 4, 5, 7 and 8 below, during the remainder of the Employment Term, the Corporation shall pay to Employee an annual base salary at a rate of (starting May 20, 2003) not less than \$675,000, payable in equal biweekly installments on the same dates the other senior officers of the Corporation are paid. Employee's annual base salary payable pursuant to this Paragraph 2 (including any increases in such salary approved by the Board pursuant to this Paragraph 2) is hereinafter referred to as "Employee's Basic Compensation."

(b) The Board shall, from time to time, review Employee's Basic Compensation and may increase (but in no event decrease) such compensation for any year after 2003 by such amounts as the Board deems proper. The criteria that the Board may take into consideration in providing for any such increases are the recommendation of the Chairman of the Board, the base compensation payable to vice chairmen or chief financial officers and other comparable officers of comparable financial institutions and corporations, Employee's ability and performance, any increases in the responsibilities assumed by Employee, the success achieved by the Corporation, any increase or change in the volume, character or variety of the business of the Corporation, increases in the cost of living and any other criteria the Board may deem relevant.

(c) The Corporation shall reimburse Employee for actual expenses incurred by Employee while Employee is employed under this Agreement or any successor agreement in obtaining tax and investment assistance and advice; provided, however, that in no event shall the Corporation be obligated to reimburse Employee under this Paragraph 2(c) for more than \$25,000 for expenses incurred in any calendar year.

(d) The Corporation shall provide Employee with access to a car and driver for transportation relating to business purposes while Employee is employed under this Agreement or any successor agreement on the same terms as the other members of the Office of the Chairman.

3. Employee's Rights Under Certain Plans

(a) Executive Pension Plan. The Corporation hereby confirms the designation of Employee as a participant in the Executive Pension Plan of the Federal National Mortgage Association (the "Executive Pension Plan") with a Pension Goal at all times equal to no less than 50% of his High-Three Total Compensation (as such terms are defined in the Executive Pension Plan), as of the Effective Date. The Corporation may amend the Executive Pension Plan from time to time; provided, however, that no such amendment shall adversely modify the vesting schedule or decrease Employee's Pension Goal or the vested benefits to which Employee or his surviving spouse, if any, would have been entitled under such plan as in effect on the date hereof or, if benefits are improved, as of the date of such improvement.

(b) Annual Incentive Plan. Employee's Maximum Potential Award (as defined in the Federal National Mortgage Association Annual Incentive Plan (the "Annual Incentive Plan")) for each year during the Employment Term, including for this purpose calendar year 2003, shall be 137.5% of Employee's Basic Compensation. The amount to be paid with respect to such award for each such year shall be determined by the extent to which any Corporate Goals (as defined in the Annual Incentive Plan) are attained. Notwithstanding any provision of the Annual Incentive Plan to the contrary, the following provisions shall apply to Employee:

(i) In the event that (x) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (y) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below) or (z) Employee is terminated by reason of serious illness, disability pursuant to Paragraph 7(a) below, or death, the Corporation shall pay to Employee at the time of payment of awards to other participants in the Plan (A) the amount of any bonus earned by and payable to Employee pursuant to the Annual Incentive Plan for a completed calendar year but not yet paid by the Corporation for such year and (B) an award calculated assuming 100% attainment of the target corporate goal specified by the Board for the Annual Incentive Plan for the year in which such termination or resignation occurred.

(ii) In the event that the Employment Term expires because of the failure of the Corporation to extend this Agreement or any successor agreement, the Corporation shall pay to Employee the amount of any bonus earned by and payable to Employee pursuant to the Annual Incentive Plan for a completed calendar year but not yet paid by the Corporation for such year.

(c) Restricted Stock. Notwithstanding any provision of the Fannie Mae Stock Compensation Plan of 2003 (together with any predecessor or successor plans, the "Stock Compensation Plan") to the contrary, the following provisions shall apply to Employee:

- (i) In the event that (w) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (x) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below), (y) the Employment Term expires because of the failure of the Corporation to extend this Agreement or any successor agreement or (z) Employee is terminated by reason of serious illness or disability pursuant to Paragraph 7(a) below, Employee's rights with respect to shares of Restricted Stock awarded after July 1, 2003 shall continue to vest and the Restricted Period applicable to such shares shall end in accordance with the schedule included in each such grant through the end of the Employment Term.
- (ii) In the event that Employee dies while employed under this Agreement or any successor agreement, Employee's rights with respect to all shares of Restricted Stock shall become immediately vested and the Restricted Period applicable to such shares shall end in accordance with the terms of the Stock Compensation Plan.

(d) Performance Shares. If grants of Performance Shares are made to other Participants for future Award Periods under the Stock Compensation Plan, Employee shall likewise be awarded a grant for each such future Award Period. Notwithstanding any provision of the Stock Compensation Plan to the contrary, the following provisions shall apply to Employee with respect to Performance Share awards to him under the Stock Compensation Plan:

- (i) In the event that (w) Employee is terminated without Cause pursuant to Paragraph 4(a) below, (x) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below), (y) the Employment Term expires because of the failure of the Corporation to extend this Agreement or any successor agreement or (z) Employee is terminated by reason of serious illness or disability pursuant to Paragraph 7(a) below, the Corporation shall pay to Employee, after the end of each such Award Period, Actual Awards with respect to Performance Shares previously awarded for each Award Period of the Performance Share Plan in which Employee has completed at least 18 months of service, in each case on a pro rata basis reflecting Employee's completed months of service in the Award Period, based on the actual achievement of Program Targets for the Award Period and using as the Valuation Date (as defined in the Stock Compensation Plan) (A) in the case of a termination upon a Change in Control, the date of such Change in Control, and (B) in the case of a termination without Cause, the failure of the Corporation to extend the Employment Term or a termination because of serious illness or disability, the last day of the Award Period.
- (ii) In the event that Employee dies while employed under this Agreement or any successor agreement, the Corporation shall pay

to Employee's designated beneficiary or, if none, Employee's estate as soon as is practicable after the date of Employee's death, Actual Awards with respect to each Award Period of the Performance Share Plan in which Employee has completed at least 18 months of service, in each case on a pro rata basis reflecting Employee's completed months of service in the Award Period, based on the Board's determination of the likelihood of the Corporation's achievement of Program Targets for the Award Period and using the date of death as the Valuation Date (as defined in the Stock Compensation Plan).

(f) General Rights Under Benefit Plans. Nothing contained herein is intended to or shall be deemed to affect adversely any of Employee's rights as a participant under any long- or short-term bonus, stock option, restricted stock or other executive compensation plans, or under any program of perquisites or disability, retirement, stock purchase, retirement savings, health, medical, life insurance, or similar plans of the Corporation now or hereafter in effect. Employee shall at all times during the Employment Term be entitled to participate in all long- or short-term bonus, stock option, restricted stock, and other executive compensation plans, and in all perquisite programs and disability, retirement stock purchase, thrift and savings, health, medical, life insurance, and similar plans of the Corporation which are from time to time in effect and in which other senior officers of the Corporation generally are entitled to participate. Except as otherwise provided in this Agreement, Employee's participation in such plans and programs shall be in accordance with the provisions of such plans and programs

applicable from time to time, it being the intent of the parties hereto that nothing in this Agreement shall decrease the rights and benefits of Employee under any such plans and programs as may be in effect from time to time. Except as specifically set forth in this Agreement, or as specifically permitted by the terms of any such plan or program, no right or benefit under any such plan or program shall become vested or exercisable after the termination of Employee's employment by the Corporation. If for any reason any benefits payable pursuant to this Agreement cannot be paid under the Corporation's employee benefit or executive compensation plans, such payments shall be made out of the general assets of the Corporation.

4. Termination Without Cause, Termination or Resignation Upon a Change of Control or Failure to Extend

(a) Notwithstanding any other provision hereunder, the Corporation shall have the right to terminate Employee's employment hereunder without Cause (as defined in Paragraph 5(b) below) at any time for any reason in its sole discretion on not less than ninety (90) days' prior written notice to Employee. In the event that (i) the Corporation terminates Employee's employment pursuant to the immediately preceding sentence, (ii) Employee is terminated or resigns within six (6) months following a Change of Control (as defined in Paragraph 4(d) below) or (iii) the Employment Term expires because of the failure of the Corporation to extend this Agreement or any successor agreement, the Corporation shall, subject to Paragraph 4(b) below, continue to pay Employee's Basic Compensation to Employee at the rate in effect at the time of such termination, resignation or expiration until the later of (A) the expiration of the Employment Term or

(B) one year following the date of such termination or resignation or notification to Employee of such failure to extend. Employee shall, subject to Paragraph 4(b) below, continue to participate in all Employee Welfare Benefit Plans (as such term is defined in Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended, and the regulations promulgated thereunder) maintained by the Corporation during the remainder of the Employment Term or until such later date as may be expressly provided under the terms of any such plan.

(b) Following a termination or resignation pursuant to Paragraph 4(a) above or the expiration of the Employment Term because of the failure of the Corporation to extend this Agreement or any successor agreement, Employee shall have the duty, commencing on the date six (6) months after the date of such termination, resignation or expiration, to seek other employment or to become self-employed; provided, however, that Employee shall not be required to accept other employment or to become self-employed in any position not at least substantially equivalent (in terms of importance, dignity and responsibilities) to his position as Vice Chairman of the Board and Chief Financial Officer of the Corporation pursuant to this Agreement. Any income received from such employment (including self-employment but excluding service on boards of directors) after such six-month period shall reduce, on a dollar-for-dollar basis (but not below zero), the Corporation's obligation to pay Employee's Basic Compensation. Any employee benefits received by Employee in consideration of such employment after such six (6) month period shall relieve the Corporation of its obligation to provide comparable benefits hereunder to the extent of the benefits so received; provided, however, that Employee's retirement benefit, if any, pursuant to Paragraph 3(a)

above shall not be reduced on account of any such income or benefits received from such employment.

(c) If at any time during the Employment Term, there is a material reduction of Employee's authority as Vice Chairman of the Board and Chief Financial Officer of the Corporation, or any material change in Employee's functions, duties or responsibilities which would in any material way cause Employee's position to become less important, with the understanding that a change in the functions reporting to him is not per se material, or if the Corporation shall require Employee to relocate outside the Washington, D.C. area, Employee shall have the right, upon not less than ninety (90) days' written notice to the Corporation, which notice must be given within four calendar months after the event giving rise to said right, to treat such event as a termination by the Corporation of his employment without Cause pursuant to Paragraph 4(a) above for all purposes under this Agreement, and all of the provisions of this Agreement applicable to such a termination without Cause shall be operative with respect to such termination.

(d) "Change of Control" shall have occurred if there is a change in the composition of a majority of the Board of Directors elected by the stockholders within twelve (12) months after any "person" (as defined in Sections 3(a)(9) and 13(d)(3) of the Securities Exchange Act of 1934 (the "Exchange Act"), as such sections are in effect on the Effective Date) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act, as such rule is in effect on the Effective Date) of securities representing 25% or more of the combined voting power of the then outstanding securities of the Corporation.

5. Termination by Employee; Breach by Employee

(a) Notwithstanding any other provision hereunder, Employee shall have the right to terminate his employment by the Corporation at any time for any reason in his sole discretion on not less than ninety (90) days' prior written notice to the Corporation. Upon receipt of any such notice from Employee, the Corporation shall have the option, exercisable by giving Employee written notice within thirty (30) days of such receipt, to designate any date after the date of such notice to Employee and prior to the expiration of the aforesaid notice period as the date on which Employee shall cease to be an officer and employee of the Corporation, and the effective date of termination hereunder shall be any such earlier date so designated by the Corporation. In no event shall the termination of Employee's employment by the Corporation without Cause pursuant to Paragraph 4(a) above, Employee's termination or resignation within six (6) months following a Change of Control pursuant to Paragraph 4(a) above or the expiration of the Employment Term because of the failure of the Corporation to extend this Agreement or any successor agreement be deemed to be a termination by Employee pursuant to this Paragraph 5(a).

(b) Notwithstanding any other provision hereunder, the Corporation may terminate Employee's employment hereunder for "Cause," which shall mean that Employee has materially breached this Agreement by engaging in dishonest or fraudulent actions or willful misconduct or has materially harmed the Corporation by performing his duties in a negligent manner. Notwithstanding the foregoing, Employee shall not be deemed to have been terminated for Cause unless the Corporation shall have provided (i) reasonable notice to Employee setting forth the reasons for the Corporation's intention to terminate for Cause, (ii) an opportunity for Employee, together with his counsel, to be heard before the Board and (iii) Employee with a notice of termination stating that

Employee was guilty of the conduct set forth in this Paragraph 5(b) and specifying the particulars thereof in detail.

(c) In the event of a termination pursuant to Paragraph 5(a) or 5(b) above, Employee shall be entitled to all of Employee's Basic Compensation which has accrued to the date of termination and any benefits or awards (whether of options, stock or other property) which have vested prior to such date. The Corporation shall have no further obligations to Employee.

(d) In the event of a termination by Employee pursuant to Paragraph 5(a) above, during the period from the effective date of termination to the earlier of (i) the first anniversary thereof and (ii) the expiration of the Employment Term, Employee shall not, directly or indirectly (x) Compete with the Corporation in the United States of America, (y) solicit any officer or employee of the Corporation or any of its affiliates to engage in any conduct prohibited hereby for Employee or to terminate any existing relationship with the Corporation or such affiliate or (z) assist any other person to engage in any activity in any manner prohibited hereby to Employee. As used herein, "Compete" shall mean to engage directly or indirectly in any business, or to become connected directly or indirectly with any business or firm, if a substantial part of such business or the business of any such firm involves transactions in what is commonly known as the secondary market in residential mortgages; provided, however, that Employee shall not be deemed, directly or indirectly, to Compete with the Corporation solely by virtue of Employee's employment with any corporation or firm involved in transactions in what is commonly known as the secondary market in residential mortgages so long as Employee himself does not participate in such corporation's or firm's involvement in such transactions.

(e) The need to protect the Corporation against Employee's competition, as well as the nature and scope of such protection, has been carefully considered by the parties hereto in light of the uniqueness of Employee's talent and his importance to the Corporation. Accordingly, Employee agrees that, in addition to any other relief to which the Corporation may be entitled, the Corporation shall be entitled to seek and obtain injunctive relief (without the requirement of a bond) from a court of competent jurisdiction for the purpose of restraining Employee from any actual or threatened breach of the covenant contained in Paragraph 5(d) above. If for any reason a final decision of any court determines that the restrictions under Paragraph 5(d) above are not reasonable or that consideration therefor is inadequate, such restrictions shall be interpreted, modified or rewritten by such court to include as much of the duration, scope and geographic area identified in Paragraph 5(d) above as will render such restrictions valid and enforceable.

6. Resignation as Board Member

In the event Employee ceases to be employed by the Corporation and Employee is then a member of the Board, Employee hereby agrees that, unless otherwise requested by the Board, he shall submit his resignation as a member of the Board and of the Fannie Mae Foundation in writing on or before the date he ceases to be an officer of the Corporation. If Employee fails or neglects to submit such resignations in writing, this Paragraph 6 may be deemed by the Corporation to constitute Employee's written resignation as a member of the Board and of the Fannie Mae Foundation effective on the same date that Employee ceases to be an officer of the Corporation.

B. DISABILITY

7. Disability

(a) In the event that, while employed under this Agreement or any successor agreement, Employee is prevented from performing his duties hereunder by reason of serious illness or disability, the Corporation may, on sixty (60) days' prior written notice to Employee, terminate Employee's employment. Upon the termination of Employee's employment pursuant to this Paragraph 7(a), the Corporation shall, subject to Paragraphs 7(b) and (c) below, continue to pay Employee's Basic Compensation at the rate in effect at the time of such termination until the later of (A) the expiration of the Employment Term or (B) one year following the date of such termination. Employee shall, subject to Paragraph 7(b) below, continue to participate in all Employee Welfare Benefit Plans maintained by the Corporation during the remainder of the Employment Term or until such later date as may be expressly provided under the terms of any such plan.

(b) Employee may, in his sole discretion, after the date he ceases to be employed by the Corporation pursuant to Paragraph 7(a) above, engage in regular employment (whether as the employee of another or as a self-employed person). Any income received from such employment, including self-employment, shall reduce, on a dollar-for-dollar basis (but not below zero), the Corporation's obligation to pay Employee's Basic Compensation under Paragraph 7(a) above. Any employee benefits received by Employee in consideration of such employment shall relieve the Corporation of its obligation to provide comparable benefits hereunder to the extent of the benefits so received; provided, however, that Employee's retirement benefits, if any, pursuant to Paragraph 3(a) above shall not be reduced on account of any such income or benefits resulting from such employment.

(c) If Employee becomes entitled to and receives disability benefits under any disability payment plan, including disability insurance, the amount of Employee's Basic Compensation otherwise payable by the Corporation to Employee pursuant to Paragraph 7(a) above shall be reduced, on a dollar-for-dollar basis (but not below zero), by the amount of any such disability benefits received by him, but only to the extent such benefits are attributable to premium payments made by the Corporation.

C. DEATH

8. Death

(a) In the event Employee dies while employed under this Agreement or any successor agreement, the Corporation shall pay Employee's designated beneficiary or, if none, Employee's estate, in one cash payment an amount equal to 100% of Employee's Basic Compensation at the rate in effect on the date of his death.

(b) The parties acknowledge that Employee is covered at the Corporation's expense under the Corporation's Executive Insurance Plan by a whole life insurance policy. In addition, during the Employment Term the Corporation shall provide additional insurance coverage for Employee such that the total death benefit provided by such coverage plus the death benefit provided by the whole life insurance contract described in the immediately preceding sentence is 200% of Employee's Basic Compensation. In order to eliminate the income tax burden on Employee by reason of the imputation of income as a result of such insurance coverages, the Corporation shall pay to Employee an amount equal to the income taxes imposed on such imputed income plus the income taxes imposed on such payment. In the event this Agreement or any successor agreement expires because of the failure of the Corporation to extend such

agreement, Employee may, pursuant to the terms of the insurance policy described in the first sentence of this Paragraph 8(b) and the agreement between the Corporation and Employee entered into with respect thereto, acquire such insurance policy by paying the Corporation an amount equal to the sum of all premium payments made by the Corporation on such policy. In the event Employee continues in service with the Corporation until January 1, 2004, such insurance policy shall automatically be transferred to Employee pursuant to the terms of such policy and the agreement between the Corporation and Employee entered into thereunder. In the event of any such transfer, in order to eliminate the income tax burden on Employee by reason of the income arising from such transfer, the Corporation shall pay to Employee an amount equal to the income taxes imposed on such income plus the income taxes imposed on such payment. Nothing contained herein shall reduce any benefit payable pursuant to Paragraph 3(a) above or under the terms of any other qualified or nonqualified pension, executive compensation or welfare plan of the Corporation.

D. MISCELLANEOUS

9. Assignment by Employee

Except as otherwise expressly provided in this Agreement, the rights and benefits of Employee pursuant hereto are personal to him and no such right or benefit shall be subject to voluntary or involuntary alienation, assignment or transfer.

10. Funding Prohibitions

All payments to be made under this Agreement shall be paid from the general funds of the Corporation or from the funds set aside or reserved for payment of the

Corporation's obligations under its employee benefit or executive compensation plans, if any. Employee shall have no right, title or interest in or to any investments which the Corporation may make to aid it in meeting its obligations under this Agreement. All such assets shall be the property solely of the Corporation and shall be subject to the claims of the Corporation's unsecured general creditors. To the extent Employee or any other person acquires a right to receive payments from the Corporation under this Agreement, such right shall be no greater than the right of any unsecured general creditor of the Corporation and such person shall have only the unsecured contractual agreement of the Corporation that such payments shall be made.

11. Disclosure of Information to the Corporation

In the event Paragraph 4 or 7 above becomes applicable, Employee or, in the event of Employee's incapacity or death, his personal representative shall make available to the Corporation on a confidential basis such records, documents and other information reasonably necessary to enable the Corporation to verify the amount of income available to offset the payments otherwise due Employee pursuant to Paragraph 4 or 7 above.

12. Nondisclosure of Confidential Information

Employee shall not, without the prior written consent of the Corporation, divulge, disclose or make accessible to any other person, firm, partnership, corporation or other entity any Confidential Information pertaining to the business of the Corporation, except (i) while employed by the Corporation, in the business of and for the benefit of the Corporation, or (ii) when required to do so by a court of competent jurisdiction, by any governmental agency having supervisory authority over the business of the Corporation,

or by any administrative body or legislative body (including a committee thereof) with purported or apparent jurisdiction to order Employee to divulge, disclose or make accessible such information. For purposes of this Paragraph 12, "Confidential Information" shall mean nonpublic information concerning the Corporation's financial data, strategic business plans, product development (or other proprietary product data), marketing plans and other nonpublic, proprietary and confidential information of the Corporation that is not otherwise available to the public. Confidential Information, however, shall not include information the disclosure of which cannot reasonably be expected to affect adversely the business of the Corporation to a material degree.

13. Waiver

The failure of either party hereto to insist upon strict compliance by the other party with any term, covenant or condition hereof shall not be deemed a waiver of such term, covenant or condition, nor shall any waiver or relinquishment or failure to insist upon strict compliance of any right or power hereunder at any one time or more times be deemed a waiver or relinquishment of such right or power at any other time or times.

14. Notice

Any notice required or desired to be given pursuant to this Agreement shall be sufficient if in writing transmitted by hand delivery or sent by prepaid courier or registered or certified mail, postage prepaid, to the addresses hereinafter set forth or to such other address as any party hereto may designate in writing and transmit in such manner. Any such notice shall be deemed given when delivered, if transmitted by hand

delivery, 24 hours after deposit with a prepaid courier service or 72 hours after deposit in the United States mail, if sent by registered or certified mail.

15. Applicable Law

This Agreement shall be governed by the laws of the District of Columbia without regard to any otherwise applicable conflict of laws principles.

16. Taxes

The Corporation shall deduct from all amounts payable under this Agreement all federal, state, local and other taxes required by law to be withheld with respect to such payments.

17. Benefit

Except as is otherwise herein expressly provided, this Agreement shall inure to the benefit of and be binding upon the Corporation, its successors and assigns, and upon Employee, his spouse, heirs, executors and administrators; provided, however, that the obligations of Employee hereunder shall not be delegated.

18. Entire Agreement

The parties hereto agree that this Agreement contains the entire understanding and agreement between them and cannot be amended, modified or supplemented in any respect except by an agreement in writing signed by both parties.

19. Interpretation

Wherever reference is made herein to the “failure of the Corporation to extend this Agreement or any successor agreement,” such a failure shall be deemed to have occurred if and only if the Corporation either notifies Employee that it does not desire to extend this Agreement or any successor agreement or that it desires to do so only on terms in the aggregate that are materially less favorable to Employee than those applicable to Employee at the time of said notice. If the Corporation notifies Employee it desires to extend this Agreement or any successor agreement on terms that are in the aggregate substantially similar to or more favorable than those applicable to Employee at the time of said notice, any nonextension shall not be deemed to be a “failure of the Corporation to extend this Agreement or any successor agreement.”

20. Severability

Except as provided in Section 21, it is the intent and understanding of each party hereto that, if any term, restriction, covenant, or promise is found to be invalid or otherwise unenforceable, then such term, restriction, covenant, or promise shall not thereby be terminated but shall be deemed modified to the extent necessary to make it enforceable and, if it cannot be so modified, shall be deemed amended to delete therefrom such provision or portion found to be invalid or unenforceable, such modification or amendment in any event to apply only with respect to the operation of this Agreement in the particular jurisdiction in which such finding is made.

21. Regulatory Approved

The parties hereto acknowledge and agree that pursuant to Section 309(d) of the Federal National Mortgage Association Charter Act, as amended by the Federal Housing

Enterprises Financial Safety and Soundness Act of 1992 (as so amended, the "Act"), 12 U.S.C. 1723a(d), no provision of this Agreement relating to the terms of Employee's termination of employment shall be effective unless and until such provision has been reviewed and approved by the Director (the "Director") of the Office of Federal Housing Enterprise Oversight ("OFHEO"). The parties therefore agree as follows:

(a) The Corporation shall promptly hereafter submit this Agreement to the Director for his review and approval of those terms hereof relating to termination of employment and shall seek diligently to obtain such approval;

(b) No such provisions shall become effective unless and until the Director's approval thereof shall have been obtained; and

(c) The Director's approval of all such provisions shall be a condition subsequent to the continued effectiveness of this Agreement such that, in the event that the Director shall reject or otherwise refuse to approve any such provision in a timely manner, this Agreement shall thereafter be voidable by Employee on thirty (30) days notice to the Corporation.

IN WITNESS WHEREOF, the Corporation has caused its name to be ascribed to this Agreement by its duly authorized representative, and Employee has executed this Agreement, each as of the day and the year first above written.

Attest:

FANNIE MAE
3900 Wisconsin Avenue, N.W.
Washington, D.C. 20016

/s/ Anthony F. Marra

By: /s/ Franklin D. Raines
Chairman of the Board of
Directors

Witness:

/s/ K. G. Gallo

/s/ J. Timothy Howard
J. TIMOTHY HOWARD

rev.

FANNIE MAE STOCK COMPENSATION PLAN OF 2003

I. The Plan

1.1 *Purpose.* The purpose of the Fannie Mae Stock Compensation Plan of 2003 is to promote the success of Fannie Mae by providing stock compensation to employees and directors that is comparable to that provided by similar companies; to attract, motivate, retain and reward employees of Fannie Mae; to provide incentives for high levels of individual performance and improved financial performance of Fannie Mae; to attract, motivate and retain experienced and knowledgeable independent directors; and to promote a close identity of interests between directors, officers, employees and shareholders.

1.2 *Definitions.*

The following terms shall have the meanings set forth below:

- (1) “*Award*” shall mean an award of any Option, Stock Appreciation Right, Restricted Stock, Performance Share Award, Stock Bonus or any other award authorized under Section 1.6, or any combination thereof, whether alternative or cumulative, or an award of any Options or Restricted Stock authorized under Articles VI and VII.
- (2) “*Award Date*” shall mean the date upon which the Committee takes the action granting an Award or a later date designated by the Committee as the Award Date at the time it grants the Award, or, in the case of Awards under Sections 6.2 or 7.2, the applicable dates set forth therein.
- (3) “*Award Document*” shall mean any writing (including in electronic or other form approved by the Committee), which may be an agreement, setting forth the terms of an Award that has been granted by the Committee.
- (4) “*Award Period*” shall mean the period beginning on an Award Date and ending on the expiration date of such Award.
- (5) “*Beneficiary*” shall mean the person or persons designated by a Participant or Permitted Transferee in writing to the senior-ranking officer in the Human Resources department of Fannie Mae to receive the benefits specified in an Award Document and under the Plan in the event of the death of the Participant or Permitted Transferee.
- (6) “*Benefit Plans Committee*” shall mean the Benefit Plans Committee established by the Board, consisting of employees of Fannie Mae.
- (7) “*Board*” shall mean the Board of Directors of Fannie Mae.
- (8) “*Cause*” shall mean significant harm to Fannie Mae in connection with a Participant’s employment by Fannie Mae, by the Participant’s engaging in dishonest or fraudulent actions or willful misconduct or performing the Participant’s duties in a negligent manner, as determined by the Committee for a member of the Board who is an officer or employee of Fannie Mae and for the General Counsel of Fannie Mae, and by the General Counsel of Fannie Mae for all other employees; provided that no act or failure to act will be considered “willful” unless it is done, or omitted to be done, by the Participant in bad faith or without reasonable belief that the act or failure to act was in the interest of Fannie Mae.
- (9) “*Change in Control Event*” shall mean a change in the composition of a majority of the Board elected by shareholders within 12 months after any “person” (as such term is used in Sections 3(a)(9), 13(d)(3) and 14(d)(2) of the Securities Exchange Act of 1934) is or becomes the beneficial owner, directly or indirectly, of securities of Fannie Mae representing more than 25 percent of the combined voting power of the then-outstanding securities of Fannie Mae entitled to then vote generally in the election of directors of Fannie Mae.

- (10) “Code” shall mean the Internal Revenue Code of 1986, as amended from time to time.
- (11) “Committee” shall mean the Compensation Committee of the Board.
- (12) “Common Stock” shall mean the common stock of Fannie Mae and, in the event such common stock is converted to another security or property pursuant to Section 8.2, such other security or property.
- (13) “Director Term” shall mean the period starting immediately following the annual meeting of the shareholders at which directors are elected to serve on the Board and ending at the close of the next annual meeting at which directors are elected.
- (14) “Early Retirement” means separation from service with Fannie Mae at or after the attainment of age 60 (but before attainment of age 65) with five years of service with Fannie Mae, or at an earlier age only if permitted by the Committee in its sole discretion. For purposes of this Section 1.2(14), a year of service shall be determined in accordance with the Federal National Mortgage Association Retirement Plan for Employees Not Covered Under Civil Service Retirement Law.
- (15) “Eligible Employee” shall mean any employee of Fannie Mae.
- (16) “ERISA” shall mean the Employee Retirement Income Security Act of 1974, as amended.
- (17) “Fair Market Value” shall mean the per share value of Common Stock as determined by using the mean between the high and low selling prices of such Common Stock, on the date of determination, as reported on the NYSE. If such prices are not available or if the Common Stock is no longer traded on the NYSE, the Fair Market Value shall be determined by the Committee, in good faith, using any reasonable method.
- (18) “Fannie Mae” shall mean Fannie Mae and its successors and, where the context requires, its Subsidiaries.
- (19) “Immediate Family Member” shall mean, with respect to a Participant, (i) the Participant’s child, stepchild, grandchild, parent, stepparent, grandparent, spouse, former spouse, sibling, half-sibling, stepsibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law or sister-in-law (including adoptive relations where the adopted individual shall not have attained the age of 18 years prior to such adoption); (ii) the Participant’s Domestic Partner (as defined in Section 2.18 of the Federal National Mortgage Association Retirement Plan for Employees Not Covered Under Civil Service Retirement Law and determined pursuant to the guidelines and procedures established thereunder); (iii) any lineal ascendant or descendant of any individual described in (i) or (ii) above; (iv) any partnership, limited liability company, association, corporation or other entity all of whose beneficial interests (including without limitation all pecuniary interests, voting rights and investment power) are held by and for the benefit of the Participant and/or one or more individuals described in (i), (ii) or (iii) above; or (v) any trust for the sole benefit of the Participant and/or one or more individuals described in (i), (ii) or (iii) above.
- (20) “Incentive Stock Option” shall mean an Option that is designated as an incentive stock option within the meaning of Section 422 of the Code, or any successor provision, and that otherwise satisfies the requirements of that section.
- (21) “NMD Participant” shall mean a Nonmanagement Director who has been granted an Award under Article VI or Article VII.
- (22) “Nonmanagement Director” shall mean a member of the Board who is not an officer or employee of Fannie Mae.
- (23) “Nonqualified Stock Option” shall mean an Option that is not an Incentive Stock Option.

- (24) “*NYSE*” shall mean the New York Stock Exchange.
- (25) “*Option*” shall mean an option to purchase shares of Common Stock pursuant to an Award.
- (26) “*Participant*” shall mean a Nonmanagement Director who has been granted an Award under the Plan or an Eligible Employee who has been granted an Award under the Plan.
- (27) “*Performance Share Award*” shall mean an Award granted under Section 5.1.
- (28) “*Permitted Transferee*” shall mean (i) any Immediate Family Member with respect to the Participant, and (ii) in the case of an Eligible Employee, any organization described in Section 170(c) of the Code that is eligible to receive tax-deductible, charitable contributions or any intermediary designated to exercise an Option for the benefit of such organization.
- (29) “*Personal Representative*” shall mean the person or persons who, upon the incompetence of a Participant or Permitted Transferee, shall have acquired, by legal proceeding or power of attorney, the power to exercise the rights under the Plan, and who shall have become the legal representative of the Participant or Permitted Transferee, or, in the event of the death of the Participant or the Permitted Transferee, the executor or administrator of the estate of the Participant or Permitted Transferee.
- (30) “*Plan*” shall mean this Fannie Mae Stock Compensation Plan of 2003.
- (31) “*Plan Termination Date*” shall mean the tenth anniversary of the date of the meeting at which shareholders of Fannie Mae approve the Plan.
- (32) “*QDRO*” shall mean a qualified domestic relations order as defined in Section 414(p) of the Code or Section 206(d)(3) of ERISA (to the same extent as if this Plan were subject thereto) and the applicable rules thereunder.
- (33) “*Restricted Stock*” shall mean shares or bookkeeping units of Common Stock awarded to a Participant subject to payment of the consideration, if any, and the conditions on vesting and transfer and other restrictions as are established under the Plan, for so long as such shares or units remain nonvested under the terms of the applicable Award Document.
- (34) “*Retirement*” shall mean, in the case of an Eligible Employee, separation from service with Fannie Mae under conditions entitling such Eligible Employee to an immediate annuity under the Federal National Mortgage Association Retirement Plan for Employees Not Covered Under Civil Service Retirement Law or under the Civil Service retirement law, whichever is applicable to such Eligible Employee, at or after the attainment of age 65.
- (35) “*Stand-Alone SAR*” shall mean a Stock Appreciation Right granted independently of any other Award.
- (36) “*Stock Appreciation Right*” shall mean a right pursuant to an Award to receive a number of shares of Common Stock or an amount of cash, or a combination of shares of Common Stock and cash, the aggregate amount or value of which is determined by reference to a change in the Fair Market Value of the Common Stock.
- (37) “*Stock Bonus*” shall mean an Award of shares of Common Stock under Section 5.2.
- (38) “*STSP*” shall mean the Fannie Mae Securities Transactions Supervision Program and the guidelines thereunder.
- (39) “*Subsidiary*” shall mean an organization whose employees are identified by the Board as eligible to participate in benefit plans of Fannie Mae.

- (40) “*Total Disability*” shall mean complete and permanent inability by reason of illness or accident to perform the duties of the occupation at which the Participant was employed when the illness commenced or accident occurred, as determined by Fannie Mae’s independent medical consultant.
- (41) “*Without Consideration*” shall mean, with respect to a transfer of an Option, that the transfer is being made purely as a gift or donation, with no promise or receipt of payment, goods, services or other thing of value in exchange for the Option; provided, however, if the terms of a transfer of Options to an otherwise Permitted Transferee require that, upon proper notice of exercise of such Options, (i) Fannie Mae may reduce the number of shares of Common Stock or sell such number of shares of Common Stock otherwise deliverable thereunder to the extent required to fund any additional withholding tax on behalf of the Eligible Employee necessitated by the exercise, delivering only the balance of the shares of Common Stock due upon exercise of the Option to the Permitted Transferee, and/or (ii) the Permitted Transferee sell the shares of Common Stock so received upon exercise of the Option, apply a portion of the net proceeds of the exercise to the payment of any additional taxes, fees or other costs or expenses incurred by the donor Eligible Employee in connection with or as a result of such transfer and then deliver (if an intermediary) or retain (if an organization described in Section 170(c) of the Code) the remaining net proceeds from such sales of shares of Common Stock, the transfer shall nevertheless continue to be Without Consideration for the purposes hereof. A distribution of an Option by an entity or trust described in Section 1.2(19)(iv) or (v) to an owner or beneficiary thereof shall be treated as a transfer Without Consideration.

1.3 Administration and Authorization; Power and Procedure.

- (a) *The Committee.* The Plan shall be administered by, and all Awards to Eligible Employees shall be authorized by, the Committee, unless otherwise required by law or regulation. Action of the Committee with respect to the administration of the Plan shall be taken by majority vote or unanimous written consent of the respective members.
- (b) *Plan Awards; Interpretation; Powers.* Subject to the express provisions of the Plan, the Committee shall have the authority:
- (i) to determine the Eligible Employees who will receive an Award;
 - (ii) to grant an Award to such Eligible Employees, to determine the amount of and the price at which shares of Common Stock will be offered or awarded, to determine the other specific terms and conditions of such Award consistent with the express limits of the Plan, to establish the installments (if any) in which such Award shall become exercisable or shall vest, and to establish the expiration date and the events of termination of such Award;
 - (iii) to construe and interpret the Plan and any Award Documents, to further define the terms used in the Plan, and to prescribe, amend and rescind rules and regulations relating to the administration of the Plan;
 - (iv) to cancel, modify or waive Fannie Mae’s rights with respect to, or modify, discontinue, suspend or terminate, an Award being granted or an outstanding Award granted to or held by an Eligible Employee, subject to any required consents under Section 8.5;
 - (v) as part of any Eligible Employee’s employment agreement approved by the Committee, to modify or change an Award;
 - (vi) to accelerate the vesting of, extend the ability to exercise, or extend the term of an Award being granted or an outstanding Award; and

- (vii) to make all other determinations and take such other actions as contemplated by the Plan or as may be necessary or advisable for the administration of the Plan and the effectuation of its purposes.

Notwithstanding the foregoing, the provisions of Articles VI and VII (except Sections 6.7 and 7.5) relating to Nonmanagement Director Awards shall be automatic and, to the maximum extent possible, self-effectuating. Ministerial, non-discretionary actions with respect to implementation of the Plan shall be performed by individuals who are officers or employees of Fannie Mae at the direction of the senior ranking officer in the Human Resources department of Fannie Mae. The senior ranking officer in the Human Resources department of Fannie Mae may also direct that certain administrative functions shall be performed by service providers outside of Fannie Mae.

- (c) *Binding Determinations.* Any action taken by, and any inaction of, Fannie Mae, any Subsidiary, the Board, the Committee or the Benefit Plans Committee relating or pursuant to the Plan shall be within the absolute discretion of that entity or body and shall be conclusive and binding upon all persons. Subject only to compliance with the express provisions of the Plan, the Board, the Committee and the Benefit Plans Committee may act in their absolute discretion in matters within their authority related to this Plan.
 - (d) *Reliance on Experts.* In making any determination or in taking or not taking any action under the Plan, the Board, the Committee and the Benefit Plans Committee may obtain and may rely upon the advice of experts, including professional advisors to Fannie Mae.
 - (e) *Delegation.* The Committee may delegate, subject to such terms and conditions as it may impose, some or all of its authority under the Plan to one or more members of the Board or, for Awards to Eligible Employees below the rank of Senior Vice President, to the senior-ranking officer in the Human Resources department. In addition, the Committee may delegate ministerial, non-discretionary functions to individuals who are officers, employees, contractors or vendors of Fannie Mae.
 - (f) *No Liability.* No member of the Board, the Committee or the Benefit Plans Committee, or director, officer or employee of Fannie Mae or any Subsidiary shall be liable, responsible or accountable in damages or otherwise for any determination made or other action taken or any failure to act by such person in connection with the administration of the Plan, so long as such person is not determined by a final adjudication to be guilty of willful misconduct with respect to such determination, action or failure to act.
 - (g) *Indemnification.* To the extent permitted by law, each of the members of the Board, the Committee and the Benefit Plans Committee and each of the directors, officers and employees of Fannie Mae and any Subsidiary shall be held harmless and be indemnified by Fannie Mae for any liability, loss (including amounts paid in settlement), damages or expenses (including reasonable attorneys' fees) suffered by virtue of any determinations, acts or failures to act, or alleged acts or failures to act, in connection with the administration of the Plan so long as such person is not determined by a final adjudication to be guilty of willful misconduct with respect to such determination, action or failure to act.
- 1.4 *Participation.* Awards may be granted by the Committee to Eligible Employees. An Eligible Employee who has been granted an Award may be granted, if otherwise eligible, additional Awards if the Committee shall so determine. Nonmanagement Directors shall be eligible to receive Awards granted automatically under Sections 6.2 and 7.2 and Awards granted under Sections 6.7 and 7.5.

1.5 *Shares Available for Awards.*

- (a) *Common Stock.* Subject to the provisions of Section 8.2, the shares of Common Stock that may be delivered under this Plan shall be shares of Fannie Mae's authorized but unissued Common Stock, shares of Common Stock held by Fannie Mae as treasury shares or shares of Common Stock purchased by Fannie Mae on the open market.
- (b) *Number of Shares.* Subject to adjustments in accordance with Section 8.2, the maximum number of shares of Common Stock that may be delivered under Awards granted to Eligible Employees and Nonmanagement Directors under the Plan shall not exceed 40,000,000 shares.
- (c) *Calculation of Available Shares and Replenishment.* A good faith estimate of the number of shares of Common Stock subject to outstanding Awards that will be satisfied by delivery of shares of Common Stock, plus the number of shares of Common Stock referenced in calculating an Award paid in cash, shall be reserved from the number of shares of Common Stock available for Awards under the Plan. The aggregate number of shares of Common Stock delivered under the Plan plus the number of shares of Common Stock referenced with respect to Awards paid in cash shall reduce the number of shares of Common Stock remaining available for Awards under the Plan. If any Award shall expire or be canceled or terminated without having been exercised in full, or any Common Stock subject to a Restricted Stock Award or other Award shall not vest or be delivered, the unpurchased, nonvested or undelivered shares of Common Stock subject thereto or the shares of Common Stock referenced with respect thereto shall again be available under the Plan. In the case of Awards granted in combination such that the exercise of one results in a proportionate cancellation of the other, the number of shares of Common Stock reserved for issuance shall be the greater of the number that would be reserved if one or the other alone were outstanding. If Fannie Mae withholds shares of Common Stock pursuant to Section 8.4, the number of shares of Common Stock that would have been deliverable with respect to an Award but that are withheld pursuant to the provisions of Section 8.4 shall be treated as delivered, and the aggregate number of shares of Common Stock deliverable with respect to the applicable Award and under the Plan shall be reduced by the number of shares of Common Stock so withheld, and such withheld shares shall not be available for additional Awards.

1.6 *Grant of Awards.* Subject to the express provisions of the Plan, the Committee shall determine the number of shares of Common Stock subject to each Award, the price (if any) to be paid for such shares or Award and other terms and conditions of the Award. Each Award to an Eligible Employee shall be evidenced by an Award Document, which, if required by the Committee, shall be signed by the Eligible Employee. Awards are not restricted to any specified form or structure and may include, without limitation, the types of Awards set forth in Articles II, III, IV and V or, without limitation, any other transfers of Common Stock or any options or warrants to acquire shares of Common Stock, or any similar right with value related to or derived from the value of Common Stock, as may be determined by the Committee. An Award may consist of one such benefit, or two or more of them in any combination or alternative.

1.7 *Award Period.* Each Award and all executory rights or obligations under the related Award Document shall expire on such date (if any) as shall be determined by the Committee.

1.8 *Limitations on Exercise and Vesting of Awards.*

- (a) *Provisions for Exercise.* An Award shall be exercisable or shall vest as determined by the Committee.

- (b) *Procedure.* Any exercisable Award shall be exercised when the person appointed by the Committee or the Committee's designee receives written notice of exercise from the Participant or by any other method, including in electronic form, approved by the Committee, together with satisfactory arrangements for any required payment to be made in accordance with Sections 2.2 or 8.4 or the terms of the Award Document, as the case may be.
- (c) *Fractional Shares.* Fractional share interests shall be disregarded, but may be accumulated, or the Committee may determine that cash will be paid or transferred in lieu of any fractional share interests.

1.9 *Transferability.*

- (a) *General Restrictions.* Awards may be exercised only by the Participant; the Participant's Personal Representative, if any; the Participant's Beneficiary, if the Participant has died; the recipient of an Award by will or the laws of descent and distribution or, in the case of a Nonqualified Stock Option, pursuant to a QDRO; in the case of a Nonqualified Stock Option, a person who was a Permitted Transferee at the time the Option was transferred to such person; a Permitted Transferee's Personal Representative, if any; or a Permitted Transferee's Beneficiary, if the Permitted Transferee has died. Amounts payable or shares of Common Stock issuable under an Award shall be paid to (or registered in the name of) the person or persons specified by the person exercising the Award. Other than (i) by will or the laws of descent and distribution or, in the case of a Nonqualified Stock Option, pursuant to a QDRO or (ii) to a Permitted Transferee in the case of any Nonqualified Stock Option and (subject to (b), (c), (d), and (e) below), no right or benefit under this Plan or any Award, whether vested or not vested, shall be transferable by a Participant or Permitted Transferee or shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance or charge (other than to Fannie Mae), and any such attempted action shall be void. Fannie Mae shall disregard any attempt at transfer, assignment or other alienation prohibited by the preceding sentences and shall pay or deliver such cash or shares of Common Stock only in accordance with the provisions of this Plan. The designation of a Beneficiary hereunder shall not constitute a transfer for these purposes.
- (b) *Tax Withholding.* An Eligible Employee may not transfer Options ("Transferred Options") to a Permitted Transferee, other than a charitable organization described in Section 1.2(28)(ii), unless the Eligible Employee agrees to retain, and not to exercise until the exercise of the Transferred Options, at least 50 percent of the exercisable Options held by the Eligible Employee with the same exercise price and expiration date as the Transferred Options. The condition set forth in the first sentence of this Section 1.9(b), however, may be waived at any time by (A) the Chairman of the Committee in the case of an Eligible Employee who is either a member of the Board or the senior-ranking officer in the Human Resources department of Fannie Mae, or (B) the senior-ranking officer in the Human Resources department of Fannie Mae in the case of any other Eligible Employee, and, as a condition of such waiver, the Chairman of the Committee or the senior-ranking officer in the Human Resources department of Fannie Mae, as the case may be, may specify other steps that the Eligible Employee must take to provide for the collection by Fannie Mae of all federal, state, local and other taxes required by law to be withheld upon the exercise of such Transferred Options.
- (c) *Notice of Transfer.* A transfer of an Option to a Permitted Transferee shall not be effective unless, prior to making the transfer, the transferor (i) provides written notice of the transfer to (A) the Chairman of the Committee in the case of a transfer by a Participant who is either a member of the Board, the senior-ranking officer in the Human Resources department of Fannie Mae or the General Counsel of Fannie Mae (or a transfer by a Permitted Transferee of an Option originally granted to a member of the Board or to

the senior-ranking officer in the Human Resources department of Fannie Mae), or (B) the senior-ranking officer in the Human Resources department of Fannie Mae in the case of any other transfer, and (ii) certifies in writing to the Chairman of the Committee or the senior-ranking officer in the Human Resources department of Fannie Mae, as the case may be, that the transfer will be Without Consideration.

- (d) *Approval of Transfer.* A transfer of an Option to a charitable organization described in section 1.2(28)(ii) shall not be effective unless, after receiving the notice described in (c) above, the Chairman of the Committee or, after consultation with the General Counsel of Fannie Mae, the senior-ranking officer in the Human Resources department of Fannie Mae, as the case may be, either approves the proposed transfer in writing or does not disapprove the proposed transfer in writing within ten business days after receipt of such notice. The Chairman of the Committee or, after consultation with the General Counsel of Fannie Mae, the senior-ranking officer in the Human Resources department of Fannie Mae, as the case may be, may disapprove a proposed transfer if he or she determines, in his or her good faith judgment, that (i) the proposed Permitted Transferee has philosophies, purposes, policies, objectives, goals or practices inconsistent with those of Fannie Mae or (ii) the Participant has not taken such steps as may be necessary or appropriate to provide for the collection by Fannie Mae of all federal, state, local and other taxes required by law to be withheld upon exercise of the Option.
- (e) *Transfer of Nonvested Options.* A nonvested Option may be transferred only to an Immediate Family Member described in section 1.2(28)(i) and only with the prior consent of (A) the Chairman of the Committee in the case of a Participant who is either a member of the Board, the senior-ranking officer in the Human Resources department of Fannie Mae or the General Counsel of Fannie Mae, or (B) after consultation with the General Counsel, the senior-ranking officer in the Human Resources department of Fannie Mae, after consultation with the General Counsel of Fannie Mae, in the case of any other Participant.

1.10 *Section 83(b) Elections.* If a Participant shall file an election with the Internal Revenue Service under Section 83(b) of the Code to include the value of any Award in the Participant's gross income while the Award remains subject to restrictions, the Participant shall promptly furnish Fannie Mae with a copy of such election.

II. Options

2.1 *Grants.* One or more Options may be granted under this Article II to any Eligible Employee. Each Option granted may be either an Incentive Stock Option or a Nonqualified Stock Option.

2.2 *Option Price.*

- (a) *Pricing Limits.* The exercise price for shares of Common Stock covered by an Option shall be determined by the Committee at the time of the Award, but shall not be less than 100 percent of the Fair Market Value of the Common Stock on the Award Date. Notwithstanding any provision of the Plan, an Option may not be modified so as to reduce the exercise price of the Option.
- (b) *Payment Provisions.* The exercise price for any shares of Common Stock purchased on exercise of an Option granted under this Article II shall be paid in full at the time of each exercise in one or a combination of the following methods: (i) by electronic funds transfer; (ii) by check payable to the order of Fannie Mae; (iii) by notice and third party payment; (iv) by the delivery of shares of Common Stock already owned by the Participant; or (v) by cashless exercise, or any other method, if permitted by law and authorized by the Committee, in its discretion, or specified in the applicable Award Document; provided, however, that the Committee, in its discretion, may limit the

Participant's ability to exercise an Option by delivering shares of Common Stock, including by imposing a requirement that the Participant satisfy a minimum holding period with respect to the shares so delivered. Shares of Common Stock used to satisfy the exercise price of an Option shall be valued at their Fair Market Value on the date of exercise.

2.3 *Limitations on Incentive Stock Options.* There shall be imposed in any Award Document relating to Incentive Stock Options such terms and conditions as from time to time are required in order that the Option be an "incentive stock option" as that term is defined in Section 422 of the Code, or any successor provision.

2.4 *Option Period.*

- (a) *Award Period.* Each Option shall specify the Award Period for which the Option is granted and shall provide that the Option shall expire at the end of such Award Period. The Committee may extend the Award Period by amendment of an Option or in an Eligible Employee's employment agreement approved by the Committee. Notwithstanding the foregoing, the Award Period with respect to an Incentive Stock Option, including all extensions, shall not exceed ten years.
- (b) *Effect of Termination of Employment.* Notwithstanding the provisions of Section 2.4(a), unless otherwise provided by the Committee or in an Eligible Employee's employment agreement approved by the Committee, (i) for a Participant whose employment is terminated for any reason other than for Cause, Retirement, Early Retirement, Total Disability, death or having attained at least age 55 with at least five years of service and is not covered by Section 2.5(d), an Option shall expire on the earlier to occur of (A) the end of the Award Period or (B) the date three months following the Participant's termination of employment, (ii) for a Participant whose employment is terminated and is covered by Section 2.5(d), an Option shall expire on the earlier to occur of (A) the end of the Award Period or (B) the date 12 months following the Participant's termination of employment, (iii) for a Participant whose employment is terminated by reason of Retirement, Early Retirement, Total Disability, death or having attained at least age 55 with at least five years of service, an Option shall expire on the end of the Award Period and (iv) for a Participant whose employment is terminated by Fannie Mae for Cause, an Option shall expire upon the Participant's termination.
- (c) *Death of Permitted Transferee.* Unless otherwise provided by the Committee, an Option held by a Permitted Transferee shall expire on the earlier of the date on which it would expire pursuant to Section 2.4(a) or (b) or the date 12 months following the Permitted Transferee's death.

2.5 *Vesting; Forfeiture.*

- (a) *Vesting Generally.* An Option shall be exercisable and vested upon such terms and conditions or pursuant to such schedule as the Committee shall determine. Except as otherwise provided in this Section 2.5 or unless otherwise specified by the Committee or in an Eligible Employee's employment agreement approved by the Committee, an Option that is not vested upon a Participant's termination of employment shall be forfeited. If a Participant's employment is terminated by Fannie Mae for Cause, an Option that is not vested upon the Participant's termination shall be forfeited.
- (b) *Change in Control.* The Committee, in its discretion, may grant Options that by their terms shall become immediately exercisable and fully vested upon a Change in Control Event.
- (c) *Retirement, Early Retirement, Total Disability or Death.* Unless otherwise specified by the Committee, an Option shall become immediately exercisable and fully vested upon the Participant's Total Disability or the Participant's termination of employment by reason of Retirement, Early Retirement or death.

(d) *Vesting Upon Termination with Separation Agreements.* Notwithstanding the foregoing, (i) for a Participant who, prior to the termination of employment, executes a separation agreement with Fannie Mae pursuant to Fannie Mae's Voluntary Separation Agreement program ("VSA") or Voluntary Separation Option program ("VSO"), one-half of the portion of each Award that would have vested within 12 months of the date of such Participant's termination of employment shall become immediately exercisable and fully vested upon the Participant's termination; (ii) for a Participant who accepts Fannie Mae's offer to terminate employment voluntarily and, prior to such termination, executes a separation agreement with Fannie Mae pursuant to an Elective Severance Window under the Federal National Mortgage Association Discretionary Severance Benefit Plan, the portion of each Award that would have vested within 12 months of the date of such Participant's termination of employment by Fannie Mae, and one-half of the portion of each Award that would have vested within 13-24 months of the date of termination, shall become immediately exercisable and fully vested upon termination; and (iii) for a Participant who, prior to the termination of his or her employment, executes a separation agreement with Fannie Mae pursuant to a Displacement Program under the Federal National Mortgage Association Discretionary Severance Benefit Plan or pursuant to the Fannie Mae Individual Severance Plan, the portion of each Award that would have vested within 12 months of the date of termination of employment shall become immediately exercisable and fully vested upon the Participant's termination. If the Committee approves an employment agreement with an Eligible Employee that provides for vesting of certain Awards upon the employee's termination, such Awards shall vest in accordance with the terms of such Eligible Employee's employment agreement.

(e) *"EPS Challenge Grants."* Section 2.5(d) shall not apply to Options granted under the "EPS Challenge Grant" program established by the Board on January 18, 2000 or, if so provided by the Committee, to Options granted under other special incentive Option programs.

2.6 *Option Amendments or Waiver of Restrictions.* Subject to Sections 1.5 and 8.5 and the specific limitations on Awards contained in the Plan, the Committee from time to time may authorize, generally or in specific cases only, for the benefit of any Participant who is an Eligible Employee, any adjustment in the vesting schedule, the restrictions upon or the term of an Award granted under this Article II by amendment, waiver or other legally valid means. The amendment or other action may provide, among other changes, for a longer or shorter vesting or exercise period.

2.7 *Gain Deferral.* Any Participant who is eligible to participate in the Fannie Mae Stock Option Gain Deferral Plan may elect to exercise a Nonqualified Stock Option under the provisions of such plan.

III. Stock Appreciation Rights

3.1 *Grants.* In its discretion, the Committee may grant to any Eligible Employee Stock Appreciation Rights either concurrently with the grant of another Award or in respect of an outstanding Award, in whole or in part, or may grant to any Eligible Employee Stand-Alone SARs. Any Stock Appreciation Right granted in connection with an Incentive Stock Option shall contain such terms as may be required to comply with the provisions of Section 422 of the Code (or any successor provision). Each Stand-Alone SAR shall specify the Award Period for which the Stand-Alone SAR is granted and shall provide that the Stand-Alone SAR shall expire at the end of such Award Period. The Committee may extend the Award Period by amendment of a Stand-Alone SAR.

3.2 *Exercise of Stock Appreciation Rights.*

(a) *Related Awards.* Unless the Award Document or the Committee otherwise provides, a Stock Appreciation Right related to another Award shall be exercisable at such time or times, and to the extent, that the related Award shall be exercisable.

- (b) *Stand-Alone SARs.* Stand-Alone SARs shall be exercisable and vest upon such terms and conditions or pursuant to such schedule as the Committee shall determine at the time of the Award. Unless otherwise provided by the Committee or in an Eligible Employee's employment agreement approved by the Committee, (i) in the case of a Participant's termination of employment for Cause, Stand-Alone SARs shall expire and no longer be exercisable upon the Participant's termination; (ii) in the case of a Participant's Total Disability or a Participant's termination of employment by reason of Retirement, Early Retirement or death or having attained at least age 55 with at least five years of service, Stand-Alone SARs shall become immediately exercisable and fully vested upon the Participant's Total Disability or termination of employment, and Stand-Alone SARs shall expire and no longer be exercisable at the end of the Award Period; and (iii) in the case of a Participant's termination of employment for any reason other than for Cause, Retirement, Early Retirement, Total Disability or death or having attained at least age 55 with at least five years of service, Stand-Alone SARs shall expire and no longer be exercisable on the earlier to occur of (A) the end of the Award Period or (B) the date three months following the Participant's termination. The Committee, in its discretion, may grant Stand-Alone SARs that by their terms shall become immediately exercisable and fully vested upon a Change in Control Event.

3.3 *Payment.*

- (a) *Amount.* Unless the Committee otherwise provides, upon exercise of a Stock Appreciation Right and surrender of the appropriate exercisable portion of any related Award, the Participant shall be entitled to receive payment of an amount determined by multiplying
- (i) the difference obtained by subtracting the exercise price per share of Common Stock under the related Award (if applicable) or the initial share value specified in the Award from the Fair Market Value on the date of exercise, by
 - (ii) the number of shares of Common Stock with respect to which the Participant is exercising the Stock Appreciation Right.
- (b) *Form of Payment.* The Committee, in its discretion, shall determine the form in which payment shall be made of the amount determined under paragraph (a) above, which may be solely in cash, solely in shares of Common Stock (valued at their Fair Market Value on the date of exercise of the Stock Appreciation Right), or partly in shares and partly in cash. If the Committee permits the Participant to elect to receive cash or shares of Common Stock (or a combination thereof) on such exercise, any such election shall be subject to such conditions as the Committee may impose.

IV. Restricted Stock Awards

- 4.1 *Grants.* The Committee, in its discretion, may grant one or more Restricted Stock Awards to any Eligible Employee. Each Restricted Stock Award Document shall specify the number of shares or units of Common Stock to be issued to the Participant, the date of such issuance, the consideration for the Restricted Stock, if any, to be paid by the Participant, the restrictions imposed on the Restricted Stock, and the conditions of release or lapse of such restrictions. Promptly after the lapse of restrictions on Restricted Stock, shares of Common Stock equal to the number of shares or units as to which the restrictions have lapsed (or such lesser number as may be permitted pursuant to Section 8.4) shall be delivered or credited to the Participant or other person entitled under the Plan to receive the shares. The Participant or such other person shall deliver to Fannie Mae such further assurance and documents as the Committee may require.

4.2 *Restrictions.*

- (a) *Pre-Vesting Restraints.* Except as provided in Section 1.9, shares or units of Restricted Stock may not be sold, assigned, transferred, pledged or otherwise disposed of or encumbered, either voluntarily or involuntarily, until the restrictions have lapsed.

- (b) *Dividend and Voting Rights.* Unless otherwise provided in the applicable Award Document, a Participant receiving shares (but not units) of Restricted Stock shall be entitled to cash dividend and voting rights for all shares of Common Stock issued even though they are not vested, provided that such rights shall terminate immediately as to any shares of Restricted Stock that cease to be eligible for vesting. If provided in the applicable Award Document, a Participant receiving units of Restricted Stock shall be entitled to cash dividend and voting rights for such units even though they are not vested, provided that such rights shall terminate immediately as to any units of Restricted Stock that cease to be eligible for vesting.
- (c) *Accelerated Vesting.* Unless otherwise provided by the Committee or in an Eligible Employee's employment agreement approved by the Committee, the restrictions on Restricted Stock shall lapse upon the Participant's Total Disability or termination of employment by reason of Retirement, Early Retirement, or death, and, if provided in the applicable Award Document, restrictions on Restricted Stock held for more than one year from the Award Date by Participants shall lapse upon a Change in Control Event.
- (d) *Vesting Upon Termination with Separation Agreements.* Notwithstanding the foregoing, (i) for a Participant who, prior to the termination of employment, executes a separation agreement with Fannie Mae pursuant to Fannie Mae's Voluntary Separation Agreement program ("VSA") or Voluntary Separation Option program ("VSO"), one-half of the portion of each Award of Restricted Stock that would have vested within 12 months of the date of such Participant's termination of employment shall become fully vested upon the Participant's termination; (ii) for a Participant who accepts Fannie Mae's offer to terminate employment voluntarily and, prior to such termination, executes a separation agreement with Fannie Mae pursuant to an Elective Severance Window under the Federal National Mortgage Association Discretionary Severance Benefit Plan, the portion of each Award of Restricted Stock that would have vested within 12 months of the date of such Participant's termination of employment by Fannie Mae, and one-half of the portion of each Award of Restricted Stock that would have vested within 13-24 months of the date of termination, shall become fully vested upon termination; and (iii) for a Participant who, prior to the termination of his or her employment, executes a separation agreement with Fannie Mae pursuant to a Displacement Program under the Federal National Mortgage Association Discretionary Severance Benefit Plan or pursuant to the Fannie Mae Individual Severance Plan, the portion of each Award of Restricted Stock that would have vested within 12 months of the date of termination of employment shall become fully vested upon the Participant's termination. If the Committee approves an employment agreement with an Eligible Employee that provides for vesting of certain Awards upon the employee's termination, such Awards shall vest in accordance with the terms of such Eligible Employee's employment agreement.
- (e) *Forfeiture.* Unless otherwise provided by the Committee or in an Eligible Employee's employment agreement approved by the Committee, Restricted Stock as to which the restrictions have not lapsed in accordance with the provisions of the Award or pursuant to Section 4.2(c) shall be forfeited upon a Participant's termination of employment. Upon the occurrence of any forfeiture of Restricted Stock, the forfeited Restricted Stock shall be automatically transferred to Fannie Mae without payment of any consideration by Fannie Mae and without any action by the Participant.

V. Performance Share Awards and Stock Bonuses

5.1 Grants of Performance Share Awards.

- (a) The Committee, in its discretion, may grant Performance Share Awards to Eligible Employees. An Award shall specify the maximum number of shares of Common Stock (if any) subject to the Performance Share Award and its terms and conditions. The Committee shall establish the specified period (a "performance cycle") for the

Performance Share Award and the measure(s) of the performance of Fannie Mae (or any part thereof) or the Eligible Employee. The Committee, during the performance cycle, may make such adjustments to the measure(s) of performance as it may deem appropriate to compensate for, or reflect, any significant changes that may occur in accounting practices, tax laws and other laws or regulations that alter or affect the computation of the measure(s). The Award Document shall specify how the degree of attainment of the measure(s) over the performance cycle is to be determined.

- (b) In its discretion, the Committee may grant Performance Share Awards which, by their terms, provide that, upon a Change in Control Event, payments shall be made with respect to a Performance Share Award held for more than one year from the Award Date by an Eligible Employee, based on the assumption that the performance achievement specified in the Award would have been attained by the end of the performance cycle. If the Committee approves an employment agreement with an Eligible Employee that provides for payments with respect to a Performance Share Award upon the employee's termination, payments shall be made with respect to such Performance Share Awards in accordance with the terms of such Eligible Employee's employment agreement.
- (c) Unless otherwise provided by the Committee or in an Eligible Employee's employment agreement approved by the Committee, if an Eligible Employee's employment is terminated because of Retirement, Total Disability or Early Retirement prior to the end of the performance cycle, but at least 18 months after the first day of the performance cycle, such Eligible Employee shall receive a pro rata Performance Share Award, calculated as if the Eligible Employee were employed by Fannie Mae at the end of the performance cycle but adjusted to reflect the portion of the performance cycle in which the Participant actually was employed by Fannie Mae, payable in full as soon as practicable after the end of the performance cycle.
- (d) Unless otherwise provided by the Committee or in an Eligible Employee's employment agreement approved by the Committee, if an Eligible Employee's employment is terminated because of the Eligible Employee's death prior to the end of the performance cycle, but at least 18 months after the first day of the performance cycle, the Eligible Employee shall receive a pro rata Performance Share Award, payable in full as soon as practicable after the Eligible Employee's death, in an amount that is based upon the Committee's assessment of the likelihood of Fannie Mae's success in attaining the performance measures by the end of the performance cycle and the portion of the performance cycle during which the Eligible Employee was employed by Fannie Mae, and calculated using the date of the Eligible Employee's death as the date for establishing the Fair Market Value of such Award.
- (e) Unless otherwise provided by the Committee or in an Eligible Employee's employment agreement approved by the Committee, if, after the end of the performance cycle, an Eligible Employee's employment is terminated because of the Eligible Employee's Retirement, Total Disability, death or Early Retirement, all portions of the Eligible Employee's Performance Share Award not yet paid shall be paid in full as soon as practicable thereafter, except to the extent subject to a deferral election under Section 5.3.
- (f) Unless otherwise provided by the Committee or in an Eligible Employee's employment agreement approved by the Committee, any Eligible Employee who is not employed by Fannie Mae on the last day of a performance cycle or on the date of a scheduled payment of any portion of a Performance Share Award (determined without regard to any deferral election under Section 5.3), other than by reason of the Eligible Employee's Retirement, Total Disability, death or Early Retirement, shall forfeit such payment and all future payments with respect to such performance cycle.

5.2 *Grants of Stock Bonuses.* The Committee may grant a Stock Bonus to any Eligible Employee in such amounts of shares of Common Stock and on such terms and conditions as determined from time to time by the Committee.

- 5.3 *Deferred Payments.* The Committee, in its discretion, may permit any Eligible Employee to defer receipt of a Performance Share Award. Such deferral shall be subject to such further conditions, restrictions or requirements as the Committee may impose, subject to any vested rights of the Eligible Employee.

VI. Nonmanagement Director Options

- 6.1 *Participation.* Awards under this Article VI shall be made only to Nonmanagement Directors.

- 6.2 *Annual Option Grants.*

- (a) *Annual Awards.* On the first day of the Director Term in 2004 and in each subsequent year prior to the Plan Termination Date (each of which shall be the Award Date), there shall be granted automatically (without any action by the Board or the Committee) to each Nonmanagement Director then in office a Nonqualified Stock Option to purchase 4,000 shares of Common Stock. Any Nonmanagement Director appointed or elected to office during a Director Term shall be granted automatically (without any action by the Board or the Committee) a Nonqualified Stock Option (the Award Date of which shall be the date such person takes office) to purchase the nearest whole number of shares of Common Stock equal to 4,000 multiplied by the number of partial or full calendar months remaining in the Director Term in which the Award is granted divided by 12.
- (b) *Maximum Number of Shares.* Annual grants that would otherwise cause the total Awards under this Plan to exceed the maximum number of shares of Common Stock under Section 1.5(b) shall be prorated to come within such limitation.

- 6.3 *Option Price.* The exercise price per share of Common Stock covered by each Option granted under Sections 6.2 or 6.7 shall be 100 percent of the Fair Market Value on the Award Date. Notwithstanding any provision of the Plan, an Option may not be modified so as to reduce the exercise price of the Option. The exercise price of any Option granted under this Article shall be paid in full at the time of each purchase, in cash or by check or in shares of Common Stock valued at their Fair Market Value on the date of exercise of the Option, or partly in shares and partly in cash.
- 6.4 *Option Period and Ability to Exercise.* Each Option granted under Sections 6.2 or 6.7 shall provide that the Option shall expire ten years from the Award Date and shall be subject to earlier termination as provided below. Each Option granted under Sections 6.2 or 6.7 shall vest and become exercisable over a four-year period at a rate of 25 percent each year on the anniversary of the date of grant.
- 6.5 *Termination of Directorship.* If an NMD Participant's services as a member of the Board terminate for any reason, any Option granted under Sections 6.2 or 6.7 held by the NMD Participant shall immediately vest and may be exercised until the earlier of one year after the date of such termination or the expiration of the stated term of the Option.
- 6.6 *Adjustments.* Options granted under Sections 6.2 or 6.7 shall be subject to adjustment as provided in Section 8.2, but only to the extent that such adjustment is based on objective criteria and is consistent with adjustments to Options or other Awards held by persons other than Nonmanagement Directors.
- 6.7 *Additional Option Awards.* Under this Article VI, the Committee may grant additional Option Awards to Nonmanagement Directors as appropriate, based on market compensation data or other information or circumstances.

VII. Nonmanagement Director Restricted Stock

- 7.1 *Participation.* Awards under this Article VII shall be made only to Nonmanagement Directors. Neither the Plan nor any action taken under the Plan shall give any NMD Participant the right to be reappointed or renominated to serve as a member of the Board.

7.2 *Amount of Awards.* Each Nonmanagement Director who is a member of the Board immediately following the annual meeting of the shareholders of Fannie Mae in 2006 or 2010 shall be granted, immediately following such annual meeting, an Award of shares of Restricted Stock (rounded to the nearest full share) having an aggregate Fair Market Value on the date of grant equal to \$75,000 in 2006 and \$90,000 in 2010. A Nonmanagement Director who is newly appointed or elected after the annual meeting of shareholders in 2006 or 2010 shall receive an Award of shares of Restricted Stock equal to the number of shares (rounded to the nearest full share) that would have been granted to such newly appointed or elected Nonmanagement Director had he or she been a member of the Board on the date of the annual meeting of the shareholders of Fannie Mae in the year 2006 or 2010, as the case may be, multiplied by the number of partial or full calendar months remaining in the four-year Award cycle from the date of the Nonmanagement Director's appointment or election divided by 48.

7.3 *Restrictions and Vesting.*

- (a) *Pre-Vesting Restrictions.* Except as provided in Section 1.9, shares of Restricted Stock may not be sold, assigned, transferred, pledged or otherwise disposed of or encumbered, either voluntarily or involuntarily, until the restrictions have lapsed.
- (b) *Dividend and Voting Rights.* A NMD Participant receiving shares of Restricted Stock shall be entitled to cash dividend and voting rights for all shares of Common Stock issued even though they are not vested, provided that such rights shall terminate immediately as to any Restricted Stock that is forfeited under Section 7.3(e).
- (c) *Vesting.* Unless otherwise provided by the Committee for Restricted Stock granted under Section 7.5, the restrictions on Restricted Stock granted under this Article VII shall lapse as follows. On the day before each annual meeting of Fannie Mae's shareholders, each Restricted Stock Award granted to a NMD Participant under this Article VII shall vest, and the restrictions on such Restricted Stock shall lapse, at a rate of 25% per year (or by the appropriate pro-rata percentage for Nonmanagement Directors newly appointed or elected after the annual meeting in 2006 or 2010). Promptly after the lapse of restrictions on Restricted Stock, shares of Common Stock equal to the number of shares or units as to which the restrictions have lapsed (or such lesser number as may be permitted pursuant to Section 8.4) shall be delivered or credited to the NMD Participant or other person entitled under the Plan to receive the shares.
- (d) *Accelerated Vesting.* Unless otherwise provided by the Committee for Restricted Stock granted under Section 7.5, the restrictions on Restricted Stock granted under this Article VII shall lapse upon the NMD Participant's membership on the Board terminating because of (i) Total Disability, (ii) death, or (iii) as to a Nonmanagement Director who is elected to the Board by the shareholders, not being renominated after reaching age 70.
- (e) *Forfeiture.* Unless otherwise provided by the Committee for Restricted Stock granted under Section 7.5, Restricted Stock granted under Article VII as to which the restrictions have not lapsed in accordance with the provisions of the Award or pursuant to Section 7.3(c) or (d) shall be forfeited upon the termination of a NMD Participant's membership on the Board. Upon the occurrence of any forfeiture of Restricted Stock, the forfeited Restricted Stock shall be automatically transferred to Fannie Mae without payment of any consideration by Fannie Mae and without any action by the NMD Participant.

7.4 *Adjustments.* Restricted Stock granted under this Article VII shall be subject to adjustment as provided in Section 8.2, but only to the extent that such adjustment is based on objective criteria and is consistent with adjustments to Restricted Stock or other Awards held by persons other than Nonmanagement Directors.

7.5 *Additional Restricted Stock Awards.* Under this Article VII, the Committee may grant additional Restricted Stock Awards to Nonmanagement Directors as appropriate, based on market compensation data or other information or circumstances.

VIII. Other Provisions

8.1 *Rights of Eligible Employees, Participants and Beneficiaries.*

- (a) *Employment Status.* Status as an Eligible Employee shall not be construed as a commitment that any Award will be made under this Plan to an Eligible Employee or to Eligible Employees generally.
- (b) *No Employment Contract.* Nothing contained in the Plan (or in any other documents related to the Plan or to any Award) shall confer upon any Participant any right to continue in the employ or other service of Fannie Mae or constitute any contract or agreement of employment or other service, nor shall the Plan interfere in any way with the right of Fannie Mae to change such person's compensation or other benefits or to terminate the employment of such person, with or without cause; provided, however, that nothing contained in the Plan or any related document shall adversely affect any independent contractual right of any Participant without the Participant's consent.
- (c) *Plan Not Funded.* Awards payable under the Plan shall be payable in shares of Common Stock or from the general assets of Fannie Mae, and (except as provided in Section 1.5(c)) no special or separate reserve, fund or deposit shall be made to assure payment of Awards. No Participant, Beneficiary or other person shall have any right, title or interest in any fund or in any specific asset (including shares of Common Stock, except as expressly otherwise provided) of Fannie Mae by reason of any Award hereunder. Neither the provisions of the Plan (or of any related documents), nor the creation or adoption of the Plan, nor any action taken pursuant to the provisions of the Plan shall create, or be construed to create, a trust of any kind or a fiduciary relationship between Fannie Mae and any Participant, Beneficiary or other person. To the extent that a Participant, Beneficiary or other person acquires a right to receive payment pursuant to any Award hereunder, such right shall be no greater than the right of any unsecured general creditor of Fannie Mae.

8.2 *Adjustments.*

- (a) *Events Requiring Adjustments.* If any of the following events occur, the Committee shall make the adjustments described in Section 8.2(b): (i) any recapitalization, stock split (including a stock split in the form of a stock dividend), reverse stock split, reorganization, merger, combination, consolidation, split-up, spin-off, combination, repurchase or exchange of Common Stock or other securities of Fannie Mae, (ii) any issuance of warrants or other rights to purchase shares of Common Stock or other securities of Fannie Mae (other than to employees) at less than 80 percent of Fair Market Value on the date of such issuance, (iii) a sale of substantially all the assets of Fannie Mae, or (iv) any other similar corporate transaction or event with respect to the Common Stock.
- (b) *Adjustments to Awards.* If any of the events described in Section 8.2(a) occurs, then the Committee shall, in the manner and to the extent (if any) as it deems appropriate and equitable, (i) proportionately adjust any or all of (1) the number and type of shares of Common Stock that thereafter may be made the subject of Awards (including the specific maximum set forth in Section 1.5), (2) the number, amount and type of shares of Common Stock subject to any or all outstanding Awards, (3) the grant, purchase or exercise price of any or all outstanding Awards, (4) the shares of Common Stock or cash deliverable upon exercise of any outstanding Awards, or (5) the performance standards appropriate to any outstanding Awards; or (ii) make provision for a cash payment or for the substitution or exchange of any or all outstanding Awards based upon the distribution or consideration payable to holders of Common Stock upon or in respect of the event; provided, however, in each case, that with respect to Awards of Incentive Stock Options, no adjustment shall be made that would cause the Plan to violate Section 422 or 424(a) of the Code or any successor provisions thereto.

- 8.3 *Compliance with Laws.* The Plan, the granting and vesting of Awards under the Plan and the issuance and delivery of shares of Common Stock and the payment of money under the Plan or under Awards granted hereunder are subject to compliance with all applicable federal and state laws, rules and regulations (including but not limited to state and federal securities law and federal margin requirements) and to approvals by any listing, regulatory or governmental authority as may, in the opinion of counsel for Fannie Mae, be necessary or advisable in connection therewith. Any securities delivered under the Plan shall be subject to such restrictions, and the person acquiring the securities shall, if requested by Fannie Mae, provide such assurances and representations to Fannie Mae, as Fannie Mae may deem necessary or desirable to assure compliance with all applicable legal requirements.
- 8.4 *Tax Withholding.* Upon any exercise, vesting or payment of any Award or upon the disposition of shares of Common Stock acquired pursuant to the exercise of an Incentive Stock Option prior to satisfaction of the holding period requirements of Section 422 of the Code (or any successor provision), the Committee may make such provisions and take such steps as it may deem necessary or appropriate for the withholding by Fannie Mae of all federal, state, local and other taxes required by law to be withheld, including without limitation, the right, at its option, to the extent permitted by law (i) to require the Participant (or Personal Representative or Beneficiary, as the case may be) to pay or provide for payment of the amount of any taxes that Fannie Mae may be required to withhold with respect to the transaction as a condition to the release of the shares of Common Stock or the making of any payment or distribution, or (ii)(a) to deduct from any amount payable in cash, or (b) to reduce the number of shares of Common Stock otherwise deliverable (or otherwise reacquire such shares), based upon their Fair Market Value on the date of delivery, or (c) to grant the Participant the right to elect reduction in the number of shares upon such terms and conditions as it may establish for the amount of any taxes that Fannie Mae may be required to withhold.
- 8.5 *Plan Amendment, Termination and Suspension.*
- (a) *Board Authorization.* Subject to this Section 8.5, the Board may, at any time, terminate or amend, modify or suspend the Plan, in whole or in part. No Awards may be granted during any suspension of the Plan or after termination of the Plan, but the Committee shall retain jurisdiction as to Awards then outstanding in accordance with the terms of the Plan.
 - (b) *Shareholder Approval.* If any amendment would (i) materially increase the benefits accruing under the Plan, or (ii) materially increase the aggregate number of shares of Common Stock that may be issued under the Plan (except as provided in Section 8.2), then to the extent deemed necessary or advisable by the Board or as required by law or the rules of the NYSE, such amendment shall be subject to shareholder approval.
 - (c) *Amendments to Awards.* Without limiting any other express authority granted under the Plan, but subject to its express limits, the Committee may waive conditions of or limitations on Awards, without the consent of the Participant, and may make other changes to the terms and conditions of Awards that do not affect the Participant's rights and benefits under an Award in any materially adverse manner.
 - (d) *Limitations on Amendments to Plan and Awards.* No amendment, suspension or termination of the Plan or any change affecting any outstanding Award shall, without the written consent of the Participant, Beneficiary or Personal Representative, as applicable, affect in any manner materially adverse to such person any rights or benefits of any such person or any obligations of Fannie Mae under any Award granted under the Plan prior to the effective date of such change; however, any changes made pursuant to Section 8.2 shall not be deemed to constitute changes or amendments for purposes of this Section 8.5.

- 8.6 *Privileges of Stock Ownership.* Except as otherwise expressly authorized by the Committee or the Plan and expressly stated in an Award Document, a Participant shall not be entitled to any privilege of stock ownership as to any shares of Common Stock not actually delivered to and held of record by the Participant. No adjustment shall be made for dividends or other shareholder rights for which a record date is prior to the date of delivery of such shares.
- 8.7 *Effective Date of the Plan.* The Plan shall be effective as of the date of the meeting at which the shareholders of Fannie Mae approve it.
- 8.8 *Term of the Plan.* Except for any Award pursuant to Section 7.2 granted to a Nonmanagement Director who is newly appointed or elected to the Board during the 2010-2014 cycle, no Award shall be granted after the Plan Termination Date. Unless otherwise expressly provided in the Plan or in an applicable Award Document, any Award may extend beyond the Plan Termination Date, and all authority of the Committee with respect to Awards hereunder shall continue during any suspension of the Plan and in respect of Awards outstanding on the Plan Termination Date.
- 8.9 *Governing Law/Construction/Severability.*
- (a) *Choice of Law.* The Plan, the Awards, all documents evidencing Awards, and all other related documents shall be governed by, and construed in accordance with the laws of the District of Columbia, without reference to its principles of conflicts of law.
 - (b) *Severability.* If any provision shall be held by a court of competent jurisdiction to be invalid and unenforceable, the remaining provisions of the Plan shall continue in effect.
- 8.10 *Captions.* Captions and headings are given to the sections and subsections of the Plan solely as a convenience to facilitate reference. The headings shall not be deemed in any way material or relevant to the construction or interpretation of the Plan or of its provisions.
- 8.11 *Effect of Change of Subsidiary Status.* For purposes of the Plan and any Award, if an entity ceases to be a Subsidiary, the employment of all Participants who are employed by such entity shall be deemed to have terminated, except any Participant who continues as an employee of another entity within Fannie Mae.
- 8.12 *Nonexclusivity of Plan.* Nothing in the Plan shall limit or be deemed to limit the authority of the Board or the Committee to grant awards or authorize any other compensation, with or without reference to the Common Stock, under any other plan or authority.
- 8.13 *Plan Binding on Successors.* The obligations of Fannie Mae under the Plan shall be binding upon any successor corporation or organization resulting from the merger, consolidation or other reorganization of Fannie Mae, or upon any successor corporation or organization succeeding to substantially all of the assets and business of Fannie Mae. Fannie Mae agrees that it will make appropriate provisions for the preservation of all Participants' rights under the Plan in any agreement or plan that it may enter into or adopt to effect any such merger, consolidation, reorganization or transfer of assets.

**COMPUTATION OF RATIO OF EARNINGS TO COMBINED FIXED CHARGES
AND PREFERRED STOCK DIVIDENDS**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Income before federal income taxes	\$ 1,102	\$ 1,464	\$ 3,042	\$ 2,672
Add:				
Provision for federal income taxes	263	485	970	848
Interest expense on all indebtedness	9,091	10,214	18,619	20,360
Earnings, as adjusted	<u>\$10,456</u>	<u>\$12,163</u>	<u>\$22,631</u>	<u>\$23,880</u>
Fixed charges:				
Interest expense on all indebtedness	\$ 9,091	\$10,214	\$18,619	\$20,360
Preferred stock dividends	34	24	64	57
Fixed charges including preferred stock dividends	<u>\$ 9,125</u>	<u>\$10,238</u>	<u>\$18,683</u>	<u>\$20,417</u>
Ratio of earnings to combined fixed charges and preferred dividends	<u>1.15:1</u>	<u>1.19:1</u>	<u>1.21:1</u>	<u>1.17:1</u>

CERTIFICATION

PURSUANT TO SECURITIES EXCHANGE ACT RULE 13a-14

I, Franklin D. Raines, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fannie Mae (formally, the Federal National Mortgage Association);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) [paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986]
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's control over internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2003

/s/ FRANKLIN D. RAINES

Franklin D. Raines
Chairman of the Board of Directors and
Chief Executive Officer

CERTIFICATION

PURSUANT TO SECURITIES EXCHANGE ACT RULE 13a-14

I, J. Timothy Howard, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fannie Mae (formally, the Federal National Mortgage Association);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) [paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986]
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's control over internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2003

/s/ J. TIMOTHY HOWARD

J. Timothy Howard
Vice Chairman and Chief Financial Officer

**Certification by the Chief Executive Officer
Pursuant to 18 U.S.C. Section 1350,
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

Pursuant to 18 U.S.C. Section 1350, I, Franklin D. Raines, hereby certify that, to the best of my knowledge,

- (a) the Quarterly Report of Fannie Mae (formally, the Federal National Mortgage Association) on Form 10-Q for the quarterly period ended June 30, 2003 (the "Report"), as filed with the Securities and Exchange Commission on August 14, 2003, fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, and
- (b) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Fannie Mae.

/s/ Franklin D. Raines
Franklin D. Raines
Chairman of the Board of Directors
and Chief Executive Officer

August 14, 2003

**Certification by the Chief Financial Officer
Pursuant to 18 U.S.C. Section 1350,
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

Pursuant to 18 U.S.C. Section 1350, I, J. Timothy Howard, hereby certify that, to the best of my knowledge,

- (a) the Quarterly Report of Fannie Mae (formally, the Federal National Mortgage Association) on Form 10-Q for the quarterly period ended June 30, 2003 (the "Report"), as filed with the Securities and Exchange Commission on August 14, 2003, fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, and
- (b) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Fannie Mae.

/s/ J. Timothy Howard
J. Timothy Howard
Vice Chairman and Chief Financial Officer

August 14, 2003