

Arlington Asset Investment Corp.  
Form 10-K  
February 09, 2015

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

**FORM 10-K**

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2014**

**OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from            to**

**Commission File Number: 001-34374**

**ARLINGTON ASSET INVESTMENT CORP.**

(Exact name of registrant as specified in its charter)

<b>Virginia</b>	<b>54-1873198</b>
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

**1001 Nineteenth Street North,  
Arlington, VA 22209  
(Address of Principal Executive Offices) (Zip Code)  
(703) 373-0200**



(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of Each Class of Securities</b>	<b>Name of Each Exchange on Which Registered</b>
Class A Common Stock, Par Value \$0.01	New York Stock Exchange
6.625% Senior Notes due 2023	New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act:  
Yes o No ☒ x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act: Yes o No ☒ x

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 ☒ x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files): Yes ☒ x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K: ☒ x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer o Accelerated Filer ☒ x Non-Accelerated Filer o Smaller Reporting Company o



Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes  
o No ☒ x

The aggregate market value of the registrant's Class A and Class B common stock held by non-affiliates computed by reference to the last reported price at which the registrant's Class A common stock was sold on the New York Stock Exchange on June 30, 2014 was approximately \$516 million. There is no public trading market for the registrant's Class B common stock; however, the Class B common stock is convertible into Class A common stock on a share-for-share basis.

As of January 30, 2015, there were 22,860,922 shares of the registrant's Class A common stock outstanding and 105,869 shares of the registrant's Class B common stock outstanding.

**Documents incorporated by reference:** Portions of the registrant's Definitive Proxy Statement for the 2015 Annual Meeting of Shareholders (to be filed with the Securities and Exchange Commission no later than 120 days after the end of the registrant's fiscal year end) are incorporated by reference in this Annual Report on Form 10-K in response to Part II, Item 5 and Part III, Items 10, 11, 12, 13 and 14.



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## CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING INFORMATION

When used in this Annual Report on Form 10-K, in future filings with the Securities and Exchange Commission (SEC) or in press releases or other written or oral communications, statements which are not historical in nature, including those containing words such as “believe,” “expect,” “anticipate,” “estimate,” “plan,” “continue,” “intend,” “should,” similar expressions, are intended to identify “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and, as such, may involve known and unknown risks, uncertainties and assumptions. The forward-looking statements we make in this Annual Report on Form 10-K include, but are not limited to, statements about the following:

the availability and terms of, and our ability to deploy, capital and our ability to grow our business through a strategy focused on acquiring primarily residential mortgage-backed securities (MBS) that are either issued by U.S. government agencies or guaranteed as to principal and interest by U.S. government agencies or U.S. government sponsored agencies (agency-backed MBS), and MBS issued by private organizations (private-label MBS);

our ability to forecast our tax attributes, which are based upon various facts and assumptions, and our ability to protect and use our net operating losses (NOLs), and net capital losses (NCLs), to offset future taxable income, including whether our shareholder rights plan (Rights Plan) will be effective in preventing an ownership change that would significantly limit our ability to utilize such losses;

our business, acquisition, leverage, asset allocation, operational, investment, hedging and financing strategies and the success of these strategies;

- the effect of changes in prepayment rates, interest rates and default rates on our portfolio;
  - the effect of governmental regulation and actions;
  - our ability to quantify and manage risk;
  - our ability to realize any reflation of our assets;
- our ability to roll our repurchase agreements on favorable terms, if at all;
  - our liquidity;



- our asset valuation policies;
- our decisions with respect to, and ability to make, future dividends;
- investing in assets other than MBS or pursuing business activities other than investing in MBS;

our ability to maintain our exclusion from the definition of “investment company” under the Investment Company Act of 1940, as amended (the 1940 Act);

- our decision not to elect to be taxed as a REIT under the Internal Revenue Code; and
- the effect of general economic conditions on our business.

Forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account information currently in our possession. These beliefs, assumptions and expectations may change as a result of many possible events or factors, not all of which are known to us or are within our control. If a change occurs, the performance of our portfolio and our business, financial condition, liquidity and results of operations may vary materially from those expressed, anticipated or contemplated in our forward-looking statements. You should carefully consider these risks, along with the following factors that could cause actual results to vary from our forward-looking statements, before making an investment in our securities:

the overall environment for interest rates, changes in interest rates, interest rate spreads, the yield curve and prepayment rates;

• current conditions and further adverse developments in the residential mortgage market and the overall economy;

- potential risk attributable to our mortgage-related portfolios, including changes in fair value;

our use of leverage and our dependence on repurchase agreements and other short-term borrowings to finance our mortgage-related holdings;

- the availability of certain short-term liquidity sources;

competition for investment opportunities, including competition from the U.S. Department of Treasury (U.S. Treasury) and the U.S. Federal Reserve, for investments in agency-backed MBS, as well as the termination by the U.S. Federal Reserve of its purchases of agency-backed MBS;



the federal conservatorship of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the federal government;

- mortgage loan prepayment activity, modification programs and future legislative action;

changes in our acquisition, hedging and leverage strategies, changes in our asset allocation and changes in our operational policies, all of which may be changed by us without shareholder approval;



• failure of sovereign or municipal entities to meet their debt obligations or a downgrade in the credit rating of such debt obligations;

- fluctuations of the value of our hedge instruments;
- fluctuating quarterly operating results;
- changes in laws and regulations and industry practices that may adversely affect our business;
- volatility of the securities markets and activity in the secondary securities markets;
- our ability to successfully expand our business into areas other than investing in MBS; and

the other important factors identified in this Annual Report on Form 10-K under the caption “Item 1A — Risk Factors.”

These and other risks, uncertainties and factors, including those described elsewhere in this Annual Report on Form 10-K, could cause our actual results to differ materially from those projected in any forward-looking statements we make. All forward-looking statements speak only as of the date on which they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.



## **ITEM 1. BUSINESS**

Unless the context otherwise requires or indicates, all references in this Annual Report on Form 10-K to “we,” “us,” “our,” the “Company,” “AAIC,” and “Arlington Asset” refer to Arlington Asset Investment Corp. and its consolidated subsidiaries.

### **Our Company**

Arlington Asset Investment Corp. is a principal investment firm that currently acquires and holds primarily mortgage-related assets and holds certain other assets. We acquire residential mortgage-backed securities (MBS), either issued by U.S. government agencies or guaranteed as to principal and interest by U.S. government agencies or U.S. government-sponsored entities (agency-backed MBS). We also acquire MBS issued by private organizations (private-label MBS), subject to maintaining our exemption from regulation as an investment company under the Investment Company Act of 1940, as amended (1940 Act). In the future, we may acquire and hold other types of assets, including commercial MBS, asset backed securities, other structured securities, commercial mortgage loans, commercial loans, residential mortgage loans, and other real estate-related loans and securities. In addition, we also may pursue other business activities that will utilize our experience in analyzing investment opportunities and applying similar portfolio management skills.

We are a Virginia corporation and taxed as a C corporation for federal income tax purposes. We operate in the United States.

Our principal executive offices are located at Potomac Tower, 1001 Nineteenth Street North, Arlington, Virginia 22209.

### **Investment Strategy**

We manage our portfolio of mortgage holdings with the goal of obtaining a high risk-adjusted return on capital. Historically, based on market conditions, we believe our MBS assets have provided us with higher relative risk-adjusted rates of return than most other portfolio opportunities we have evaluated. Consequently, we have maintained a high allocation of our assets and capital in this sector and have continued to analyze other opportunities and compare risk-adjusted returns to our MBS assets.



During 2014, our principal investing strategy was to acquire and hold fixed-rate agency-backed MBS that we believed exhibited prepayment protection and fixed- and adjustable-rate, private-label MBS. Although the interest rate (or coupon) on adjustable-rate MBS changes over time, there are aspects of this class of security that result in the coupon being fixed for a period of time or the change in the coupon being limited. We will seek to maintain a certain level of whole-pool agency-backed MBS, due to our view of the long-term attractiveness of the asset class and for purposes of our exemption under the 1940 Act.

We evaluate the rates of return that can be achieved in each asset class and for each individual security within an asset class in which we participate. We then evaluate opportunities against the returns available in each of our investment alternatives and attempt to allocate our assets and capital with an emphasis toward what we believe to be the highest risk-adjusted return available. We expect this strategy will cause us to have different allocations of capital and leverage in different market environments.

We may change our acquisition strategy, leverage strategy, hedging strategy, asset allocation and operational policies at any time without the consent of our shareholders, which could result in our making investments or hedges that are different from, and possibly riskier than, the investments and hedges described in this Annual Report on Form 10-K. A change in our investment, funding or hedging strategy may increase our exposure to interest rate and real estate market fluctuations. Our Board of Directors oversees our operational policies, including those with respect to our acquisitions, growth, operations, indebtedness, capitalization and variable distributions, or approves transactions that deviate from these policies, without a vote of, or notice to, our shareholders. Operational policy changes could adversely affect the market value of our capital stock and our ability to make distributions to our shareholders.

Liquidity, or ready access to funds, is essential to our business. Liquidity is of particular importance to our business and perceived liquidity issues may affect our counterparties' willingness to engage in transactions with us. Our liquidity could be impaired due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects us or third parties. Further, our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time or the market is experiencing significant volatility. If we cannot obtain funding from third parties or from our subsidiaries, our results of operations could be negatively impacted. For a discussion of other factors that could affect our liquidity, see "Item 1A — Risk Factors" in this Annual Report on Form 10-K.

## **MBS Portfolio**

As of December 31, 2014, the fair value of our MBS portfolio was \$3.7 billion. The yield on our MBS for the year ended December 31, 2014 was 4.34%, including 10.08% on private-label MBS, with a corresponding cost of funds related to repurchase agreements of 0.37%. The yield on our MBS is calculated based upon the adjusted par value, which includes the effects of any other-than-temporary impairment charges recorded by us and an adjustment for any principal and interest for which collection is not probable. The yield on our MBS based on unadjusted par value was 4.30% for the year ended December 31, 2014.







The following table summarizes our principal investing portfolio including principal receivable on MBS, as of December 31, 2014 (dollars in thousands):

	Face Amount	Fair Value
Trading		
Agency-backed MBS		
Fannie Mae	\$ 1,923,588	\$ 2,064,465
Freddie Mac	1,260,088	1,349,835
Available-for-sale		
Agency-backed MBS		
Fannie Mae	36	40
Private-label MBS		
Senior securities	—	—
Re-REMIC securities	353,237	267,437
Other mortgage related assets	63,232	212
Total	\$ 3,600,181	\$ 3,681,989

### ***Agency-Backed MBS***

We acquire direct interests in residential MBS guaranteed as to principal and interest by Fannie Mae or Freddie Mac (referred to as agency-backed MBS). The market value of these securities, however, is not guaranteed by these companies. The following is a description of the agency-backed MBS we currently own and may acquire in the future:

***Fannie Mae MBS.*** The Federal National Mortgage Association (Fannie Mae) is a privately-owned, government-sponsored corporation organized and existing under the Federal National Mortgage Association Charter Act. Fannie Mae provides funds to the mortgage market primarily by purchasing home mortgage loans from local lenders, thereby replenishing their funds for additional lending. Fannie Mae guarantees to registered holders of Fannie Mae certificates that it will distribute amounts representing scheduled principal and interest (at the rate provided by the Fannie Mae certificate) on the mortgage loans in the pool underlying the Fannie Mae certificate, whether or not received, and the full principal amount of any mortgage loan foreclosed or otherwise finally liquidated, whether or not the principal amount is actually received by Fannie Mae.

***Freddie Mac MBS.*** The Federal Home Loan Mortgage Corporation (Freddie Mac) is a privately-owned, government-sponsored enterprise created pursuant to Title III of the Emergency Home Finance Act of 1970. Freddie Mac's principal activities currently consist of the purchase of mortgage loans or participation interests in mortgage loans and the resale of the loans and participations in the form of guaranteed MBS. Freddie Mac guarantees to holders of Freddie Mac certificates the timely payment of interest at the applicable pass-through rate and ultimate collection of all principal on the holder's pro rata share of the unpaid principal balance of the underlying mortgage loans, but does not guarantee the timely payment of scheduled principal on the underlying mortgage loans.



Between 2007 and 2011, Fannie Mae and Freddie Mac reported substantial losses and a need for significant amounts of additional capital. In response to the deteriorating financial condition of Fannie Mae and Freddie Mac and the overall credit market disruption, Congress and the U.S. Treasury undertook a series of actions to stabilize these U.S. government-sponsored entities (GSEs) and the financial markets, generally. In July 2008, the U.S. government passed the Housing and Economic Recovery Act of 2008 (HERA), which established the Federal Housing Finance Agency (FHFA), with enhanced regulatory authority over, among other things, the business of Fannie Mae and Freddie Mac. In September 2008, the FHFA placed Fannie Mae and Freddie Mac into conservatorship and, together with the U.S. Treasury, established a program designed to boost investor confidence in Fannie Mae's and Freddie Mac's debt and MBS. In addition to the FHFA becoming the conservator of Fannie Mae and Freddie Mac, the U.S. Treasury has taken steps to capitalize and provide financing to Fannie Mae and Freddie Mac. The FHFA, together with the U.S. Treasury and the U.S. Federal Reserve, has also undertaken actions designed to boost investor confidence in Fannie Mae and Freddie Mac, support the availability of mortgage financing and protect taxpayers. Despite these government actions to capitalize and provide financing to Fannie Mae and Freddie Mac, there can be no assurance that these actions will be adequate for their needs. If these actions are inadequate, Fannie Mae and Freddie Mac could continue to suffer losses and could fail to honor their guarantees and other obligations. If Fannie Mae and Freddie Mac were unable to satisfy their obligations, distributions to holders of Fannie Mae and Freddie Mac certificates would consist solely of payments and other recoveries on the underlying mortgage loans and, accordingly, defaults and delinquencies on the underlying mortgage loans would adversely affect monthly distributions to holders of these certificates. For additional discussion of how the changes to the roles of Fannie Mae and Freddie Mac and related governmental actions may adversely affect our business, see "Item 1A — Risk Factors" in this Annual Report on Form 10-K.

The securities issued by Fannie Mae and Freddie Mac are not rated by any rating agency; however, they are commonly thought of as having an implied rating of "AAA." There is no assurance, particularly given the downgrade of the U.S. credit rating to "AA+" by Standard & Poor's during the quarter ended September 30, 2011 and Fitch Ratings Inc.'s announcement on October 15, 2013 that it had placed the U.S. credit rating on negative watch (although this negative watch was changed to "stable" on March 21, 2014) that these securities would receive such a rating if they were ever rated by a rating agency. For a discussion of the risks relating to credit ratings, see "Item 1A — Risk Factors" in this Annual Report on Form 10-K.



### ***Private-Label MBS***

We also acquire and hold non-agency, or private-label, MBS. Private-label MBS are MBS that are not issued or guaranteed by a U.S. government agency or a GSE, such as Fannie Mae or Freddie Mac. The private-label MBS in which we invest are generally backed by a pool of single-family residential mortgage loans. These certificates are issued by originators of, investors in, and other owners of residential mortgage loans, including savings and loan associations, savings banks, commercial banks, mortgage banks, investment banks and special purpose “conduit” subsidiaries of these institutions. While agency-backed MBS are backed by the express obligation or guarantee of Fannie Mae or Freddie Mae as described above, private-label MBS are generally supported by one or more forms of private (*i.e.*, non-governmental) credit enhancement. These credit enhancements provide an extra layer of loss coverage in the event that losses are incurred upon foreclosure sales or other liquidations of underlying mortgaged properties in amounts that exceed the equity holder’s equity interest in the property. Forms of credit enhancement include limited issuer guarantees, reserve funds, private mortgage guaranty pool insurance, overcollateralization and subordination. We may purchase private-label MBS without private credit enhancement. Subordination is a form of credit enhancement frequently used and involves the issuance of classes of senior and subordinated MBS to allocate losses on the underlying mortgage loans. Typically, one or more classes of senior MBS were created during the securitization process, which were generally initially rated in one of the two highest rating levels by one or more nationally recognized rating agencies. However, as of December 31, 2014, these MBS are generally rated below investment grade or unrated. The following is a description of the various private-label MBS we currently own or we may acquire in the future:

***Residential Prime Senior MBS.*** Residential prime securities are MBS backed by prime residential mortgage loans. We believe prime residential mortgage loans were generally high credit-quality loans, and generally had balances greater than conforming loan limits. Prime securities were typically backed by loans that had relatively high weighted average FICO scores (700 or higher), low weighted average loan-to-value ratios (75% or less), limited concentrations of investor properties, and a low percentage of loans with low FICO scores or high loan-to-value ratios at origination. Senior securities are those interests in a securitization that have the first right to cash flows and are last in line to absorb losses, and therefore have the least credit risk in a securitization transaction. To further reduce credit risk, most, if not all, principal collected from the underlying asset pool is used to pay down the senior securities until certain performance tests are satisfied. If certain performance tests are satisfied, principal payments are allocated, generally on a pro rata basis, between the senior securities and the subordinated securities.

***Residential Non-Prime Senior MBS.*** Residential non-prime securities are MBS backed by non-prime residential mortgage loans. Non-prime residential loans included Alt-A loans, which generally had higher credit quality than subprime and lower credit quality than prime loans. Alt-A loans originally represented loans with alternative documentation, but the definition has shifted over time to include loans with additional risk characteristics and a higher percentage of investor loans. In an Alt-A loan, the borrower’s income may not be verified, and in some cases, may not be disclosed on the loan application. Alt-A loans may also have expanded criteria that allow for higher debt-to-income ratios with higher accompanying loan-to-value ratios than would otherwise be permissible for prime loans. Residential non-prime senior securities are those interests in a securitization that have the first right to cash flows and are last in line to absorb losses. Delinquencies are expected to be higher than the prime senior MBS; however, the levels of credit and structural support are also higher and, as a result, the non-prime senior MBS is expected to better withstand the higher levels of credit losses than subordinate securities of the same securitization.



Credit support is the face amount of securities subordinate to the applicable security that protects the security from credit losses and is generally expressed as a percentage of the securitization's underlying pool balance.

*Residential Subordinate MBS.* Subordinate securities are the interests in a securitization that are not senior interests. The most subordinate securities are those interests in a securitization that have the last right to cash flows and are first in line to absorb losses. Subordinate securities absorb the initial credit losses from a securitization structure, thus protecting the senior securities. Subordinate securities have a lower priority to receive principal and interest payments than the senior securities. Subordinate securities receive few, if any, principal payments until certain performance tests are satisfied. If certain performance tests are satisfied, principal payments are shared between the senior securities and the subordinated securities. Subordinate securities generally receive interest payments even if they do not receive principal payments. Residential subordinate securities can be backed by prime and non-prime residential loans.

*Residential Re-REMIC Support MBS.* A re-REMIC MBS is a re-securitization of MBS. Depending on the structure of the re-REMIC MBS, the cash flows from, and any credit losses absorbed by, the underlying MBS are allocated among the re-REMIC MBS issued in the re-securitization transaction in a variety of ways. For instance, when one or more prime residential senior securities are pooled and securitized to create a two-tranche structure with a re-REMIC senior security and a re-REMIC support security, all principal payments from the underlying senior securities are directed to the re-REMIC senior security until its face value is zero. Thereafter, all principal payments are directed to the re-REMIC support security. Credit losses, if any, are first absorbed by the re-REMIC support security; however, these credit losses occur only when credit losses exceed the credit protection provided to the underlying senior securities by the subordinate securities within their respective securitization structures. Both the re-REMIC senior security and the re-REMIC support security generally receive interest while any face value is outstanding.



MBS differ from other forms of traditional fixed-income securities which normally provide for periodic payments of interest in fixed amounts with principal payments at maturity. Instead, MBS provide for a monthly payment that consists of both interest and principal. In effect, these payments are a “pass-through” of the monthly interest and principal payments made by borrowers on their mortgage loans, net of any fees paid to the servicer or guarantor of the MBS. In addition, outstanding principal on the MBS may be prepaid at any time due to prepayments on the underlying mortgage loans. These differences can result in significantly greater price and yield volatility than is the case with more traditional fixed-income securities. Whole mortgage loans and other mortgage assets share many of the characteristics of MBS.

### **Use of Leverage**

Because of the credit and interest rate risks inherent in our strategy, we closely monitor the leverage (debt-to-equity ratio) of our MBS portfolio. However, from time to time, the leverage may increase or decrease due to several factors, including changes in the value of the underlying portfolio holdings and the timing and amount of acquisitions or asset sales.

We may reduce the amount of equity capital we have invested in agency-backed MBS or other mortgage assets by funding a portion of those acquisitions with repurchase agreements or other borrowing arrangements, to the extent available on favorable terms or at all. To the extent that revenue derived from those assets exceeds our interest expense and other costs of the financing, our net income will be greater than if we had not borrowed funds and had not invested in the assets. Conversely, if the revenue from our MBS and other mortgage assets does not sufficiently cover the interest expense and other costs of the financing, our net income will be less or our net loss will be greater than if we had not borrowed funds.

We currently use repurchase agreements to finance our investments in MBS. When we engage in a repurchase transaction, we initially sell securities to the transaction counterparty under a master repurchase agreement in exchange for cash from the counterparty. The counterparty is obligated to resell the same securities back to us at the end of the term of the repurchase agreement, which typically is 30 to 90 days, but may be up to one year. These transactions are accounted for as secured financings, and we present the investment securities and related funding on our consolidated balance sheet. We believe the current financial environment is primarily driven by the U.S. government’s current policy of monetary easing although, as discussed later in this Annual Report on Form 10-K, this policy is gradually being reduced by the U.S. government. Funding for agency-backed MBS through repurchase agreements continues to remain available to us at rates we consider to be attractive from multiple counterparties, and we have observed increased availability for funding for private-label MBS through repurchase agreements.

### **Hedging and Interest Rate and Prepayment Risk Management Strategy**



We follow an interest rate risk management program intended to protect our MBS portfolio against the effects of major interest rate changes. As part of our overall portfolio risk management, we analyze interest rate changes and prepayment trends separately and collectively to assess their effects on our investment portfolio. Generally, our interest rate risk management program is formulated with the intent to mitigate the potential adverse effects resulting from differences in the amount and timing of rate adjustment to our assets versus those affecting our corresponding liability. We attempt to hedge a portion of our exposure to interest rate fluctuations associated with our agency-backed MBS primarily through the use of Eurodollar futures, interest rate swap futures and U.S. Treasury note futures. Our agency-backed MBS hedging strategy includes an element of reliance on coupon repricing of assets in addition to hedging our liability cost.

Additionally, our interest rate risk management program may encompass from time to time a number of procedures including structuring some borrowings to have interest rate adjustment indices and interest rate adjustment periods that, on an aggregate basis, generally correspond to the interest rate adjustment indices and interest rate adjustment periods of our adjustable-rate MBS and other mortgage assets.

We adjust the average maturity and interest rate adjustment periods of our borrowings on an ongoing basis by changing the mix of maturities and interest rate adjustment periods as borrowings come due and are renewed. Through use of these procedures, we attempt to minimize the differences between the interest rate adjustment periods of our MBS and other mortgage assets and related borrowings that may occur.

We primarily use Eurodollar futures contracts to mitigate the risk of the cost of our variable rate liabilities. From time-to-time, we have purchased and may in the future continue to purchase U.S. Treasury futures, interest rate swaps, interest rate collars, interest rate caps or floors, forward sales, and similar financial instruments to attempt to mitigate the risk of the cost of our variable rate liabilities increasing at a faster rate than the yield on our assets during a period of rising interest rates or to mitigate prepayment risk. It is not our policy to use derivatives to speculate on interest rates. These derivative instruments have an active secondary market and are intended to provide income and cash flow to offset potential reduced interest income and cash flow under certain interest rate environments. We reported the derivative financial instruments and any related margin accounts on our consolidated balance sheets at their fair value. We may hedge as much of the interest rate risk as our management determines is in our best interests, given the cost of the hedging transactions. This determination may result in our electing to bear a level of interest rate or prepayment risk that could otherwise be hedged when management believes, based on all relevant facts, that the cost of hedging exceeds the level of risk that management believes is present.

We seek to build a balance sheet and undertake an interest rate risk management program that we believe are likely to generate positive earnings and maintain an equity liquidation value sufficient to maintain operations given a variety of potential environments. Our interest rate risk management strategies also provide support for our leverage strategies. In determining our target leverage, we monitor, among other things, our “duration.” This is the expected percentage change in market value of our assets that would be caused by a 1% change in short and long-term interest rates. To monitor duration and the related risks of fluctuations in the liquidation value of our equity, we model the impact of various economic scenarios on the market value of our MBS and other mortgage assets and liabilities. See the additional discussion of interest rate risk relative to our leveraged portfolio of MBS and other mortgage assets included in “Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Quantitative and Qualitative Disclosures about Market Risk” in this Annual Report on Form 10-K. We



believe that our interest rate risk management program will allow us to maintain operations throughout a wide variety of potentially adverse circumstances. Nevertheless, in order to further preserve our capital base during periods when we believe a trend of rapidly rising interest rates has been established, we may decide to enter into or increase hedging activities or to sell assets. Each of these actions may lower our earnings and dividends in the short term to further our objective of maintaining attractive levels of earnings and dividends over the long term. There is no assurance, however, that any of these strategies will be successful.



We seek to purchase fixed-rate agency-backed MBS that exhibit some form of prepayment protection. Prepayment protection can take many forms but includes (i) agency-backed MBS backed by mortgage loans that are originated in certain states or through the Home Affordable Modification Program or some other government program, or (ii) high loan-to-value ratio loans. These loans are believed to have less incentive to prepay and will result in lower overall prepayments in MBS backed by these types of loans. In 2013 and 2014, we purchased many of our agency-backed MBS backed by higher concentration of loans that fall within these categories. We cannot be assured that prepayments will not increase in the future if government refinance programs target a much broader borrower base. We believe that we maintain a cost-effective asset/liability management program to provide a level of protection against interest rate and prepayment risks. However, no strategy can completely insulate us from interest rate changes and prepayment risks. In addition, asset/liability management involves transaction costs which increase dramatically as the period covered by the hedging protection increases. Therefore, we may be unable to hedge effectively our interest rate and prepayment risks.

### **Credit Risk Management**

Although we do not expect to encounter credit risk in our agency-backed MBS portfolio assuming Fannie Mae and Freddie Mac remain solvent, we are exposed to credit risk in our private-label MBS portfolio. With respect to our private-label MBS, credit support contained in these MBS deal structures provides a level of protection from losses, as do the discounted purchase prices in the event of the return of less than 100% of par. We also evaluate the impact of credit risk on our investments through a comprehensive investment review and selection process, which is predominantly focused on quantifying and pricing credit risk. We review our private-label MBS based on quantitative and qualitative analysis of the risk-adjusted returns on such investments. Through modeling and scenario analysis, we seek to evaluate each investment's credit risk. Credit risk is also monitored through our ongoing asset surveillance. Despite these measures to manage credit risk, unanticipated credit losses could nevertheless occur, which could adversely impact our operating results.

### **Compliance, Legal, Risk Management and Internal Audit**

In conducting our business, we are exposed to a range of risks including, without limitation:

*Market risk.* Market risk is the risk to our earnings or capital resulting from adverse changes in the values of assets resulting from movement in market interest rates, equity prices, as well as market expectations concerning the underlying assets.

- *Interest rate risk.* Interest rate risk is the risk of loss resulting from changes in interest rates and the resulting changes in our cash flows, including prepayments. Another component of interest rate risk is the risk to our earnings or capital resulting from adverse changes in the values of assets due to a change in the



level of market interest rates, as well as market expectations concerning the underlying assets.

*Prepayment risk.* Prepayment risk is the risk related to the early unscheduled payment of principal on our MBS portfolio. The effective yield over the remaining life of a security cannot be known for certain as the actual cash flow is not known. With the early payment of principal, we will not earn future interest income on that portion of the principal; therefore, decreasing the yield we had expected to earn at the time of purchase.

*Credit risk.* Credit risk is the risk of loss due to a borrower's or institutional counterparty's unwillingness or inability to pay its obligations.

*Operations risk.* Operations risk is the risk of loss resulting from systems failure, inadequate controls, human error, fraud or unforeseen catastrophes.

*Liquidity risk.* Liquidity risk is the risk that we may be unable to meet our obligations as they come due because of our inability to liquidate assets or obtain funding. Liquidity risk also includes the risk of having to sell assets at a loss to generate liquid funds.

*Regulatory risk.* Regulatory risk is the risk of loss, including fines, penalties or restrictions in our activities from failing to comply with current or future federal, state or local laws (including federal and state securities laws), and rules and regulations pertaining to financial services activities, including the loss of our exclusion from regulation as an investment company under the 1940 Act.

*Legal risk.* Legal risk is the risk of loss, disruption or other negative effect on our operations or condition that arises from unenforceable contracts, lawsuits, adverse judgments, or adverse governmental or regulatory actions or proceedings, or the threat thereof.

*Reputational risk.* Reputational risk is the risk that negative publicity regarding our business, whether true or not, will reduce our revenues or result in costly litigation.

*Equity ownership risk.* Equity ownership risk arises from making equity investments that create an ownership interest in portfolio companies, and is a combination of credit, market, operational, liquidity, compliance and reputation risks.



For a detailed discussion of the material risks facing our company, see “Item 1A — Risk Factors” in this Annual Report on Form 10-K.

We are responsible for our compliance procedures with regard to the legal and regulatory requirements of our Company and our operating businesses and for our procedures with regard to our exposure to market, interest rate, prepayment, credit, operations, liquidity, regulatory, legal, reputational and equity ownership risk. In addition, our internal audit personnel (staffed through an external third-party service firm) test and audit for compliance by our personnel with our policies and procedures. Our outside legal counsel also provides legal service to our company, including advice on managing legal risk. The supervisory personnel in these areas have direct access to, and meet regularly with, our executive management and with the Audit Committee of our Board of Directors to ensure their independence in performing these functions. Pursuant to its charter, the Audit Committee has oversight of the staffing, qualifications and performance of our internal audit function. In addition to our internal compliance and risk management personnel, we outsource certain functions to outside consultants and attorneys for their expertise.

Our risk management program is designed to focus on the following:

- identifying, assessing and reporting on risk exposures and trends;
- establishing and revising as necessary policies, procedures and risk limits;
- monitoring and reporting on adherence with risk policies and limits;
- developing and applying new measurement methods to the risk process as appropriate; and
- approving new business initiatives.

Although we believe that our risk management program and our internal controls are appropriately designed to address the risks to which we are exposed, we cannot provide assurance that our risk management program or our internal controls will prevent or reduce such risks. For additional discussion of our strategy for managing interest rate risk, prepayment risk and credit risk, see “— Hedging and Interest Rate and Prepayment Risk Management Strategy” and “— Credit Risk Management” above.

#### **Accounting, Administration and Operations**



Our accounting, administration and operations personnel are responsible for financial controls, internal and external financial reporting, human resources and personnel services, office operations, information technology and telecommunications systems, the processing of securities transactions, and corporate communications. With the exception of payroll processing and information technology support services, which are performed by outside service providers, most data processing functions are performed internally.

## **Competition**

Our success depends, in large part, on our ability to acquire MBS at favorable spreads over our borrowing costs. In acquiring these assets, we compete with mortgage finance and specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, mortgage real estate investment trusts (REITs), investment banking firms, other lenders, governmental bodies and other entities. In addition, there are numerous entities with similar asset acquisition objectives and others may be organized in the future. The effect of the existence of additional entities may be to increase competition for the available supply of agency-backed MBS, including collateralized mortgage obligations (CMOs), private-label MBS and other mortgage-related assets suitable for purchase by us. Moreover, our success depends on our ability to acquire MBS issued by Fannie Mae or Freddie Mac, and we cannot predict what role Fannie Mae and Freddie Mac will play in the future housing market. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be considerably limited relative to historical measurements. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes an agency security and could have broad adverse market implications and significant implications for our own business. In addition, competition is also intense for the recruitment and retention of qualified professionals. Our ability to continue to compete effectively in our businesses will depend upon our continued ability to attract new professionals and retain and motivate our existing professionals. For a further discussion of the competitive factors affecting our business, see “Item 1A — Risk Factors” in this Annual Report on Form 10-K.

## **Our Tax Status**

We are subject to corporate income tax on our taxable income that is not offset by our NOL and NCL carry-forwards. Even though we are able to use NOL and NCL carry-forwards against our taxable income, we still have some tax liability that is attributable to federal alternative minimum tax and state and local taxes. On December 31, 2014, \$50.8 million of our NCL carry-forwards expired without being utilized, which left us with \$140.5 million of NCL carry-forwards and \$147.1 million of NOL carry-forwards at December 31, 2014. Our remaining NCL carry-forwards are available to offset taxable capital gains through 2019, and our NOL carry-forwards will begin to expire in 2027 (see Note 6 to our consolidated financial statements included in “Item 8 — Financial Statements and Supplementary Data”).

Our ability to use our NOL and NCL carry-forwards to offset future taxable income would be severely limited if we experienced an “ownership change” under Sections 382 and 383 of the Internal Revenue Code of 1986, as amended (the Code). We adopted our shareholder rights plan (the Rights Plan) on June 1, 2009 in an effort to protect against the occurrence of an “ownership change.” The Rights Plan is intended to act as a deterrent to any person or group acquiring



4.9% or more of our outstanding Class A common stock (an Acquiring Person) without the approval of our Board of Directors. Our Rights Plan, however, does not protect against all transactions that could cause an ownership change, such as dispositions by existing 5% shareholders and transactions in our Class B common stock. Accordingly, we may experience an “ownership change” that would severely limit our ability to use our NOL and NCL carry-forwards.



## **Our Exclusion from Regulation as an Investment Company**

We intend to operate so as to be excluded from regulation under the 1940 Act. We rely on Section 3(c)(5)(C) of the 1940 Act, which provides an exclusion for entities that are “primarily engaged in purchasing or otherwise acquiring . . . interests in real estate.” Section 3(c)(5)(C) provides an exclusion from registration for a company if at least 55% of its assets, on an unconsolidated basis, consist of qualified assets such as whole loans and whole pool agency certificates, and if at least 80% of its assets, on an unconsolidated basis, are real estate related assets. We will need to ensure not only that we qualify for an exclusion or exemption from regulation under the 1940 Act, but also that each of our subsidiaries qualifies for such an exclusion or exemption. We intend to maintain our exclusion by monitoring the value of our interests in our subsidiaries. We may not be successful in this regard.

If we fail to maintain our exclusion or secure a different exclusion or exemption if necessary, we may be required to register as an investment company, or we may be required to acquire or dispose of assets in order to meet our exemption. Any such asset acquisitions or dispositions may include assets that we would not acquire or dispose of in the ordinary course of business, may be at unfavorable prices and result in a decline in the price of our common stock. If we are required to register under the 1940 Act, we would become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with affiliated persons (as defined in the 1940 Act), and portfolio composition, including restrictions with respect to diversification and industry concentration and other matters. Accordingly, registration under the 1940 Act could limit our ability to follow our current investment and financing strategies and result in a decline in the price of our common stock.

## **Available Information**

You may read and copy the definitive proxy materials and any other reports, statements or other information that we file with the SEC at the SEC’s public reference room at 100 F Street, N.E., Washington, DC 20549. You may call the SEC at 1-800-SEC-0330 for further information on the public reference room. Our SEC filings are also available to the public from commercial document retrieval services and at the Internet worldwide web site maintained by the SEC at <http://www.sec.gov>. These SEC filings may also be inspected at the offices of the New York Stock Exchange (NYSE), which is located at 20 Broad Street, New York, New York 10005.

Our website address is <http://www.arlingtonasset.com>. We make available free of charge through our website this Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as well as the annual report to shareholders and Section 16 reports on Forms 3, 4 and 5 as soon as reasonably practicable after such documents are electronically filed with, or furnished to, the SEC. In addition, our Bylaws, Statement of Business Principles (our code of ethics), Corporate Governance Guidelines, and the charters of our Audit, Compensation, and Nominating and Governance Committees are available on our website and are available in print, without charge, to any shareholder upon written request in writing c/o our Secretary at 1001 Nineteenth Street North, Arlington, Virginia 22209.



Information on our website should not be deemed to be a part of this report or incorporated into any other filings we make with the SEC.

## **Employees**

As of December 31, 2014, we had 11 employees. Our employees are not subject to any collective bargaining agreement, and we believe that we have good relations with our employees.



## ITEM 1A. RISK FACTORS

*Investing in our company involves various risks, including the risk that you might lose your entire investment. Our results of operations depend upon many factors including our ability to implement our business strategy, the availability of opportunities to acquire assets, the level and volatility of interest rates, the cost and availability of short- and long-term credit, financial market conditions and general economic conditions.*

*The following discussion concerns the material risks associated with our business. These risks are interrelated, and you should consider them as a whole. Additional risks and uncertainties not presently known to us may also materially and adversely affect the value of our capital stock and our ability to pay dividends to our shareholders. In connection with the forward-looking statements that appear in this Annual Report on Form 10-K, including these risk factors and elsewhere, you should carefully review the section entitled “Cautionary Statement About Forward-Looking Information.”*

### **Risks Related to our Principal Investing Activities**

***The U.S. Federal Reserve’s recent conclusion of its monthly purchases pursuant to QE3 could impact the market for and value of the agency-backed MBS in which we invest as well as our net asset value and net interest margin.***

On September 13, 2012, the U.S. Federal Reserve announced a third round of quantitative easing, or QE3, which was an open-ended program designed to expand the U.S. Federal Reserve’s holdings of long-term securities by purchasing an additional \$40 billion of agency-backed MBS per month until key economic indicators, such as the unemployment rate, show signs of improvement. On December 18, 2013, the U.S. Federal Reserve announced that it would reduce its purchases of agency-backed MBS by \$5 billion per month and reduce its purchases of U.S. Treasury bonds by \$5 billion per month beginning in January 2014.

Notwithstanding the October 2014 conclusion to discontinue these purchases, the U.S. Federal Reserve continues to reinvest principal and interest payments from its holdings of longer-term U.S. Treasury securities and agency-backed MBS and roll maturing Treasury securities at auction.

It is unclear what effect, if any, the absence of the Federal Reserve’s monthly purchases, other than its reinvestment of principal and interest payments it receives for agency-backed MBS in its portfolio, will have on the value of the agency-backed MBS in which we invest. However, it is possible that the market for such securities, the price of such securities and, as a result, our net asset value and net interest margin could be negatively affected.



***Changes in interest rates and adverse market conditions could negatively affect the value of our MBS investments and increase the cost of our borrowings, which could result in reduced earnings or losses and negatively affect the cash available for distribution to our shareholders.***

We acquire indirect interests in mortgage loans by purchasing MBS and we currently intend to continue this strategy. Under a normal yield curve, an investment in MBS will decline in value if long-term interest rates increase. In addition, net interest income could decrease if the yield curve becomes inverted or flat. Fannie Mae or Freddie Mac guarantees of the agency-backed MBS we own do not protect us from declines in market value caused by changes in interest rates. Declines in market value may ultimately reduce earnings or result in losses to us, which may negatively affect cash available for distribution to our shareholders.

A significant risk associated with our portfolio of mortgage-related assets is the risk that both long-term and short-term interest rates will increase significantly. If long-term rates were to increase significantly, the market value of these MBS would decline and the duration and weighted average life of the investments would increase. We could realize a loss in the future if the MBS were sold. At the same time, an increase in short-term interest rates would increase the amount of interest owed on the repurchase agreements we enter into in order to finance the purchase of MBS.

Market values of MBS may decline without any general increase in interest rates for a number of reasons, such as increases in defaults, increases in voluntary prepayments and widening of credit spreads. If the market values of our investments were to decline for any reason, the value of your investment in our capital stock could also decline.

***Hedging against interest rate exposure may not completely insulate us from interest rate risk and may adversely affect our earnings, which could adversely affect cash available for distribution to our shareholders.***

We engage in certain hedging transactions to limit our exposure to changes in interest rates and therefore may expose our company to the risks associated with such transactions. We have historically entered into and may enter into interest rate swap agreements, Eurodollar futures, swap futures or U.S. Treasury futures contracts, put options or pursue other hedging strategies. Hedging against a decline in the values of our portfolio positions does not eliminate the possibility of fluctuations in the values of such positions or prevent losses if the values of such positions decline. However, we may establish other hedging positions designed to gain from those same developments, thereby offsetting the decline in the value of such portfolio positions. Such hedging transactions may also limit the opportunity for gain if the values of the portfolio positions should increase. Moreover, it may not be possible to hedge against an interest rate fluctuation that is so generally anticipated that we are not able to enter into a hedging transaction at an acceptable price.



The success of our hedging transactions depends on our ability to accurately predict movements of interest rates and credit spreads. Therefore, while we may enter into such transactions to seek to reduce interest rate risks, unanticipated changes in interest rates may result in poorer overall investment performance than if we had not engaged in any such hedging transactions. In addition, the degree of correlation between price movements of the instruments used in a hedging strategy and price movements in the portfolio positions being hedged may vary. Moreover, for a variety of reasons, we may not seek to establish a perfect correlation between such hedging instruments and the portfolio holdings being hedged. Any such imperfect correlation may prevent us from achieving the intended hedge and expose us to risk of loss.



We currently hedge against interest rate risk. Our hedging activity will vary in scope based on the level and volatility of interest rates and principal prepayments, the type of MBS held, and other changing market conditions. Interest rate hedging may fail to protect or could adversely affect us because, among other things:

- interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;

- available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought;

- the duration of the hedge may not match the duration of the related liability;

- the credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and

- the party owing money in the hedging transaction may default on its obligation to pay.

Our hedging activity may adversely affect our earnings and result in volatile fluctuations in the value of our hedges and GAAP income, which could adversely affect cash available for distribution to our shareholders, our book value and GAAP income.

***Adoption of the Basel III standards and other proposed supplementary regulatory standards may negatively impact our access to financing or affect the terms of our future financing arrangements.***

In response to various financial crises and the volatility of financial markets, the Basel Committee on Banking Supervision adopted the Basel III standards several years ago. The final package of Basel III reforms was approved by the G20 leaders in November 2010. In January 2013, the Basel Committee agreed to delay implementation of the Basel III standards and expanded the scope of assets permitted to be included in a bank's liquidity measurement.

U.S. regulators have elected to implement substantially all of the Basel III standards. Financial institutions will have until 2019 to fully comply with the Basel III standards, which could cause an increase in capital requirements for, and could place constraints on, the financial institutions from which we borrow.

In April 2014, U.S. regulators adopted rules requiring enhanced supplemental leverage ratio standards beginning in January 2018, which would impose capital requirements more stringent than those of the Basel III standards and the



supplemental regulatory standards adopted by U.S. regulators may negatively impact our access to financing or affect the terms of our future financing arrangements.

***New assets we acquire may not generate yields as attractive as yields on our current assets, resulting in a decline in our earnings per share over time.***

We believe the assets we acquire have the potential to generate attractive economic returns and GAAP yields, but acquiring assets in an uncertain economic environment poses significant risks. Potential cash flow and mark-to-market returns from new asset acquisitions could be negative, including both new assets that are backed by newly-originated loans, as well as new acquisitions that are backed by more seasoned assets that may experience higher than expected levels of delinquency and default. In order to maintain and grow our portfolio size and our earnings, we must reinvest in new assets a portion of the cash flows we receive from principal, interest, and sales. We receive monthly payments from many of our assets, consisting of principal and interest. Principal payments reduce the size of our current portfolio and generate cash for us. We may also sell assets from time to time as part of our portfolio management and capital recycling strategies. If the assets we acquire in the future earn lower GAAP yields than the assets we currently own, our reported earnings per share will likely decline over time as the older assets pay down, are called, or are sold.

***Clearing facilities or exchanges upon which some of our hedging instruments are traded may increase margin requirements on our hedging instruments in the event of adverse economic developments.***

In response to events having or expected to have adverse economic consequences or which create market uncertainty, clearing facilities or exchanges upon which some of our hedging instruments, such as Eurodollar futures and swap futures, are traded may require us to post additional collateral against our hedging instruments. In the event that future adverse economic developments or market uncertainty result in increased margin requirements for our hedging instruments, it could materially adversely affect our liquidity position, business, financial condition and results of operations.

***The conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the federal government, may adversely affect our business.***

The agency-backed MBS in which we invest depend on a steady stream of payments on the mortgages underlying the securities. The interest and principal payments we receive on the agency-backed MBS that we acquire are guaranteed by Fannie Mae or Freddie Mac. Fannie Mae and Freddie Mac are GSEs, but their guarantees are not backed by the full faith and credit of the U.S. government.



Between 2007 and 2011, Fannie Mae and Freddie Mac reported substantial losses and a need for substantial amounts of additional capital. In response to the deteriorating financial condition of Fannie Mae and Freddie Mac and the credit market disruption several years ago, Congress and the U.S. Treasury have undertaken a series of actions to stabilize these GSEs and the financial markets generally. The Housing and Economic Recovery Act was signed into law on July 30, 2008, and it established the FHFA. On September 7, 2008, the FHFA placed Fannie Mae and Freddie Mac into conservatorship, which is a statutory process pursuant to which the FHFA operates Fannie Mae and Freddie Mac in an effort to stabilize the entities. The FHFA, together with the U.S. Treasury and the U.S. Federal Reserve, has also undertaken actions designed to boost investor confidence in Fannie Mae and Freddie Mac, support the availability of mortgage financing and protect taxpayers. In addition, the U.S. Treasury has taken steps to capitalize and provide financing to Fannie Mae and Freddie Mac and agreed to purchase direct obligations and agency-backed MBS issued or guaranteed by Fannie Mae or Freddie Mac although the rate of purchases has recently been reduced via tapering.



Shortly after Fannie Mae and Freddie Mac were placed in federal conservatorship, the Secretary of the U.S. Treasury, in announcing the actions, noted that the guarantee structure of Fannie Mae and Freddie Mac required examination and that changes in the structures of the entities were necessary to reduce risk to the financial system. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be eliminated or considerably limited relative to historical measurements. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes agency-backed MBS, have broad adverse market implications and negatively impact us.

Based on various legislative proposals, significant differences appear to exist within Congress regarding housing finance reform. The 2014 elections likely exacerbated this dynamic, further dampening prospects for legislative action in 2015. GSE reform lost momentum in 2014 when a proposed GSE reform bill introduced by Senators Tim Johnson (D-SD) and Mike Crapo (R-ID), the two most senior members of the Senate Banking Committee, failed to secure enough support for the bill to be considered by Congress. The congressional Republican leadership, now controlling both houses of Congress, continues to favor a very different approach, which is generally based on earlier legislation proposed by Senators Bob Corker (R-TN) and Mark Warner (D-VA). As the FHFA and both houses of Congress each discussed and considered separate measures intended to restructure the U.S. housing finance system and the operations of Fannie Mae and Freddie Mac, there was no resolution. We expect debate and discussion on housing finance reform to continue in 2015. It is unclear which, if any, of these measures will be enacted and, if any are enacted, what the effects would be. It is possible that the 2016 Presidential election may be required for meaningful housing finance debate and reform to occur, while it is also possible that the status quo will prevail for some time to come.

On November 25, 2013, the FHFA issued a progress report with regards to the goals set forth in the FHFA White Paper and the Strategic Plan for Enterprise Conservatorships. The report stated that significant progress had been made on the development and testing of a common securitization platform for Fannie Mae and Freddie Mac and that both entities had contracted the less liquid portions of their portfolios. Despite this progress, the report conceded that significant impediments to the full realization of the FHFA's stated goals remain. If such goals are achieved, it is unclear what the effects might be. In May 2014, the FHFA issued a progress report on the initiatives outlined in the Strategic Plan for the Enterprise Conservatorships detailing important progress toward the building of a new secondary mortgage market infrastructure. According to the progress report, Fannie Mae and Freddie Mac have made some progress in developing the common securitization infrastructure (CSP). As of March 2014, roughly half of the necessary software development had been completed. A consultant hired by Fannie Mae and Freddie Mac found the CSP is well-designed. However, other critical technology-related functions, such as disaster recovery, have only recently been initiated. The FHFA has also established an independent corporate entity, Common Securitization Solutions, LLC, that will develop, build, own, and operate the CSP. While some progress has been made in developing the CSP, the project faces considerable challenges that could undermine its prospects for success, including: (i) the difficulties inherent in developing a large-scale information technology system and (ii) the risks involved with preparing the Fannie Mae and Freddie Mac to integrate with the CSP, including modifying internal financial and information systems.

Legislation has changed the relationship between Fannie Mae and Freddie Mac and the U.S. government and requires Fannie Mae and Freddie Mac to reduce the amount of mortgage loans they own or the amount of agency-backed MBS



for which they provide guarantees. The passage of any additional new legislation affecting Fannie Mae and Freddie Mac may create market uncertainty and reduce the actual or perceived credit quality of securities issued or guaranteed by the U.S. government through a new or existing successor entity to Fannie Mae and Freddie Mac. If the charters of Fannie Mae and Freddie Mac were revoked, it is unclear what effect, if any, this would have on the value of the existing Fannie Mae and Freddie Mac agency-backed MBS. It is also possible that the above-referenced proposed legislation, if made law, could adversely impact the market for securities issued or guaranteed by the U.S. government and the spreads at which they trade. The foregoing could materially adversely affect the pricing, supply, liquidity and value of our target assets and otherwise materially adversely affect our business, operations and financial condition.

If Fannie Mae or Freddie Mac were eliminated, or their structures were to change radically, we may not be able to acquire agency-backed MBS from these companies, which could drastically reduce the amount and type of agency-backed MBS available for investment, thereby increasing the price of these assets. Additionally, the current credit support provided by the U.S. Treasury to Fannie Mae and Freddie Mac, and any additional credit support it may provide in the future, could have the effect of lowering the interest rate we receive from agency-backed MBS, thereby tightening the spread between the interest we earn on our portfolio and our financing costs. The effects of the current reduction of this support from the U.S. Treasury (tapering) are not yet known. Additionally, the U.S. government could elect to stop providing credit support of any kind to the mortgage market. If any of these events were to occur, our business, financial condition and results of operations and our ability to pay distributions to our stockholders could be materially adversely affected.

***To the extent that we invest in agency-backed MBS that are guaranteed by Fannie Mae and Freddie Mac, we are subject to the risk that these GSEs may not be fully able to satisfy their guarantee obligations or that these guarantee obligations may be repudiated, which would adversely affect the value of our investment portfolio and our ability to sell or finance these securities.***



All the agency-backed MBS in which we invest depend on a steady stream of payments on the mortgages underlying the MBS. The interest and principal payments we receive on the agency-backed MBS that we acquire are guaranteed by Fannie Mae or Freddie Mac, but are not guaranteed by the U.S. government. To the extent these GSEs are not able to fully satisfy their guarantee obligations or that these guarantee obligations are repudiated or otherwise defaulted upon, the value of our investment portfolio and our ability to sell or finance these securities would be adversely affected.

***Market conditions and actions by governmental authorities may upset the historical relationship between interest rate changes and prepayment trends, which would make it more difficult for us to analyze our investment portfolio.***

Our success depends on our ability to analyze the relationship of changing interest rates on prepayments of the mortgage loans that underlie our MBS. Changes in interest rates and prepayments affect the market price of MBS that we intend to purchase and any MBS that we hold at a given time. As part of our overall portfolio risk management, we analyze interest rate changes and prepayment trends separately and collectively to assess their effects on our investment portfolio. In conducting our analysis, we depend on certain assumptions based upon historical trends with respect to the relationship between interest rates and prepayments under normal market conditions. If recent or future government actions or other developments change the way that prepayment trends have historically responded to interest rate changes, our ability to (i) assess the market value of our investment portfolio, (ii) implement our hedging strategies and (iii) implement techniques to reduce our prepayment rate volatility would be significantly affected. If we are unable to accurately forecast interest and prepayment rates, our financial position and results of operations could be materially adversely affected.

***An increase in prepayment rates could negatively affect the value of our MBS purchased at a premium, which could result in reduced earnings or losses and negatively affect the cash available for distribution to our shareholders.***

In the case of residential mortgage loans, there are seldom any restrictions on borrowers' abilities to prepay their loans. Homeowners tend to prepay mortgage loans more quickly when interest rates decline. When interest rates decline, owners of the loans have to reinvest the money received from the prepayments at the lower prevailing interest rates. Conversely, homeowners tend not to prepay mortgage loans when interest rates increase. Consequently, owners of the loans are unable to reinvest money that would have otherwise been received from prepayments at the higher prevailing interest rates. This volatility in prepayment rates may affect our ability to maintain targeted amounts of leverage on our mortgage-based securities portfolio and may result in reduced earnings or losses for us and negatively affect the cash available for distribution to our shareholders. Fannie Mae or Freddie Mac guarantees of principal and interest related to the agency-backed MBS we own do not protect us against prepayment risks. Prepayments are generally reflected as a reduction of premium, which means that prepayments may result in recognition of loss in investment value for us.



***Mortgage loan modification programs, future legislative action and changes in the requirements necessary to qualify for refinancing a mortgage with Fannie Mae, Freddie Mac or Ginnie Mae may adversely affect the value of, and the returns on, the MBS in which we invest.***

Over the last few years, the U.S. government, through the Federal Housing Administration (FHA), the U.S. Treasury and the Federal Deposit Insurance Corporation (FDIC), has implemented a variety of programs designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures, including the Hope for Homeowners Act of 2008, which allows certain distressed borrowers to refinance their mortgages into FHA-insured loans. In addition, Fannie Mae and Freddie Mac instituted programs designed to assist distressed homeowners avoid foreclosure. These and any future programs may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or to extend the payment terms of the loans.

It is likely that loan modifications would result in increased prepayments on agency-backed MBS. See “Risks to our Business — An increase in prepayment rates could negatively affect the value of our MBS purchased at a premium, which could result in reduced earnings or losses and negatively affect the cash available for distribution to our shareholders” for information relating to the impact of prepayments on our business. These initiatives, any loan modification programs and future legislative or regulatory actions, including amendments to the bankruptcy laws, that result in the modification of outstanding mortgage loans, as well as changes in the requirements necessary to qualify for refinancing a mortgage with Fannie Mae, Freddie Mac or Ginnie Mae, may adversely affect the value of, and the returns on, our MBS.

***Changes in the fair values of our MBS may have various negative effects on us, including reduced earnings, increased earnings volatility and volatility in our book value.***

Fair values for our MBS can be volatile. The fair values can change rapidly and significantly and changes can result from changes in interest rates, actual and perceived risk, supply, demand, and actual and projected cash flows and prepayments and credit performance. A decrease in fair value may not necessarily be the result of deterioration in future cash flows. A decrease in the fair value of MBS we own may result in a reduction in our book value due to the accounting standards we are required to apply. Reporting a low book value could have adverse effects even if that book value is not indicative of the actual value of our net investments in assets. The adverse effects include the inability to meet or agree upon covenants with counterparties, to enter into derivative contracts or a reduction in the market price of our Class A common stock.

***Declines in the market values of the securities in our MBS portfolio may adversely affect periodic reported results and credit availability, which may reduce earnings and, in turn, cash available for distribution to our shareholders.***



A substantial portion of our assets are classified for accounting purposes either as “trading securities” or as “available-for-sale.” Changes in the market values of those assets will be directly charged or credited to shareholders’ equity. As a result, a decline in value may reduce the book value of our assets. Moreover, if the decline in value of an available-for-sale security is other-than-temporary, such decline will reduce earnings, as will a decline in the value of our securities classified as trading securities for accounting purposes.

A decline in the market value of the securities in our MBS portfolio may adversely affect us particularly in instances where we have borrowed money based on the market value of those assets. If the market value of those assets declines, the lender may require us to post additional collateral to support the loan. If we were unable to post the additional collateral, we would have to sell the assets at a time when we might not otherwise choose to do so. A reduction in credit available may reduce our earnings and, in turn, cash available for distribution to shareholders.

***Our mortgage investing strategy involves leverage, which could adversely affect our operations and negatively affect cash available for distribution to our shareholders.***

We may reduce the amount of equity capital we have invested in agency-backed MBS or other mortgage-backed assets by funding a portion of those acquisitions with repurchase agreements, commercial paper (to the extent commercial paper is available on favorable terms or at all) or other borrowing arrangements. To the extent that revenue derived from those assets exceeds our interest expense, hedging expense and other costs of the financing, our net income will be greater than if we had not borrowed funds and had not invested in the assets. Conversely, if the revenue from our MBS and other mortgage-backed assets does not sufficiently cover the interest expense, hedging expense and other costs of the financing, our net income will be less or our net loss will be greater than if we had not borrowed funds. Because of the credit and interest rate risks inherent in our strategy, we closely monitor the leverage (debt-to-equity ratio) of our MBS portfolio. From time to time, our leverage ratio may increase or decrease due to several factors, including changes in the value of the underlying portfolio holdings and the timing and amount of acquisitions.

***An increase in our borrowing costs relative to the interest we receive on our assets may impair our profitability and thus our cash available for distribution to our stockholders.***

As our repurchase agreements and other short term borrowings mature, we must either enter into new borrowings or liquidate certain of our investments at times when we might not otherwise choose to do so. Lenders may seek to use a maturity date as an opportune time to demand additional terms or increased collateral requirements that could be adverse to us and harm our operations. An increase in short term interest rates when we seek new borrowings would reduce the spread between our returns on our assets and the cost of our borrowings. This would reduce the returns on our assets, which might reduce earnings and in turn cash available for distribution to our stockholders. We generally expect that the interest rates tied to our borrowings will adjust more rapidly than the interest rates tied to the assets in which we invest.



***Our lenders may require us to provide additional collateral, especially when the market values for our investments decline, which may restrict us from leveraging our assets as fully as desired, and reduce our liquidity, earnings and cash available for distribution to our shareholders.***

We currently use repurchase agreements to finance our investments in MBS. Our repurchase agreements allow the lenders, to varying degrees, to determine a new market value of the collateral to reflect current market conditions. If the market value of the securities pledged or sold by us to a funding source declines in value, we may be required by the lender to provide additional collateral or pay down a portion of the funds advanced on minimal notice, which is known as a margin call. Posting additional collateral will reduce our liquidity and limit our ability to leverage our assets, which could adversely affect our business. Additionally, in order to satisfy a margin call, we may be required to liquidate assets at a disadvantageous time, which could cause us to incur further losses and adversely affect our results of operations and financial condition, and may impair our ability to make distributions to our shareholders. In the event we do not have sufficient liquidity to satisfy these margin calls, lending institutions can accelerate our indebtedness, increase our borrowing rates, liquidate our collateral and terminate our ability to borrow. Such a situation would likely result in a rapid deterioration of our financial condition and possibly necessitate a filing for protection under the bankruptcy code.

***If we fail to maintain adequate repurchase agreement financing or to renew or replace existing borrowings upon maturity, we will be limited in our ability to implement our principal investing activities, which will adversely affect our results of operations and may, in turn, negatively affect the market value of our Class A common stock and our ability to make dividends to our shareholders.***

We depend upon repurchase agreement financing to purchase our target assets and reach our target leverage ratio. We cannot assure you that sufficient repurchase agreement financing will be available to us in the future on terms that are acceptable to us. Investors and financial institutions that lend in the securities repurchase market have tightened lending standards and some have stopped lending entirely in the repurchase market in response to the difficulties and changed economic conditions that have materially adversely affected the MBS market. If we fail to obtain adequate funding or to renew or replace existing funding upon maturity, we will be limited in our ability to implement our business strategy, which will adversely affect our results of operations and may, in turn, negatively affect the market value of our Class A common stock and our ability to make dividends to our shareholders.

***Our use of repurchase agreements may give our lenders greater rights in the event that either we or any of our lenders file for bankruptcy, which may make it difficult for us to recover our collateral.***



Our borrowings under repurchase agreements may qualify for special treatment under the bankruptcy code, giving our lenders the ability to avoid the automatic stay provisions of the bankruptcy code and take possession of and liquidate our collateral under the repurchase agreements without delay if we file for bankruptcy. Furthermore, the special treatment of repurchase agreements under the bankruptcy code may make it difficult for us to recover our pledged assets in the event that any of our lenders file for bankruptcy. Thus, the use of repurchase agreements exposes our pledged assets to risk in the event of a bankruptcy filing by either our lenders or us. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970 or an insured depository institution subject to the Federal Deposit Insurance Act, our ability to exercise our rights to recover our investment under a repurchase agreement or to be compensated for any damages resulting from the lender's insolvency may be further limited by those statutes.

***If the lending institution under one or more of our repurchase agreements defaults on its obligation to resell the underlying security back to us at the end of the agreement term, we will lose money on our repurchase transactions.***

When we engage in a repurchase transaction, we initially sell securities to the transaction counterparty under a master repurchase agreement in exchange for cash from the counterparty. The counterparty is obligated to resell the same securities back to us at the end of the term of the repurchase agreement, which typically is 30 to 90 days, but may be up to one year. If the counterparty in a repurchase transaction defaults on its obligation to resell the securities back to us, we will incur a loss on the transaction equal to the amount of the haircut (assuming no change in the value of the securities). Losses incurred on our repurchase transactions would adversely affect our earnings and our cash available for distribution to our shareholders.

***If we default on our obligations under our repurchase agreements, we may be unable to establish a suitable replacement facility on acceptable terms or at all.***

If we default on one of our obligations under a repurchase agreement, the counterparty may terminate the agreement and cease entering into any other repurchase agreements with us. In that case, we would likely need to establish a replacement repurchase facility with another financial institution in order to continue to leverage our investment portfolio and carry out our investment strategy. We may be unable to establish a suitable replacement repurchase facility on acceptable terms or at all.

***Limitations on our access to capital could impair our liquidity and our ability to conduct our business.***

Liquidity, or ready access to funds, is essential to our business. Failures of similar businesses have often been attributable in large part to insufficient liquidity. Liquidity is of particular importance to our business and perceived



liquidity issues may affect our clients' and counterparties' willingness to engage in transactions with us. Our liquidity could be impaired due to circumstances that we may be unable to control, such as a general market disruption, the payment of significant legal defense and indemnification costs, expenses, damages or settlement amounts, or an operational problem that affects us or third parties. Further, our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time or the market is experiencing significant volatility. Our inability to maintain adequate liquidity would materially harm our business and operations.

***The nature of the securities we hold exposes us to concentrated credit risk that could reduce our earnings, dividends, cash flows and access to liquidity, and otherwise negatively affect our business.***

Our private-label MBS portfolio has concentrated risks with respect to residential real estate loans. In general, losses on an asset securing a residential real estate loan included in a securitization will be borne first by the owner of the property (*i.e.*, the owner will first lose the equity invested in the property) and, thereafter, by mezzanine or preferred equity investors, if any, then by a cash reserve fund or letter of credit, if any, then by the first-loss holder, and then by holders of more senior securities. In the event the losses incurred upon default on the loan exceed any equity support, reserve fund, letter of credit and classes of securities junior to those in which we invest (if any), we may not be able to recover any or all of our investment in the securities we hold. In addition, if the underlying properties have been overvalued by the originating appraisal or if the values subsequently declined and, as a result, less collateral is available to satisfy interest and principal payments due on the related private-label MBS, then the first-loss securities may suffer a total loss of principal, followed by losses on the second-loss and so on. Any credit enhancement we may have with respect to our private-label MBS could be insufficient to protect us from a complete loss.

***Our due diligence of potential investments may not reveal all of the liabilities associated with those investments and may not reveal aspects of the investments which could lead to investment losses, and our ability to manage exposures to assets in which we have an indirect interest is limited.***

Before making certain acquisitions, we may undertake due diligence efforts with respect to various aspects of the acquisition, including investigating the strengths and weaknesses of the originator or issuer of the asset and, in the case of acquisitions of private-label MBS, verifying certain aspects of the underlying assets themselves as well as other factors and characteristics that may be material to the performance of the acquisition. In making the assessment and otherwise conducting due diligence, we rely on resources available to us and, in some cases, third party information. There can be no assurance that any due diligence process that we conduct will uncover relevant facts that could be determinative of whether or not an investment will be successful.

Moreover, our ability to manage our exposures is significantly limited by contractual and other constraints of the securitization vehicle structures in which such assets are held.



***The securities and loans we own are likely to lead to variable returns.***

We actively manage the risks associated with acquiring, holding and disposing of MBS. No amount of risk management or mitigation, however, can change the variable nature of the cash flows, fair values of, and financial results generated by these loans and securities. Changes in the credit performance or the prepayments on the loans underlying private-label MBS and changes in interest rates impact the cash flows on these securities, and the impact could be significant for our securities with concentrated risks. Changes in cash flows lead to changes in our return and also to potential variability in reported income.

The revenue recognized on our private-label MBS is based on an estimate of the yield over the remaining life of the asset. Thus, changes in our estimates of expected cash flow from an asset will result in changes in our reported earnings on that asset in the current reporting period. We may be forced to recognize adverse changes in expected future cash flows as a current expense, further adding to earnings volatility.

***Our investments are recorded at fair value based upon assumptions that are inherently subjective and involve a high degree of management judgment. Our results of operations and financial condition could be adversely affected if our determinations regarding the fair value of our investments are materially higher than the values that we ultimately realize upon their disposal.***

Our current portfolio investments are, and our future portfolio investments may be, in the form of securities that are not publicly traded. The fair value of securities and other investments that are not publicly traded may not be readily determinable. In computing the fair values for MBS for which there are limited observable third-party trades, we make a number of market-based assumptions, including assumptions regarding future interest rates, prepayment rates, discount rates, credit loss rates, and the timing of credit losses. These assumptions are inherently subjective and involve a high degree of management judgment, and our determinations of fair value may differ materially from the values that would have been used if a public market for these securities existed. Although we rely on our internal calculations to compute the fair value of securities we own, we also request and consider indications of value (marks) from third-party dealers to assist us in our valuation process. The results of market disruptions over the past several years have generated fewer third-party data points for us to consider in connection with our estimates of the fair value of our securities than were available to us in the past. Our reported fair value may not reflect what a willing buyer would pay for those assets. Our results of operations and financial condition may be adversely affected if our determinations regarding the fair value of our investments is materially higher than the values that we ultimately realize upon their disposal.

***Credit ratings assigned to debt securities by the credit rating agencies may not accurately reflect the risks associated with those securities.***



We make certain acquisition decisions after factoring in a series of data, including credit rating. However, a credit rating may not accurately reflect the risks associated with a particular debt security. Rating agencies rate certain debt securities based upon their assessment of the safety of the receipt of principal and interest payments. Rating agencies do not consider the risks of fluctuations in fair value or other factors that may influence the value of debt securities and, therefore, the assigned credit rating may not fully reflect the true risks of an investment in securities. Also, rating agencies may fail to make timely adjustments to credit ratings based on available data or changes in economic outlook or may otherwise fail to make changes in credit ratings in response to subsequent events, so that our investments may be better or worse than the ratings indicate.

The assignment of an “investment grade” rating to a security by a rating agency does not mean that there is not credit risk associated with the security or that the risk of a credit loss with respect to such security is remote. For example, a large number of MBS that were previously rated triple-A by one or more rating agencies have been downgraded, in many cases by several rating levels at one time. A downgrade in credit rating can materially adversely affect the fair value of a security. Our assessment of the quality of an investment that relies, in part, on that asset’s credit rating, may prove to be inaccurate and we may incur credit losses in excess of our initial expectations.

Furthermore, credit rating agencies may change their methods of evaluating credit risk and determining ratings on MBS. These changes may occur quickly and often. The market’s ability to understand and absorb these changes, and the impact to the securitization market in general, are difficult to predict. Such changes will have an impact on the amount of investment-grade and non-investment-grade securities that are created or placed on the market in the future. A change in the amount of investment-grade and non-investment-grade securities that are created or placed on the market could materially adversely impact the value of the MBS in our portfolio and potentially limit or increase the value of MBS available for purchase in the future.

***We may change our investment strategy, hedging strategy, asset allocation and operational policies without shareholder consent, which may result in riskier investments and adversely affect the market value of our Class A common stock and our ability to make distributions to our shareholders.***

We may change our investment strategy, hedging strategy, asset allocation and operational policies at any time without the consent of our shareholders, which could result in our making investments or hedges that are different from, and possibly riskier than, the investments and hedges described in this Annual Report on Form 10-K. A change in our investment or hedging strategy may increase our exposure to interest rate and real estate market fluctuations. A change in our asset allocation could result in us making investments in instrument categories different from those described in this Annual Report on Form 10-K. Our Board of Directors oversees our operational policies, including those with respect to our acquisitions, growth, operations, indebtedness, capitalization and distributions or approves transactions that deviate from these policies without a vote of, or notice to, our shareholders. Operational policy changes could adversely affect the market value of our Class A common stock and our ability to make distributions to our shareholders. Investing in assets other than MBS or pursuing business activities other than investing in MBS may not be successful and could adversely affect our results of operations and the market value of our Class A common stock.







***Our Board of Directors does not approve each of our investment decisions.***

Our Board of Directors oversees our operational policies and periodically reviews our investment guidelines and our investment portfolio. However, our Board of Directors does not review all of our proposed investments. In addition, in conducting periodic reviews, our Board of Directors may rely primarily on information provided to them by our management. Furthermore, transactions entered into or structured for us by our management may be difficult or impossible to unwind by the time they are reviewed by our directors.

***We operate in a highly-competitive market for investment opportunities, which could make it difficult for us to purchase or originate investments at attractive yields and thus have an adverse effect on our business, results of operations and financial condition.***

We gain access to investment opportunities only to the extent that they become known to us. Gaining access to investment opportunities is highly competitive. Many of our competitors are substantially larger than us and have considerably greater financial, technical and marketing resources, more long-standing relationships, broader product offerings and other advantages. Some of our competitors may have a lower cost of funds and access to funding sources that are not available to us. The Federal Reserve's continuing reinvestment of principal and interest payments on the RMBS held in its portfolio may result in increased competition for attractive opportunities in our target investments. As a result of this competition, we may not be able to purchase or originate our target investments at attractive yields, which could have an adverse effect on our business, results of operations and financial condition.

## **Risks Related to our Business and Structure**

***Our Rights Plan could inhibit a change in our control and we may not be successful in protecting our anticipated tax benefits.***

In June 2009, our Board of Directors implemented a Rights Plan in an effort to protect against a possible limitation on our ability to use our NOLs, NCLs and built-in losses by dissuading investors from aggregating ownership of our Class A common stock and triggering an "ownership change" for purposes of Sections 382 and 383 of the Code. The Rights Plan may not be successful in preventing an "ownership change" within the meaning of Sections 382 and 383 of the Code, and we may lose all or most of the anticipated tax benefits associated with our prior losses. Under the terms of the Rights Plan, in general, if a person or group acquires or commences a tender or exchange offer for beneficial ownership of 4.9% or more of the outstanding shares of our Class A common stock upon a determination by our Board of Directors (an Acquiring Person), all of our other Class A and Class B common shareholders will have the right to purchase securities from us at a discount to such securities' fair market value, thus causing substantial dilution to the Acquiring Person. The Rights Plan may have the effect of inhibiting or impeding a change in control not



approved by our Board of Directors and, notwithstanding its purpose, could adversely affect our shareholders' ability to realize a premium over the then-prevailing market price for our common stock in connection with such a transaction. In addition, because our Board of Directors can prevent the Rights Plan from operating, in the event our Board of Directors approves of an Acquiring Person, the Rights Plan gives our Board of Directors significant discretion over whether a potential acquirer's efforts to acquire a large interest in us will be successful. Consequently, the Rights Plan may not succeed in protecting anticipated tax benefits and could impede transactions that would otherwise benefit our shareholders.

***The trading price of our Class A common stock may be adversely affected by factors outside of our control.***

Any negative changes in the public's perception of the prospects for our business or the types of assets in which we invest could depress our stock price regardless of our results. The following factors, among others, could contribute to the volatility of the price of our Class A common stock:

- actual or unanticipated variations in our quarterly results;
- changes in our financial estimates by securities analysts;
- conditions or trends affecting companies that make investments similar to ours;
- changes in interest rate environments and the mortgage market that cause our borrowing costs to increase, our reported yields on our MBS portfolio to decrease or that cause the value of our MBS portfolio to decrease;
- changes in the market valuations of the securities in our MBS portfolio and other principal investments;
- negative changes in the public's perception of the prospects of investment or financial services companies;
- changes in the regulatory environment in which our business operates;
- dilution resulting from new equity issuances or the conversion of Class B common stock into Class A common stock;
- general economic conditions such as a recession, or interest rate or currency rate fluctuations; and
- additions or departures of our key personnel.



Many of these factors are beyond our control.

*We may experience significant fluctuations in quarterly operating results.*

Our revenues and operating results may fluctuate from quarter to quarter and from year to year due to a combination of factors, many of which are beyond our control, including the market value of the MBS we acquire, our hedging instruments, prepayment rates and changes in interest rates. As a result, we may fail to meet profitability or dividend expectations, which could negatively affect the market price of our Class A common stock and our ability to pay dividends to our shareholders.



***We cannot assure you that we will be able to pay dividends in the future.***

Pursuant to our variable dividend policy, our Board of Directors, in its sole discretion, reinstated the payment of a cash dividend during 2010. However, there can be no assurances that they will continue to do so. The amount and timing of any distributions we may make are in the sole discretion of our Board of Directors.

***Litigation involving our company could result in significant legal expenses and have a material adverse effect on our business, financial condition, results of operations and cash flows.***

As described under “Item 3 — Legal Proceedings” in this Annual Report on Form 10-K, we may in the future become subject to litigation. Such litigation may result in significant defense costs and potentially significant judgments against us, some of which are not, or cannot be, insured against. We cannot predict the ultimate outcome of any litigation, and cannot estimate the likelihood or potential dollar amount of any adverse results. We may be unable to accurately estimate our exposure to litigation risk when we record balance sheet reserves for probable loss contingencies. As a result, any reserves we establish to cover any settlements or judgments, if any, may not be sufficient to cover our actual financial exposure, which may have a material impact on our results of operations or financial condition. In the event of an adverse judgment in any action or proceeding, we may be required to pay damages or penalties, or other remedies may be imposed upon us, which could have a material adverse impact upon our financial position, results of operations and cash flows and could also cause us significant reputational harm, which in turn could seriously harm our business and prospects.

***Indemnification obligations to certain of our current and former directors and officers may increase the costs to us of legal proceedings involving our company.***

Our charter contains a provision that limits the liability of our directors and officers to us and our shareholders for money damages, except for liability resulting from willful misconduct or a knowing violation of the criminal law or any federal or state securities law. Our charter also requires us to indemnify our directors and officers in connection with any liability incurred by them in connection with any action or proceeding (including any action by us or in our right) to which they are or may be made a party by reason of their service in those or other capacities if the conduct in question was in our best interests and the person was acting on our behalf or performing services for us, unless the person engaged in willful misconduct or a knowing violation of the criminal law. The Virginia Stock Corporation Act requires a Virginia corporation (unless its charter provides otherwise, which our charter does not) to indemnify a director or officer who has been successful, on the merits or otherwise, in the defense of any proceeding to which he is made a party by reason of his service in that capacity.



In addition, we have entered into indemnification agreements with certain of our current and former directors and officers under which we are generally required to indemnify them against liability incurred by them in connection with any action or proceeding to which they are or may be made a party by reason of their service in those or other capacities, if the conduct in question was in our best interests and the person was conducting themselves in good faith (subject to certain exceptions, including liabilities arising from willful misconduct, a knowing violation of the criminal law or receipt of an improper benefit).

In the future we may be the subject of indemnification assertions under our charter, Virginia law or these indemnification agreements by our current and former directors and officers who are or may become party to any action or proceeding. We maintain directors' and officers' insurance policies that may limit our exposure and enable us to recover a portion of any amounts paid with respect to such obligations. However, if our coverage under these policies is reduced, denied, eliminated or otherwise not available to us, our potential financial exposure would be increased. The maximum potential amount of future payments we could be required to make under these indemnification obligations could be significant. Amounts paid pursuant to our indemnification obligations could adversely affect our financial results and the amount of cash available for distribution to our shareholders.

***Loss of our exclusion from regulation as an investment company under the 1940 Act would adversely affect us and may reduce the market price of our shares.***

We rely on Section 3(c)(5)(C) for our exclusion from the registration requirements of the 1940 Act. This provision requires that 55% of our assets, on an unconsolidated basis, consist of qualifying assets, such as agency whole pool certificates and 80% of our assets, on an unconsolidated basis, consist of qualifying assets or real estate-related assets. We will need to ensure not only that we qualify for an exclusion or exemption from regulation under the 1940 Act, but also that each of our subsidiaries qualifies for such an exclusion or exemption. We intend to maintain our exclusion by monitoring the value of our interests in our subsidiaries. We may not be successful in this regard.

If we fail to maintain our exclusion and another exclusion or exemption is not available, we may be required to register as an investment company, or we may be required to acquire or dispose of assets in order to meet our exemption. Any such asset acquisitions or dispositions may include assets that we would not acquire or dispose of in the ordinary course of business, may be at unfavorable prices and result in a decline in the price of our Class A common stock. If we are required to register under the 1940 Act, we would become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with affiliated persons (as defined in the 1940 Act), and portfolio composition, including restrictions with respect to diversification and industry concentration and other matters. Accordingly, registration under the 1940 Act could limit our ability to follow our current investment and financing strategies and result in a decline in the price of our Class A common stock.



***Failure to obtain and maintain an exemption from being regulated as a commodity pool operator could subject us to additional regulation and compliance requirements and may result in fines and other penalties which could materially adversely affect our business, financial condition and results of operations.***

The Dodd-Frank Act established a comprehensive new regulatory framework for derivative contracts commonly referred to as “swaps.” As a result, any investment fund that trades in swaps or other derivatives may be considered a “commodity pool,” which would cause its operators (in some cases the fund’s directors) to be regulated as “commodity pool operators,” or CPOs. Under rules adopted by the U.S. Commodity Futures Trading Commission (CFTC) for which the compliance date generally was December 31, 2012 as to those funds that become commodity pools solely because of their use of swaps, CPOs must by then have filed an application for registration with the National Futures Association (NFA) and have commenced and sustained good faith efforts to comply with the Commodity Exchange Act and CFTC’s regulations with respect to capital raising, disclosure, reporting, recordkeeping and other business conduct applicable for their activities as CPOs as if the CPOs were in fact registered in such capacity (which also requires compliance with applicable NFA rules). However, the CFTC’s Division of Swap Dealer and Intermediary Oversight issued a no-action letter saying, although it believes that mortgage REITs are properly considered commodity pools, it would not recommend that the CFTC take enforcement action against the operator of a mortgage REIT who does not register as a CPO if, among other things, the mortgage REIT limits the initial margin and premiums required to establish its swaps, futures and other commodity interest positions to not more than five percent (5%) of its total assets, the mortgage REIT limits the net income derived annually from those commodity interest positions which are not qualifying hedging transactions to less than five percent (5%) of its gross income and interests in the mortgage REIT are not marketed to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures, commodity options or swaps markets.

We use hedging instruments in conjunction with our investment portfolio and related borrowings to reduce or mitigate risks associated with changes in interest rates, mortgage spreads, yield curve shapes and market volatility. These hedging instruments include interest rate swaps, interest rate futures and options on interest rate futures. We do not currently engage in any speculative derivatives activities or other non-hedging transactions using swaps, futures or options on futures. We do not use these instruments for the purpose of trading in commodity interests, and we do not consider our company or its operations to be a commodity pool as to which CPO registration or compliance is required. We have claimed the relief afforded by the above-described no-action letter. Consequently, we will be restricted to operating within the parameters discussed in the no-action letter and will not enter into hedging transactions covered by the no-action letter if they would cause us to exceed the limits set forth in the no-action letter. However, there can be no assurance that the CFTC will agree that we are entitled to the no-action letter relief claimed.

The CFTC has substantial enforcement power with respect to violations of the laws over which it has jurisdiction, including their anti-fraud and anti-manipulation provisions. For example, the CFTC may suspend or revoke the registration of or the no-action relief afforded to a person who fails to comply with commodities laws and regulations, prohibit such a person from trading or doing business with registered entities, impose civil money penalties, require restitution and seek fines or imprisonment for criminal violations. In the event that the CFTC staff does not provide the no action letter relief we requested or asserts that we are not entitled to the mortgage REIT no-action letter relief claimed or if CFTC otherwise determines that CPO registration and compliance is required of us, we may be obligated to furnish additional disclosures and reports, among other things. Further, a private right of action exists against those



who violate the laws over which the CFTC has jurisdiction or who willfully aid, abet, counsel, induce or procure a violation of those laws. In the event that we fail to comply with statutory requirements relating to derivatives or with the CFTC's rules thereunder, including the mortgage REIT no-action letter described above, we may be subject to significant fines, penalties and other civil or governmental actions or proceedings, any of which could have a materially adverse effect on our business, financial condition and results of operations.

***We face competition for personnel, which could adversely affect our business and in turn negatively affect the market price of our Class A common stock and our ability to pay dividends to our shareholders.***

We are dependent on the highly-skilled, and often highly-specialized, individuals we employ. Retention of specialists to manage our portfolio is particularly important to our prospects. Competition for the recruiting and retention of employees may increase elements of our compensation costs. We may not be able to recruit and hire new employees with our desired qualifications in a timely manner. Our incentives may be insufficient to recruit and retain our employees. Increased compensation costs could adversely affect the amount of cash available for distribution to shareholders and our failure to recruit and retain qualified employees could materially and adversely affect our future operating results.

***We are dependent upon a small number of key senior professionals and loss of any of these individuals could adversely affect our financial results which may, in turn, negatively affect the market price of our Class A common stock and our ability to pay dividends to our shareholders.***

We currently do not have employment agreements with any of our senior officers and other key professionals. We cannot guarantee that we will continue to have access to members of our senior management team or other key professionals. The loss of any members of our senior management and other key professionals could materially and adversely affect our operating results.



***We are highly dependent upon communications and information systems operated by third parties, and systems failures could significantly disrupt our business, which may, in turn, negatively affect the market price of our Class A common stock and our ability to pay dividends to our shareholders.***

Our business is highly dependent upon communications and information systems that allow us to monitor, value, buy, sell, finance and hedge our investments. These systems are primarily operated by third parties and, as a result, we have limited ability to ensure their continued operation. Furthermore, in the event of systems failure or interruption, we will have limited ability to affect the timing and success of systems restoration. Any failure or interruption of our systems or third-party trading or information systems could cause delays or other problems in our securities trading activities, including MBS trading activities, which could have a material adverse effect on our operating results and negatively affect the market price of our Class A common stock and our ability to pay dividends to our shareholders.

***If we issue additional debt securities or other equity securities that rank senior to our common stock for the purposes of dividing and liquidating distributions, our operations may be restricted and we will be exposed to additional risk and the market price of our Class A common stock could be adversely affected.***

If we decide to issue additional debt securities in the future, it is likely that such securities will be governed by an indenture or other instrument containing covenants restricting our operating flexibility. Additionally, any convertible or exchangeable or other securities registered pursuant to our shelf registration statement that we issue in the future may have rights, preferences and privileges more favorable than those of our Class A common stock or shares of preferred stock, if issued, could have a preference on liquidating distributions or a preference on dividend payments that could limit our ability to make a dividend distribution to the holders of our Class A common stock. We, and indirectly our shareholders, will bear the cost of issuing and servicing such securities. Holders of debt securities may be granted specific rights, including but not limited to, the right to hold a perfected security interest in certain of our assets, the right to accelerate payments due under the indenture, rights to restrict dividend payments, and rights to approve the sale of assets. Such additional restrictive covenants, operating restrictions and preferential dividends could have a material adverse effect on our operating results and negatively affect the market price of our Class A common stock and our ability to pay distributions to our shareholders.

***Future decreases in the Company's book value attributable to deferred tax assets may reduce the market price of our shares.***

As disclosed elsewhere throughout this Annual Report on Form 10-K, our book value per share of \$27.95 as of December 31, 2014 reflects \$5.33 per share related to the deferred tax assets on our balance sheet. As we benefit from the utilization of the deferred tax assets in future periods, the corresponding book value attributable to the deferred tax assets utilized will be deducted against future pre-tax income. However, if the deferred tax assets expire without being utilized, the corresponding deferred tax asset will reduce book value and reported GAAP net income. These reductions could negatively affect the market price of our Class A common stock and our ability to pay dividends to



our shareholders.

## **Tax Risks of our Business and Structure**

***Our ability to use NOL carry-forwards and NCL carry-forwards to reduce our taxable income may be limited.***

We revoked our status as a REIT effective as of January 1, 2009, in part to maximize the use of potential tax benefits associated with our NOLs and NCLs. We believe that the NOLs are realizable within the 20 years carry-forward period. We believe that it is more-likely-than not that a portion of the NCLs are realizable and to the extent that is not, a valuation allowance has been recorded. Although we believe that a significant portion of our NOLs will be utilized to offset the taxable income, no assurance can be provided that we will have taxable income or gains in the future to apply against our remaining NOLs and NCLs.

In addition, our NOL and NCL carry-forwards may be limited by Sections 382 and 383 of the Code if we experience an “ownership change.” In general, an “ownership change” occurs if 5% shareholders increase their collective ownership of the aggregate amount of the outstanding shares of our company by more than 50 percentage points looking back over the relevant testing period. If an ownership change occurs, our ability to use our NOLs, NCLs and certain recognized built-in losses to reduce our taxable income in a future year would be limited to a Section 382 limitation equal to the fair market value of our stock immediately prior to the ownership change multiplied by the long-term tax-exempt interest rate in effect for the month of the ownership change. The long-term tax-exempt rate for 2015 is 2.68%. In the event of an ownership change, NOLs and NCLs that exceed the Section 382 limitation in any year will continue to be allowed as carry-forwards for the remainder of the carry-forward period and such losses can be used to offset taxable income for years within the carry-forward period subject to the Section 382 limitation in each year. However, if the carry-forward period for any NOL or NCL were to expire before that loss had been fully utilized, the unused portion of that loss would be lost. The carry-forward period for NOLs is 20 years from the year in which the losses giving rise to the NOLs were incurred, and the carry-forward period for NCLs is five years from the year in which the losses giving rise to the NCLs were incurred. Our use of new NOLs or NCLs arising after the date of an ownership change would not be affected by the Section 382 limitation (unless there were another ownership change after those new losses arose).

On June 1, 2009, our Board of Directors adopted the Rights Plan in an effort to protect against the occurrence of an ownership change. The Rights Plan is intended to act as a deterrent to any person or group acquiring 4.9% or more of our outstanding Class A common stock without the approval of our Board of Directors. Shareholders who own 4.9% or more of our outstanding Class A common stock as of the close of business on June 5, 2009 will not trigger the Rights Plan so long as they do not (i) acquire any additional shares of Class A common stock or (ii) fall under 4.9% ownership of Class A common stock and then re-acquire additional shares so that they own 4.9% or more of the Class A common stock. The Rights Plan does not exempt any future acquisitions of Class A common stock by such persons. Any Rights held by an Acquiring Person are void and may not be exercised. No Person shall be an Acquiring Person unless our Board of Directors shall have affirmatively determined, in its sole and absolute discretion, within ten (10) business days (or such later time as the Board of Directors may determine) after such person has otherwise met the requirements of becoming an Acquiring Person, that such person shall be an Acquiring Person. The Rights Plan,



however, does not protect against all transactions that could cause an ownership change, such as dispositions by existing 5% shareholders and transactions in our Class B common stock. The Rights Plan was ratified by the shareholders in June 2010.



Based on our knowledge of our stock ownership, we do not believe that an ownership change has occurred since our losses were generated. Accordingly, we believe that at the current time there is no annual limitation imposed on our use of our NOLs and NCLs to reduce future taxable income. The determination of whether an ownership change has occurred or will occur is complicated and depends on changes in percentage stock ownership among shareholders. Other than the Rights Plan, there are currently no restrictions on the transfer of our stock that would discourage or prevent transactions that could cause an ownership change, although we may adopt such restrictions in the future. As discussed above, the Rights Plan is intended to discourage transactions that could cause an ownership change. The Rights Plan, however, does not protect against all transactions that could cause an ownership change. In addition, we have not obtained, and currently do not plan to obtain, a ruling from the Internal Revenue Service, regarding our conclusion as to whether our losses are subject to any such limitations. Furthermore, we may decide in the future that it is necessary or in our interest to take certain actions that could result in an ownership change. Therefore, no assurance can be provided as to whether an ownership change has occurred or will occur in the future.

***Preserving the ability to use our NOLs and NCLs may cause us to forgo otherwise attractive opportunities.***

Limitations imposed by Sections 382 and 383 of the Code may discourage us from, among other things, redeeming our stock or issuing additional stock to raise capital or to acquire businesses or assets. Accordingly, our desire to preserve our NOLs and NCLs may cause us to forgo otherwise attractive opportunities.

***If we elect in the future to be treated as a REIT, complying with the REIT requirements may cause us to forego otherwise attractive opportunities.***

We are eligible to elect to be treated as a REIT. We might make such election for various business reasons. To qualify as a REIT for federal income tax purposes, we would be required to continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders and the ownership of our stock. In order to meet these tests, we may be required to forego attractive business or investment opportunities. Thus, compliance with the REIT requirements may hinder our ability to operate solely on the basis of maximizing profits. In addition, in order to qualify as a REIT, an entity must distribute to its stockholders, each calendar year, at least 90% of its REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gain. As a result, if we elect to be treated as a REIT, we generally will be required to distribute our earnings to our stockholders rather than retaining our earnings for reinvestment in our business. The decision to elect REIT status is in the sole discretion of our Board of Directors, and no assurance can be given that we will, or will not, elect such status for 2015 or in the future.

## **ITEM 1B. UNRESOLVED STAFF COMMENTS**



None.

## **ITEM 2. PROPERTIES**

Our principal executive offices are located at Potomac Tower, 1001 Nineteenth Street North, Arlington, Virginia 22209.

We sublease office space to Billings Capital Management, LLC (BCM) which is an investment management company owned and operated by Eric F. Billings, our Executive Chairman of the Board of Directors, and his sons. The lease term is month-to-month, based on pro-rata share of the space occupied by BCM. The lease payments to us totaled \$49 thousand for the year ended December 31, 2014.

## **ITEM 3. LEGAL PROCEEDINGS**

We are from time to time involved in civil lawsuits, legal proceedings and arbitration matters relating to our business that we consider to be in the ordinary course. There can be no assurance that these matters individually or in aggregate will not have a material adverse effect on our financial condition or results of operations in a future period. We are also subject to the risk of litigation, including litigation that may be without merit. As we intend to actively defend such litigation, significant legal expenses could be incurred. An adverse resolution of any future litigation against us could materially affect our financial condition, results of operations and liquidity. Furthermore, we operate in highly-regulated markets that currently are under intense regulatory scrutiny, and we have received, and we expect in the future that we may receive, inquiries and requests for documents and information from various federal, state and foreign regulators. In addition, one or more of our subsidiaries have received requests to repurchase loans from various parties in connection with the former securitization business conducted by a subsidiary. We believe that the continued scrutiny of MBS, structured financed and derivative market participants increases the risk of additional inquiries and requests from regulatory or enforcement agencies and other parties. We cannot provide any assurance that these inquiries and requests will not result in further investigation of or the initiation of a proceeding against us or that, if any such investigation or proceeding were to arise, it would not materially adversely affect our Company.

## **ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.



**PART II****ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS  
5. AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our Class A common stock is listed on the NYSE under the symbol "AI." The following table shows the high and low sales prices of our Class A common stock during each fiscal quarter during the years ended December 31, 2014 and 2013.

	Price Range of Class A Common Stock	
	High	Low
Year Ended December 31, 2014		
Fourth Quarter	\$ 28.19	\$ 24.95
Third Quarter	28.66	25.41
Second Quarter	28.21	25.12
First Quarter	28.50	24.77
Year Ended December 31, 2013		
Fourth Quarter	27.58	22.79
Third Quarter	27.28	22.50
Second Quarter	29.65	24.92
First Quarter	26.97	21.24

On January 30, 2015, there were approximately 185 record holders of our Class A common stock. There is no established public trading market for our Class B common stock, and on January 30, 2015, there were approximately 15 record holders of our Class B common stock. If declared, Class B shares receive dividends in the same amounts and on the same dates as Class A shares.

Pursuant to our variable dividend policy, our Board of Directors evaluates dividends on a quarterly basis and, in its sole discretion, approves the payment of dividends. Our dividend payments, if any, may vary significantly from quarter to quarter. The Board of Directors approved and we declared and paid the following dividends for 2014:

Quarter Ended	Dividend Amount	Declaration Date	Record Date	Pay Date
December 31	\$ 0.875	December 18	December 31	January 30, 2015
September 30	0.875	September 17	September 29	October 31
June 30	0.875	June 11	June 30	July 31
March 31	0.875	March 13	March 31	April 30



The Board of Directors approved and we declared and paid the following dividends for 2013:

Quarter Ended	Dividend Amount	Declaration Date	Record Date	Pay Date
December 31	\$ 0.875	December 19	December 31	January 31, 2014
September 30	0.875	September 18	September 30	October 31
June 30	0.875	June 17	June 28	July 31
March 31	0.875	March 15	March 28	April 30

## Securities Reserved for Issuance

Information about securities authorized for issuance under our 2014 Long-Term Incentive Plan is incorporated by reference from our Definitive Proxy Statement for the 2015 Annual Meeting of Shareholders.

## Purchases of Equity Securities by the Issuer

During the three and twelve months ended December 31, 2014, we did not repurchase any shares of our Class A common stock.

## Stock Comparison Graph

The following graph compares the change in the cumulative total shareholder return for our Class A common stock from December 31, 2009 to December 31, 2014 as calculated by Securities Industry Analytics, LLC, with the comparable cumulative return of two indices: the Standard & Poor's (S&P) 500 Stock Index, our Peer Group Index (New) and Peer Group Index (Old). Blackstone Mortgage Trust, Inc. was removed as it acquired Capital Trust, Inc. In selecting the new peer group, our Board of Directors considered the industry focus, size, and corporate structure of similar real estate finance companies and mortgage REITs in order to ensure an appropriate comparison. The New Peer Group Index is consistent with the peer group approved by the Compensation Committee of our Board of Directors based on the size of market capitalization and/or lines of business.

Our Class A common stock trades on the NYSE. The graph assumes \$100 invested on December 31, 2009 in our Class A common stock and \$100 invested at the same time in each of the above-mentioned indexes. The comparison assumes that all dividends are reinvested.



**Comparison of 5-Year Cumulative Total Return Among Arlington Asset Investment Corp., the Peer Group Index, and the S&P 500 Index**

	<b>AAIC</b>	<b>AAIC</b>	<b>Peer</b>	<b>Peer</b>	<b>S&amp;P 500</b>
	<b>Prices</b>	<b>Indexed</b>	<b>Group (Old)<sup>(1)</sup></b>	<b>Group (New)<sup>(2)</sup></b>	<b>Indexed</b>
December 31, 2009	\$15.23	\$100.00	\$ 100.00	\$ 100.00	\$ 100.00
December 31, 2010	23.99	172.01	183.60	170.12	115.03
December 31, 2011	21.33	173.88	160.53	154.11	117.48
December 31, 2012	20.77	197.96	256.44	233.78	136.20
December 31, 2013	26.39	287.89	331.27	297.73	180.24
December 31, 2014	26.61	330.91	320.47	289.47	204.82

Our Peer Group Index (Old) includes the following companies: American Capital, Ltd., Arbor Realty Trust, Inc., Blackstone Mortgage Trust, Inc. (acquired Capital Trust, Inc.), Dynex Capital, Inc., Hercules Technology Growth Capital, Inc., KCAP Financial, Inc., Main Street Capital Corporation, MCG Capital Corporation, NewStar Financial, Inc., NorthStar Realty Finance Corp., RAIT Financial Trust, Redwood Trust, Inc., and Resource America, Inc.

Our Peer Group Index (New) includes the following companies: American Capital, Ltd., Arbor Realty Trust, Inc., Capstead Mortgage Corporation, Dynex Capital, Inc., Hercules Technology Growth Capital, Inc., KCAP Financial Inc., Main Street Capital Corporation, MCG Capital Corporation, NewStar Financial, Inc., NorthStar Realty Finance Corp., RAIT Financial Trust, Redwood Trust, Inc., Resource America, Inc. and Triangle Capital Corporation.



**ITEM 6. SELECTED FINANCIAL DATA****SELECTED CONSOLIDATED FINANCIAL INFORMATION****(Dollars in thousands, except per share amounts)**

	Year Ended December 31,				
	2014	2013	2012 <sup>(1)</sup>	2011	2010
Consolidated Statements of Operations					
Interest income					
Interest on MBS	\$123,544	\$87,016	\$64,153	\$52,380	\$39,566
Other interest income	3	3	1	165	1
Total interest income	123,547	87,019	64,154	52,545	39,567
Interest expense					
Interest on short-term debt	9,181	6,899	4,475	2,043	593
Interest on long-term debt	2,210	1,630	490	465	562
Total interest expense	11,391	8,529	4,965	2,508	1,155
Net interest income	112,156	78,490	59,189	50,037	38,412
Other (loss) income, net					
Investment (loss) gain, net	(38,672 )	(47,745 )	(10,723 )	(19,166 )	3,328
Other loss, net	(15 )	(15 )	(15 )	(14 )	(14 )
Total other (loss) income, net	(38,687 )	(47,760 )	(10,738 )	(19,180 )	3,314
Operating income before other expenses	73,469	30,730	48,451	30,857	41,726
Other expenses					
Compensation and benefits	13,467	11,195	10,339	10,065	10,660
Professional services	1,529	2,561	4,118	1,833	1,263
Business development	253	145	136	121	97
Occupancy and equipment	422	427	467	374	388
Communications	201	191	202	197	204
Other operating expenses	2,197	2,072	2,184	1,599	2,022
Total other expenses	18,069	16,591	17,446	14,189	14,634
Income before income taxes	55,400	14,139	31,005	16,668	27,092
Income tax provision (benefit)	49,446	(35,322)	(152,937)	1,495	506
Net income	\$5,954	\$49,461	\$183,942	\$15,173	\$26,586



	December 31, 2014	2013	2012 <sup>(1)</sup>	2011	2010
Consolidated Balance Sheet Data					
Assets					
Cash and cash equivalents	\$33,832	\$48,628	\$35,837	\$20,018	\$12,412
Receivables					
Interest	10,701	5,173	4,869	2,366	2,345
Sold securities receivable	—	—	26,773	41,321	—
Other	1,138	212	644	11	219
Investments					
Mortgage-backed securities, at fair value					
Available-for-sale	267,477	341,346	199,156	179,566	252,909
Trading	3,414,300	1,576,452	1,556,440	636,872	174,055
Other investments	1,837	2,065	2,347	2,946	8,287
Derivative assets, at fair value	1,267	8,424	—	504	—
Deferred tax assets, net	122,365	165,851	154,418	—	—
Deposits	160,427	45,504	85,652	71,079	4,748
Prepaid expenses and other assets	1,145	1,311	159	377	358
Total assets	\$4,014,489	\$2,194,966	\$2,066,295	\$955,060	\$455,333
Liabilities					
Repurchase agreements	\$3,179,775	\$1,547,630	\$1,497,191	\$647,977	\$190,220
Interest payable	1,106	774	582	504	187
Accrued compensation and benefits	6,067	5,584	1,542	6,177	7,201
Dividend payable	20,195	14,630	—	6,785	4,655
Derivative liabilities, at fair value	124,308	33,129	76,850	63,024	2,398
Purchased securities payable	—	—	—	15,820	2,555
Accounts payable, accrued expenses and other liabilities	1,006	1,391	17,837	16,401	16,373
Long-term debt	40,000	40,000	15,000	15,000	15,000
Total liabilities	3,372,457	1,643,138	1,609,002	771,688	238,589
Equity					
Common stock and additional paid-in capital	1,897,257	1,727,564	1,638,193	1,508,790	1,506,048
Accumulated other comprehensive income, net of taxes	42,793	53,190	39,006	38,367	63,495
Accumulated deficit	(1,298,018)	(1,228,926)	(1,219,906)	(1,363,785)	(1,352,799)
Total equity	642,032	551,828	457,293	183,372	216,744
Total liabilities and equity	\$4,014,489	\$2,194,966	\$2,066,295	\$955,060	\$455,333
Statistical Data					
Basic earnings per share	\$0.30	\$3.09	\$18.02	\$1.97	\$3.44
Diluted earnings per share	\$0.29	\$3.06	\$17.96	\$1.96	\$3.38
Book value per share <sup>(2)</sup>	\$27.95	\$33.10	\$34.65	\$23.67	\$28.46
Total employees <sup>(2)</sup>	11	11	11	10	10
Return on average assets	0	% 2	% 13	% 2	% 7
Return on average equity	1	% 10	% 74	% 7	% 15
Dividend payout ratio	1,178	% 113	% 20	% 172	% 55
Average Equity to assets ratio	19	% 24	% 18	% 24	% 46



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Basic weighted average shares outstanding (in thousands)	20,043	15,990	10,205	7,720	7,734
Diluted weighted average shares outstanding (in thousands)	20,397	16,189	10,242	7,741	7,873
Cash dividends per common share	\$3.50	\$3.50	\$3.50	\$3.375	\$1.90

Reflects revisions to correct an immaterial error in the tax rate applied to calculate our deferred tax assets.

(1) See Note 10, “Revisions to Previously Reported Financial Statements,” of Notes to Consolidated Financial Statements included elsewhere in this Report on Form 10-K.

(2) As of end of the period reported.



## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Overview**

Arlington Asset Investment Corp. is a principal investment firm that currently acquires and holds primarily mortgage-related assets. We acquire residential mortgage-backed securities (MBS), either issued by U.S. government agencies or guaranteed as to principal and interest by U.S. government agencies or U.S. government-sponsored entities (agency-backed MBS). We also acquire MBS issued by private organizations (private-label MBS), subject to maintaining our exemption from regulation as an investment company under the Investment Company Act of 1940, as amended (1940 Act). In the future, we may acquire and hold other types of assets, including commercial MBS, asset backed securities, other structured securities, commercial mortgage loans, commercial loans, residential mortgage loans, and other real estate-related loans and securities. In addition, we also may pursue other business activities that will utilize our experience in analyzing investment opportunities and applying similar portfolio management skills.

When we use the terms "Arlington Asset," "AAIC," "we" "us" "our" and "the Company," we mean Arlington Asset Investment Corp. and its consolidated subsidiaries. We are a Virginia corporation and taxed as a C corporation for federal income tax purposes. We operate in the United States.

### **Factors that Affect our Results of Operations and Financial Condition**

Our business is materially affected by a variety of industry and economic factors, including:

- conditions in the global financial markets and economic conditions generally;
- changes in interest rates and prepayment rates;
- actions taken by the U.S. government, U.S. Federal Reserve and the U.S. Treasury;
- changes in laws and regulations and industry practices; and
- other market developments.



Adverse market conditions and actions by governmental authorities could adversely affect our business in many ways, including, but not limited to, making it more difficult for us to analyze our investment portfolio, reducing the market value of our MBS portfolio, adversely affecting our ability to maintain targeted amounts of leverage on our MBS portfolio and successfully implement our hedging strategy, and limiting our ability to follow our current investment and financing strategies. While uncertain, these potentially adverse market conditions and actions by governmental authorities may adversely affect our liquidity, financial position and results of operations. We have been evaluating, and will continue to evaluate, the potential impact of recent government actions, affecting the market price and availability of MBS, related derivative securities, and interest rates. For further discussions on how market conditions and government actions may adversely affect our business, see “Item 1A — Risk Factors.”

Our MBS portfolio is affected by general U.S. residential real estate market conditions and the overall U.S. economic environment. In particular, our MBS strategy and the performance of our MBS portfolio is influenced by the specific characteristics of these markets, including prepayment rates, credit losses, interest rates and the interest rate yield curve. Our results of operations with respect to our MBS portfolio primarily depend on, among other things, the level of our interest income, the amount and cost of borrowings we may obtain by pledging our investment portfolio as collateral for the borrowings and the cost and impact of our hedging transactions. Our borrowing cost varies based on changes in interest rates and changes in the amount we can borrow, which is generally based on the fair value of the MBS portfolio and the advance rate at which the lenders are willing to lend against the collateral provided. We have entered into various hedging transactions to mitigate the interest rate sensitivity which directly impacts our cost of borrowing and the value of our MBS portfolio. The market value of these hedging instruments is expected to fluctuate inversely relative to the value of the MBS portfolio and decrease in value during periods of declining interest rates and/or widening mortgage spreads. Conversely, during periods of increasing rates and/or tightening mortgage spreads, these instruments are expected to increase in value.

The payment of principal and interest on the agency-backed MBS that we acquire and hold is guaranteed by the Federal Home Loan Mortgage Corporation (Freddie Mac) or the Federal National Mortgage Association (Fannie Mae). The payment of principal and interest on agency-backed MBS issued by Freddie Mac or Fannie Mae is not guaranteed by the U.S. government. Any failure to honor its guarantee of agency-backed MBS by Freddie Mac or Fannie Mae or any downgrade of securities issued by Freddie Mac or Fannie Mae by the rating agencies could cause a significant decline in the value of and cash flow from any agency-backed MBS we own that are guaranteed by such entity.

## **Current Market Conditions and Trends**

The U.S. Federal Reserve’s continued reductions of its monthly purchases of agency-backed MBS and U.S. Treasury bonds, commonly referred to as “QE3” officially concluded in October 2014. Home sales and new single-family home construction remain slow due to tight mortgage lending rules coming from the Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) legislation and bank conservatism in efforts to prevent future mortgage “put-backs”. In October 2014, FHFA Director Watt announced a number of general policy initiatives by the FHFA, including restoring a program that allows Fannie Mae and Freddie Mac to guarantee loans with down payments as low as 3%. Director Watt also said that the FHFA was taking steps to bring certainty to the circumstances under which Fannie Mae and Freddie Mac will require originators to repurchase defaulted mortgages that were later discovered to have underwriting defects. We cannot predict the prospects for the enactment, timing or final content of housing reform



legislation. These factors have contributed to a shortage of mortgage origination. One consequence of this is that new residential agency-backed MBS issuance is low. While the Federal Reserve officially ended QE3 in October 2014, it still purchased \$22 billion in residential agency-backed MBS in December 2014 through its reinvestment of principal and interest it received on the agency-backed MBS in its portfolio, as much as it purchased in any other month during 2014. The Federal Reserve's asset purchase program has continued to dominate the residential agency-backed MBS markets.



On January 28, 2015, the Open Market Committee of the Federal Reserve (FOMC) issued a release noting that inflation has declined “substantially” in recent months and that the FOMC anticipates inflation to decline further in the near term. However, on a more hawkish note, the FOMC stated that recent declines in energy prices have boosted household purchasing power and that economic activity has been expanding at a solid pace. In short, despite recent declines in energy prices and the FOMC expectation of inflation rising gradually toward 2 percent over the medium term, we do not expect a rate increase until summer 2015 at the earliest given current conditions.

Given the low inflation projections, we believe that the U.S. government’s monetary policy will likely be dependent on actual growth in employment rather than inflation concerns. It is important to note that over the past several years, actual employment growth has been consistently below the U.S. Federal Reserve’s projections. While there are signs of a recovery, uncertainty continues to dominate the market, due to the continued low interest rate environment and actions by the U.S. Federal Reserve and other global regulators. We believe the general business environment will continue to be challenging in 2015 and future periods. Our growth outlook is dependent, in part, on the strength of the financial markets, the impact of fiscal and monetary policy actions by the United States and other countries, particularly those in Europe and east Asia, the overall market value of U.S. equities and liquidity in the financial system. Depending on recent market developments and movements, we may seek to re-align our strategy and our portfolio. We will continue to closely monitor the developments in the market and evaluate the opportunities across the spectrum in the mortgage industry and other types of assets and seek the highest risk-adjusted returns for our capital.

We believe the limited liquidity and volatility in the credit markets will continue while the markets seek to determine the right equilibrium levels for benchmark interest rates as the U.S. Federal Reserve stimulus leaves the market place.

### **Recent Government Activity**

Based on various legislative proposals, significant differences appear to exist within Congress regarding housing finance reform. The 2014 elections likely exacerbated this dynamic, further dampening prospects for legislative action in 2015. GSE reform lost momentum in 2014 when a proposed GSE reform bill introduced by Senators Tim Johnson (D-SD) and Mike Crapo (R-ID), the two most senior members of the Senate Banking Committee, failed to secure enough support for the bill to be considered by Congress. The congressional Republican leadership, now controlling both houses of Congress, continues to favor a very different approach, which is generally based on earlier legislation proposed by Senators Bob Corker (R-TN) and Mark Warner (D-VA). As the FHFA and both houses of Congress each discussed and considered separate measures intended to restructure the U.S. housing finance system and the operations of Fannie Mae and Freddie Mac, there was no resolution. We expect debate and discussion on housing finance reform to continue in 2015. It is unclear which, if any, of these measures will be enacted and, if any are enacted, what the effects would be. It is possible that the 2016 Presidential election may be required for meaningful housing finance debate and reform to occur, while it is also possible that the status quo will prevail for some time to come.



In August 2014, the FHFA issued a request for comment on its proposal to establish a “Single Security” for agency-backed MBS, with conformed structures, terms, disclosures and settlement date. Under the plan, the proposed Single Security would leverage the GSEs’ existing security structures and would encompass many of the pooling features of the current Fannie Mae MBS and more of the disclosure framework of the current Freddie Mac Participation Certificate (“PC”). The FHFA indicated that the ultimate goal for the new structure is for the legacy MBS and PC securities to be fungible or transferable with the new security. Such a plan would benefit investors in agency-backed MBS by simplifying the structures, terms, disclosures and settlement rules for agency-backed MBS, and making these securities more comparable for purposes of pricing and transacting.

The passage of any new legislation affecting Fannie Mae and Freddie Mac may create market uncertainty and reduce the actual or perceived credit quality of securities issued or guaranteed by the U.S. government through a new or existing successor entity to Fannie Mae and Freddie Mac. If the charters of Fannie Mae and Freddie Mac were revoked, it is unclear what effect, if any, this would have on the value of the existing Fannie Mae and Freddie Mac agency-backed MBS. It is also possible that the above-referenced proposed legislation, if made law, could adversely impact the market for securities issued or guaranteed by the U.S. government and the spreads at which they trade. The foregoing could materially adversely affect the pricing, supply, liquidity and value of our target assets and otherwise materially adversely affect our business, operations and financial condition.

## **Executive Summary**

On June 11, 2014, the Company’s Board of Directors appointed J. Rock Tonkel, Jr. as the Company’s Chief Executive Officer effective immediately. Mr. Tonkel succeeded Eric F. Billings as Chief Executive Officer, who retired from this position in order to focus on his other business activities. Mr. Tonkel has served as President and Chief Operating Officer, a member of the Company’s Board of Directors and a member of the Company’s Investment Committee since 2007. Mr. Tonkel will also continue to serve as President of the Company, as a director and as a member of the Investment Committee. Mr. Billings will continue to serve as Executive Chairman of the Board as well as the Chairman of the Company’s Investment Committee.

During the year ended December 31, 2014, we raised \$166.9 million in additional capital through equity offerings. On March 28, 2014, we completed a public offering of 3,062,500 shares of Class A common stock, including 312,500 shares of Class A common stock purchased by the underwriters pursuant to an option granted by us to cover over-allotments, at a public offering price of \$27.40 per share, for net proceeds of \$81.7 million after deducting underwriting discounts and commissions and expenses. On September 8, 2014, we completed a public offering of 3,162,500 shares of Class A common stock, including 412,500 shares of Class A common stock purchased by the underwriters pursuant to an option granted by us to cover over-allotments, at a public offering price of \$27.61 per share, for net proceeds of \$85.2 million after deducting underwriting discounts and commissions and expenses. We invested this additional capital into our agency-backed MBS portfolio on leveraged basis.



Based on current economic indicators and trends in underlying credit and housing data, we continue to review the allocation of our available capital in an effort to maximize return to our shareholders. As of December 31, 2014, our MBS portfolio consisted of \$3.7 billion in fair value, with \$3.4 billion of agency-backed MBS and \$0.3 billion of private-label MBS. Our combined MBS portfolio performed consistently with our expectations during the year ended December 31, 2014. Our private-label MBS portfolio value increased due to continued demand for these assets and the continued improvement in their credit metrics. The agency-backed MBS values increased during the year ended December 31, 2014 due to market fluctuations and conditions. Our hedge design and structure is intended to offset substantially the decrease in value of our assets due to changes in interest rates. Other factors, such as the steepness or flatness of the yield curve, will potentially have an effect on the value of our hedges as compared to the assets.

Contrary to market expectations, the 10-year U.S. Treasury rate continued to fall, ending the year at 2.17% on December 31, 2014, representing a decrease of 86 basis points from December 31, 2013. As a result, the value of our derivatives that we utilize for hedging purposes have deteriorated significantly. During the latter half of 2014, the 10-year Treasury yield curve has flattened since June 30, 2014. The 10-year Treasury decreased 35 basis points and the 5-year to 10-year Treasury curve flattened by 38 basis points. In addition, the spread between agency-backed MBS and interest rate swaps tightened during the six-months ended December 31, 2014, with the spread between Fannie Mae 30-year par priced securities and 5-year interest rate swaps tightening by approximately 44 basis points.

Continued expectations of stabilization and improvement in the housing market, increased liquidity and available leverage have stabilized prices for our private-label MBS, particularly among re-REMIC mezzanine securities. Our re-REMIC securities are predominantly held in the subordinate tranches. We will continue to closely monitor the performance of these securities.

Based on the improvements we have observed in the general economic indicators and trends in underlying credit and housing data, we reallocated some of our available capital from capital raises and the sale of some of the private-label MBS in our portfolio to the agency-backed MBS portfolio during 2014.

We continued to evaluate the opportunities across the MBS industry and seek the highest risk-adjusted returns for our capital, and to strengthen our position and to maximize return to our shareholders. We evaluated and prioritized the risk-adjusted return we expect to receive on every asset based upon a current cash yield perspective as well as from a total yield perspective that includes expected reflation, which is defined as an increase in value between the amortized cost basis and the par value of the security. Historically, based on market conditions, we believe our MBS assets have provided us with higher relative risk-adjusted rates of return than most other portfolio opportunities we have evaluated. We intend to continue to evaluate acquisition opportunities against the returns available in each of our asset alternatives and endeavor to allocate our assets and capital with an emphasis toward what we believe will generate the highest risk-adjusted return available. This strategy may cause us to have different allocations of capital in different environments. We believe we have constructed an MBS portfolio with attractive characteristics and will continue to monitor relative value between the various classes of MBS and may re-allocate our portfolio at any time based on management's view of the market. We also believe the strategy of maintaining our combined portfolio, agency-backed MBS and private-label MBS, allows us to mitigate risk exposures in a sometimes unexpected and volatile



environment.

As of December 31, 2014, we had net deferred tax assets of \$122.4 million, including a \$26.0 million valuation allowance on our deferred tax asset attributable to net capital losses (NCLs). On a quarterly basis, we determine whether a valuation allowance is necessary on our net deferred tax asset. In doing so, we consider all evidence available, both positive and negative, in determining whether, based on the weight of the evidence, it is more-likely-than-not that the deferred tax assets will be realized. In conducting our assessment at December 31, 2014, we evaluated the historical results of operations and future income projections, the value of the MBS portfolio, net yield and comparison of management's forecasts to actual results. With respect to the \$54.7 million deferred tax asset relating to NCLs, we determined it was more-likely-than-not that \$26.0 million would expire without being utilized; and therefore, a corresponding valuation allowance was established. With respect to the net deferred tax assets relating to net operating losses (NOLs) and other temporary differences, we determined that the positive evidence out-weighed the negative evidence as of December 31, 2014 and that it is more-likely-than-not that these deferred tax assets will be realized based primarily on our positive and consistent earnings trend over the three year period ended December 31, 2014 as well as taxable income over the same period. In future quarters, we will continue to evaluate our ability to realize the net deferred tax asset. If evidence in future period changes our assessment of the realizability of the deferred tax assets, we will adjust the valuation allowance at that time. Examples of factors that could affect our assessment are a downturn in the economy that negatively impacts the value of the MBS portfolio, our overall business, and a change to our business. See "Item 1A — Risk Factors — Future decreases in the Company's book value attributable to deferred tax assets may reduce the market price of our shares." in this Annual Report on Form 10-K.

Our book value per share of \$27.95 as of December 31, 2014 reflects \$5.33 per share related to the deferred tax assets on our balance sheet. As we benefit from the utilization of the deferred tax assets in future periods, the corresponding book value attributable to the deferred tax assets utilized will be deducted against future pre-tax income. However, if the deferred tax assets expire without being utilized, the corresponding deferred tax asset will reduce book value and reported GAAP net income.

For the year ended December 31, 2014, we had net income of \$6.0 million, or \$0.29 per share (diluted), compared to net income of \$49.5 million, or \$3.06 per share (diluted) for the year ended December 31, 2013.



The following is a summary of our net income for the periods indicated:

(Dollars in thousands)	Year Ended December 31,		
	2014	2013	2012
Net interest income	\$112,156	\$78,490	\$59,189
Other loss, net	(38,687 )	(47,760)	(10,738 )
Other expenses	18,069	16,591	17,446
Income before income taxes	55,400	14,139	31,005
Income tax provision(benefit)	49,446	(35,322)	(152,937)
Net income	\$5,954	\$49,461	\$183,942

In addition to the financial results reported in accordance with generally accepted accounting principles as consistently applied in the United States (GAAP), we calculated non-GAAP core operating income for the years ended December 31, 2014 and 2013. Our non-GAAP core operating income for the years ended December 31, 2014 and 2013 was \$105.8 million and \$77.3 million, respectively. In determining core operating income, we excluded certain legacy litigation expenses and the following non-cash expenses: (1) compensation costs associated with stock-based awards, (2) accretion of MBS purchase discounts adjusted for contractual interest and principal repayments in excess of proportionate invested capital, (3) other-than-temporary impairment charges recognized, (4) non-cash income tax provisions, and (5) benefit from the reversal of previously accrued federal and state tax liability and accrued interest related to uncertain tax positions. Additionally, starting in 2014, the Company has excluded both realized and unrealized gains and losses on the agency-backed MBS and all related hedge instruments, and has presented prior periods on a consistent basis. These adjustments are only for the purpose of calculating our non-GAAP core operating income; therefore, they do not change our GAAP book value as reported.

The Company's portfolio strategy on the agency-backed MBS portfolio is to generate a net interest margin on the leveraged assets and hedge the market value of the assets, expecting that the fluctuations in the market value of the agency-backed MBS and related hedges should substantially offset each other over time. As a result, the Company excludes both the realized and unrealized fluctuations in the gains and losses in the assets and hedges on its hedged agency-backed MBS portfolio when assessing the underlying core operating income of the Company. However, the Company's portfolio strategy on the private-label MBS is to generate a total cash return comprised of both interest income and the cash return realized when the private-label MBS are sold which equals the difference between the sale price and the discount to par paid at acquisition. Therefore, the Company excludes non-cash accretion of private-label MBS purchase discounts from core operating income, but includes realized cash gains or losses on its private-label MBS portfolio in core operating income to reflect the total cash return on those securities over their holding period.

This non-GAAP core operating income measurement is used by management to analyze and assess the Company's operating results on its portfolio and assist with the determination of the appropriate level of dividends. We believe that this non-GAAP measurement assists investors in understanding the impact of these non-core items and non-cash expenses on our performance and provides additional clarity around our earnings capacity and trends. A limitation of utilizing this non-GAAP measure is that the GAAP accounting effects of these events do in fact reflect the underlying financial results of our business and these effects should not be ignored in evaluating and analyzing our financial



results. Therefore, we believe net income on a GAAP basis and core operating income on a non-GAAP basis should be considered together.



The following is a reconciliation of GAAP net income to non-GAAP core operating income for the years ended December 31, 2014 and 2013 (dollars in thousands):

	Year Ended December 31,		
	2014	2013 Revised	2013 As Previously Reported
GAAP net income	\$5,954	\$49,461	\$ 49,461
Adjustments			
Legacy litigation expenses <sup>(1)</sup>	54	1,061	1,061
Non-cash income tax provisions	48,153	(20,051)	(20,051 )
Stock compensation	3,814	2,546	2,546
Non-cash interest income related to purchase discount accretion <sup>(2)</sup>	(8,496 )	(4,743 )	(4,743 )
Net realized and unrealized loss on trading MBS and hedge instruments	55,830	63,864	53,812
Benefit from the reversal of federal tax liability and accrued interest related to uncertain tax position	—	(16,212)	(16,212 )
Other-than-temporary impairment charges	449	1,354	1,354
Non-GAAP core operating income	\$105,758	\$77,280	\$ 67,228

Legacy litigation expenses relate to legal matters pertaining to events related to business activities the Company <sup>(1)</sup>completed or exited in or prior to 2009 — primarily debt extinguishment, sub-prime mortgage origination and securitization and broker/dealer operations.

Non-cash interest income related to purchase discount accretion represents interest income recognized in excess of <sup>(2)</sup>cash receipts related to contractual interest income and principal repayments in excess of proportionate invested capital.

As of December 31, 2014, our agency-backed MBS consisted of \$3.2 billion in face value with a cost basis of \$3.4 billion and was fair valued at \$3.4 billion. Our agency-backed MBS had a weighted-average coupon of 4.03% and a weighted-average cost of funding of 0.38% at December 31, 2014. During the year ended December 31, 2014, we received proceeds of \$65.3 million from the sale of \$61.7 million in face value of our agency-backed MBS, realizing \$1.4 million in gains, or realized net losses of \$0.1 million from the acquisition price.

In the normal course of our operations, we utilize financial instruments to hedge economic risk. These instruments may include interest rate swaps, Eurodollar futures, swap futures, and U.S. Treasury futures contracts, put options and certain commitments to purchase and sell MBS. We have entered into 10-year swap futures that are uniquely designed to replicate the over-the-counter swap economics and are valued based upon the difference between a series of semi-annual fixed interest payments and quarterly floating interest payments based on the 3-month U.S. Dollar LIBOR rate over the term to maturity. Because 10-year swap futures mature or roll on a quarterly basis, the change in



value during the quarter represents the impact of the change in the underlying interest indices during the term. As a result, the 10-year swap futures exhibit longer duration and are sensitive to changes in interest rates. Due to the shorter term maturity, the fluctuations in the value of these derivatives may be volatile and are included in GAAP income each quarter as unrealized gains or losses until such time as they are terminated or expire, whereupon they are included in GAAP income as realized gains or losses.

We have entered into Eurodollar futures to mitigate the interest rate sensitivity which directly impacts our cost of borrowing and the market value of our agency-backed MBS. The Eurodollar futures mature through September 30, 2019 and have a lifetime weighted-average rate of 2.61%, as compared to a lifetime weighted-average market rate of 1.87% as of December 31, 2014. The swap futures traded on the Chicago Board of Trade Exchange mature in March 2015 and have a weighted-average rate of 2.47%, as compared to a weighted-average market rate of 2.34% as of December 31, 2014. The swap futures traded on the Eris Exchange have a stated maturity of March 2024 and have a weighted-average rate of 3.15%, as compared to a weighted-average market rate of 2.23% as of December 31, 2014. The value of these hedge instruments is expected to fluctuate inversely relative to the change in value of the agency-backed MBS portfolio and decrease in value during periods of declining interest rates and/or widening mortgage spreads. Conversely, during periods of increasing interest rates and/or tightening mortgage spreads, these instruments are expected to increase in value. As discussed above, as a result of the continued decline in the 10-year U.S. Treasury yield to 2.17% on December 31, 2014, the Company recorded \$41.2 million in realized and \$99.2 million in unrealized losses related to the value changes in these derivative positions.

As of December 31, 2014, our private-label MBS portfolio consisted of \$353.2 million in face value with an amortized cost basis of \$219.9 million and was fair valued at \$267.4 million. The unamortized net discount on our private-label MBS portfolio was \$133.3 million as of December 31, 2014. During the year ended December 31, 2014, we recognized net interest income of \$24.5 million, representing a 9.6% annualized yield, including coupon and accretion of purchase discount based on the current accretable yield rate, from our private-label MBS portfolio. During 2014, we received proceeds of \$86.3 million from the sale of \$112.3 million in face value of our private-label MBS, realizing \$17.3 million in net gains.



For available-for-sale, private-label MBS securities that have been acquired at discounts to face value due in part to credit deterioration since origination, we re-evaluate the undiscounted expected future cash flows and the changes in cash flows from those originally projected at the time of purchase or last revised for each security. For those securities in an unrealized loss position, we recognized \$0.4 million and \$29.3 thousand in other-than-temporary impairment (OTTI) charges on our private-label MBS portfolio and on an investment in agency interest-only MBS, respectively, during 2014. The OTTI charges represent the difference between the carrying value and the net present value of expected future cash flows discounted using the current yield used for income recognition purposes, as compared to fair value which is discounted using the current expected market rate in accordance with GAAP for the securities acquired at discount due to credit deterioration since origination. As a result, the OTTI charges are greater than the difference between the carrying value and fair value. These OTTI charges do not represent additional credit deterioration but the change in timing of cash flow projection primarily due to higher than projected actual cash flows during the earlier periods. In addition, these OTTI charges do not affect non-GAAP core operating income or book value, but do reduce our net income and lower the accounting basis used to record future discount accretion.

### Principal Investing Portfolio

The following table summarizes our principal investing portfolio including principal receivable on MBS, as of December 31, 2014 (dollars in thousands):

	Face Amount	Fair Value
Trading		
Agency-backed MBS		
Fannie Mae	\$ 1,923,588	\$2,064,465
Freddie Mac	1,260,088	1,349,835
Available-for-sale		
Agency-backed MBS		
Fannie Mae	36	40
Private-label MBS		
Senior securities	—	—
Re-REMIC securities	353,237	267,437
Other mortgage related assets	63,232	212
Total	\$ 3,600,181	\$3,681,989

### Operating Income

Our operating income consists primarily of net interest income, net investment gains and losses, and investment fund earnings.



## Expenses

Interest expense includes the costs of our repurchase agreement borrowings and long-term debt securities.

Compensation and benefits expense includes base salaries as well as incentive compensation. Salaries, payroll taxes and employee benefits are relatively fixed in nature. In addition, compensation and benefits expense includes estimated performance-based incentive compensation, including the discretionary component that is expected to be paid and non-cash expenses associated with all stock-based awards granted to employees.

Professional services expense includes accounting, legal and consulting fees. Many of these expenses, such as legal fees, are to a large extent variable related to level of transactions, ongoing litigation and initiatives.

Business development expense includes primarily travel and entertainment expenses.

Occupancy and equipment expense includes rental costs for our facilities and depreciation and amortization of equipment and software. These expenses are largely fixed in nature.

Communications expenses include voice, data and internet service fees, and data processing costs.

Other operating expenses include professional liability and property insurance, directors' fees including cash and stock awards, printing and copying, business licenses and taxes, offices supplies, penalties and fees, charitable contributions and other miscellaneous office expenses, if any.



## Results of Operations

### *Comparison of the years ended December 31, 2014 and 2013*

We reported net income of \$6.0 million for the year ended December 31, 2014 compared to net income of \$49.5 million for the year ended December 31, 2013, which included the following results for the periods indicated (dollars in thousands):

	Year Ended December 31,	
	2014	2013
Interest income	\$ 123,547	\$ 87,019
Interest expense	11,391	8,529
Net interest income	112,156	78,490
Other loss, net		
Investment loss, net	(38,672 )	(47,745 )
Other loss	(15 )	(15 )
Total other loss, net	(38,687 )	(47,760 )
Other expenses	18,069	16,591
Income before income taxes	55,400	14,139
Income tax provision (benefit)	49,446	(35,322 )
Net income	\$ 5,954	\$ 49,461

Net income decreased \$43.5 million from net income of \$49.5 million for the year ended December 31, 2013 to net income of \$6.0 million for the year ended December 31, 2014. The decrease in net income is due to the following changes:

#### *Net Interest Income*

Net interest income increased \$33.7 million (42.9%) from \$78.5 million for the year ended December 31, 2013 to \$112.2 million for the year ended December 31, 2014. The increase is due primarily to a \$34.7 million increase due to a change in volume (average balance) offset by a \$0.4 million decrease due to a change in net rate on our principal investing activities as discussed below. The increase in the average balance of our agency-backed MBS is the result of deploying our investable capital generated from the capital raised from our public offerings in 2014 on a leveraged basis to our MBS portfolio. See additional yield analysis below. The components of income from our principal investment activities, net of related interest expense are as follows (dollars in thousands):



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	Year Ended December 31,	
	2014	2013
Net interest income	\$ 114,366	\$ 80,120
Investment loss, net	(38,672 )	(47,745 )

The components of net interest income from our MBS related portfolio is summarized in the following table (dollars in thousands):

	Year Ended December 31,			2013		
	Average Balance	Income (Expense)	Yield (Cost)	Average Balance	Income (Expense)	Yield (Cost)
Agency-backed MBS	\$2,590,460	\$ 97,900	3.78 %	\$1,599,589	\$ 60,386	3.78 %
Private-label MBS						
Senior securities	1,365	226	16.55 %	5,435	893	16.43 %
Re-REMIC securities	252,588	25,371	10.04 %	241,880	25,693	10.62 %
Other investments	258	27	10.48 %	427	44	10.37 %
	\$2,844,671	123,524	4.34 %	\$1,847,331	87,016	4.71 %
Other <sup>(1)</sup>		23			3	
		123,547			87,019	
Repurchase agreements	\$2,438,479	(9,181 )	(0.37 )%	\$1,515,137	(6,899 )	(0.45 )%
Net interest income/spread		\$ 114,366	3.97 %		\$ 80,120	4.26 %

(1) Includes interest income on cash and other miscellaneous interest-earning assets.



The increase in net interest income of \$34.3 million from \$80.1 million from the year ended December 31, 2013 to \$114.4 million from the year ended December 31, 2014 is primarily due to the increase in our agency-backed MBS portfolio from the deployment of capital raised from our public offerings during 2014 on a leveraged basis. The decreases in interest rates in the MBS portfolio and related repurchase agreements did not materially impact the change in net interest income for the year ended December 31, 2014 from the year ended December 31, 2013. Interest income from other investments represents interest on interest-only MBS securities.

The effects of changes in the composition of our investments on our net interest income from our principal investment activities are summarized below (dollars in thousands):

	Year Ended December 31, 2014 vs. Year Ended December 31, 2013		
	Rate <sup>(1)</sup>	Volume <sup>(1)</sup>	Total Change
MBS			
Agency-backed MBS	\$ 66	\$ 37,447	\$ 37,513
Private-label MBS			
Senior securities	7	(674 )	(667 )
Re-REMIC securities	(1,431 )	1,109	(322 )
Total private-label MBS	(1,424 )	435	(989 )
Total MBS	(1,358 )	37,882	36,524
Other interest	—	3	3
Repurchase agreements	930	(3,211 )	(2,281 )
	\$ (428 )	\$ 34,674	\$ 34,246

<sup>(1)</sup> The change in interest income and interest expense due to both rate and volume has been allocated to rate and volume changes in proportion to the relationship of the absolute dollar amounts of the change in each.

Interest expense related to repurchase agreements increased \$2.3 million (33.3%) to \$9.2 million for the year ended December 31, 2014 from \$6.9 million for the year ended December 31, 2013 due to the increase in the repurchase agreement borrowings. Our repurchase borrowings increased primarily as a result of leveraging the net proceeds raised from our public offerings in 2014 in connection with the investment of such net proceeds. Interest expense unrelated to our principal investing activity relates to long-term debt. These costs increased to \$2.2 million for the year ended December 31, 2014 from \$1.6 million for the year ended December 31, 2013 due to the increase in long-term debt outstanding as a result of the issuance of \$25.0 million in Senior Notes in May 2013.

*Other Loss, Net*



Total other loss, net, decreased \$9.0 million from a loss of \$47.7 million for the year ended December 31, 2013 to a loss of \$38.7 million for the year ended December 31, 2014 primarily due to an decrease in net investment losses as follows (dollars in thousands):

	Year Ended December 31,	
	2014	2013
Realized gains on sale of available-for-sale investments, net	\$ 17,257	\$ 17,458
Available-for-sale and cost method securities — OTTI charges	(449 )	(1,354 )
Gains (losses) on trading investments, net	84,152	(122,163 )
(Losses) gains from derivative instruments, net	(140,353 )	58,003
Other, net	721	311
Investment loss, net	\$ (38,672 )	\$ (47,745 )

The realized gains on sale of available-for-sale investments, net, recognized for the year ended December 31, 2014 and 2013 were primarily the result of \$86.3 million and \$69.3 million of proceeds received, respectively, from the sales of \$112.3 million and \$102.1 million in face value of MBS, respectively. We recorded a net gain of \$17.3 million and \$17.5 million from these sales for the years ended December 31, 2014 and 2013, respectively.

We recorded OTTI charges of \$0.4 million and \$1.3 million for the years ended December 31, 2014 and 2013, respectively, on available-for-sale, private-label MBS, with a cost basis of \$2.2 million and \$11.7 million, respectively prior to recognizing the OTTI charges. The OTTI charges represent the difference between the carrying value and the net present value of expected future cash flows discounted using the current yield used for income recognition purposes, as compared to fair value which is discounted using the current expected market rate in accordance with GAAP for the securities acquired at discount due to credit deterioration since origination. These OTTI charges do not represent additional credit deterioration but the change in timing of cash flow projection primarily due to higher than projected actual cash flows during the earlier periods. For the years ended December 31, 2014 and 2013, we recorded OTTI charges of \$29.3 thousand and \$84.2 thousand, respectively, on an investment in agency interest-only MBS.



The gains on trading investments, net, recognized for the year ended December 31, 2014 were primarily the result of net mark-to-market gain adjustments of \$82.8 million and gains of \$1.4 million from sales of trading investments. The securities sold during the year ended December 31, 2014 had \$0.1 million in net cumulative losses from the acquisition price. The losses on trading investments, net, recognized for the year ended December 31, 2013 were primarily the result of net mark-to-market loss adjustments of \$96.4 million and net losses of \$25.8 million from sales of trading investments. The securities sold during the year ended December 31, 2013 had \$16.2 million in net cumulative losses from the acquisition price.

The losses from derivative instruments recognized for the year ended December 31, 2014 were the result of net unrealized mark-to-market loss adjustments of \$99.2 million and net realized losses of \$41.2 million. The derivative instruments closed during the year ended December 31, 2014 had \$42.0 million in net cumulative losses from the acquisition price. The gains from derivative instruments recognized for the year ended December 31, 2013 were the result of net realized gains of \$45.4 million and net unrealized mark-to-market gain adjustments of \$12.6 million. The derivative instruments closed during the year ended December 31, 2013 had \$5.9 million in net cumulative gains from the acquisition price. The value of our hedge instruments is expected to fluctuate inversely relative to the change in value of the agency-backed MBS portfolio. The decline in value of our derivative instruments during the year ended December 31, 2014 is the result of 86 basis point decline in the 10-year U.S. Treasury yield during the year to 2.17% on December 31, 2014.

#### *Other Expenses*

Other expenses increased by \$1.5 million (9.0%) from \$16.6 million for the year ended December 31, 2013 to \$18.1 million for the year ended December 31, 2014. The increase is primarily a result of increases in compensation expenses offset by a decrease in legal expenses.

#### *Income Tax Provision (Benefit)*

Total income tax provision increased from a benefit of \$35.3 million for the year ended December 31, 2013 to a provision of \$49.4 million for the year ended December 31, 2014. The increase in income tax provision was due primarily to an increase in pre-tax income as discussed above, an increase in the valuation allowance on certain deferred tax assets and the realization of previously unrecognized tax benefits including related accrued interest that were fully reserved related to an uncertain tax position during the year ended December 31, 2013. As a result of the realization of previously unrecognized tax benefits, our effective tax rate for the year ended December 31, 2013 was lower than the statutory tax rate. There was no such activity during the year ended December 31, 2014. The net deferred tax assets, which are partially offset by a valuation allowance, include NOLs, which are available to offset the current and future taxable income. We recorded an expected tax liability for 2014 due to being subject to alternative minimum tax.



*Comparison of the years ended December 31, 2013 and 2012*

We reported net income of \$49.5 million for the year ended December 31, 2013 compared to \$183.9 million for the year ended December 31, 2012. Net income included the following results for the periods indicated (dollars in thousands):

	Year Ended December 31,	
	2013	2012
Interest income	\$ 87,019	\$ 64,154
Interest expense	8,529	4,965
Net interest income	78,490	59,189
Other loss, net		
Investment loss, net	(47,745 )	(10,723 )
Other loss	(15 )	(15 )
Total other loss, net	(47,760 )	(10,738 )
Other expenses	16,591	17,446
Income before income taxes	14,139	31,005
Income tax benefit	(35,322 )	(152,937 )
Net income	\$ 49,461	\$ 183,942

Net income decreased \$134.4 million to \$49.5 million for the year ended December 31, 2013 from \$183.9 million for the year ended December 31, 2012. The decrease in net income is due to the following changes:

*Net Interest Income*

Net interest income increased \$19.3 million (32.6%) to \$78.5 million for the year ended December 31, 2013 from \$59.2 million for the year ended December 31, 2012. The increase is due primarily to a \$33.3 million increase due to a change in volume (average balance) and a \$12.9 million decrease due to a change in net rate on our principal investing activities as discussed below. The increase is primarily the result of fully deploying our investable capital generated from the capital raised from our public offerings in 2013 on a leveraged basis to our MBS portfolio. See additional yield analysis below. The components of income from our principal investment activities, net of related interest expense are as follows (dollars in thousands):



	Year Ended December 31,	
	2013	2012
Net interest income	\$ 80,120	\$ 59,679
Investment loss, net	(47,745 )	(10,723 )

The components of net interest income from our MBS related portfolio is summarized in the following table (dollars in thousands):

	Year Ended December 31,			2012		
	Average	Income	Yield	Average	Income	Yield
	Balance	(Expense)	(Cost)	Balance	(Expense)	(Cost)
Agency-backed MBS	\$ 1,599,589	\$ 60,386	3.78 %	\$ 971,725	\$ 39,705	4.09 %
Private-label MBS						
Senior securities	5,435	893	16.43 %	7,787	1,319	16.94 %
Re-REMIC securities	241,880	25,693	10.62 %	140,890	23,007	16.33 %
Other investments	427	44	10.37 %	1,054	122	11.57 %
	\$ 1,847,331	87,016	4.71 %	\$ 1,121,456	64,153	5.72 %
Other <sup>(1)</sup>		3			1	
		87,019			64,154	
Repurchase agreements	\$ 1,515,137	(6,899 )	(0.45 )%	\$ 953,152	(4,475 )	(0.46 )%
Net interest income/spread		\$ 80,120	4.26 %		\$ 59,679	5.26 %

(1) Includes interest income on cash and other miscellaneous interest-earning assets.

The increase in net interest income of \$20.4 million is primarily due to the increases in our MBS portfolio from the deployment of capital raised from our public offerings during 2012 and 2013 on a leveraged basis. The decreases in interest rates in the MBS portfolio and related repurchase agreements did not materially impact the change in net interest income for the year ended December 31, 2013 from the year ended December 31, 2012. Interest income from other investments represents interest on interest-only MBS securities.

The effects of changes in the composition of our investments on our net interest income from our principal investment activities are summarized below (dollars in thousands):

Year Ended December 31, 2013  
vs.  
Year Ended December 31, 2012



	<b>Rate <sup>(1)</sup></b>	<b>Volume <sup>(1)</sup></b>	<b>Total Change</b>
MBS			
Agency-backed MBS	\$ (3,227 )	\$ 23,908	\$ 20,681
Private-label MBS			
Senior securities	(39 )	(387 )	(426 )
Re-REMIC securities	(9,931 )	12,617	2,686
Total private-label MBS	(9,970 )	12,230	2,260
Total MBS	(13,197 )	36,138	22,941
Other interest	—	(76 )	(76 )
Repurchase agreements	295	(2,719 )	(2,424 )
	\$ (12,902 )	\$ 33,343	\$ 20,441

<sup>(1)</sup> The change in interest income and interest expense due to both rate and volume has been allocated to rate and volume changes in proportion to the relationship of the absolute dollar amounts of the change in each.



Interest expense related to repurchase agreements increased \$2.4 million (53.3%) to \$6.9 million for the year ended December 31, 2013 from \$4.5 million for the year ended December 31, 2012 due to the increase in the repurchase agreement borrowings. Our repurchase borrowings increased primarily as a result of leveraging the net proceeds raised from our public offerings of common stock in 2013 in connection with the investment of such net proceeds. Interest expense unrelated to our principal investing activity relates to long-term debt. These costs increased to \$1.6 million for the year ended December 31, 2013 from \$0.5 million for the year ended December 31, 2012 due to the increase in long-term debt outstanding as a result of the Senior Notes.

### *Other Loss, Net*

Total other loss, net, increased \$37.1 million to a loss of \$47.8 million for the year ended December 31, 2013 from a loss of \$10.7 million for the year ended December 31, 2012 primarily due to an increase in net investment losses as follows (dollars in thousands):

	Year Ended December 31,	
	2013	2012
Realized gains on sale of available-for-sale investments, net	\$ 17,458	\$ 9,813
Available-for-sale and cost method securities — OTTI charges	(1,354 )	(15,708 )
(Losses) gains on trading investments, net	(122,163 )	22,280
Gains (losses) from derivative instruments, net	58,003	(28,755 )
Other, net	311	1,647
Investment loss, net	\$ (47,745 )	\$ (10,723 )

The realized gains on sale of available-for-sale investments, net, recognized for the year ended December 31, 2013 and 2012 were primarily the result of \$69.3 million and \$34.1 million of proceeds received, respectively, from the sales of \$102.1 million and \$53.5 million in face value of MBS, respectively. We recorded a net gain of \$17.5 million and \$9.8 million from these sales for the years ended December 31, 2013 and 2012, respectively.

We recorded OTTI charges of \$1.3 million and \$15.2 million for the years ended December 31, 2013 and 2012, respectively, on available-for-sale, private-label MBS, with a cost basis of \$11.7 million and \$49.4 million, respectively. The OTTI charges represent the difference between the carrying value and the net present value of expected future cash flows discounted using the current yield used for income recognition purposes, as compared to fair value which is discounted using the current expected market rate in accordance with GAAP for the securities acquired at discount due to credit deterioration since origination. These OTTI charges do not represent additional credit deterioration but the change in timing of cash flow projection primarily due to higher than projected actual cash flows during the earlier periods. For the years ended December 31, 2013 and 2012, we recorded OTTI charges of \$0.1 million and \$0.5 million, respectively, on an investment in agency interest-only MBS.



The losses on trading investments, net, recognized for the year ended December 31, 2013 were primarily the result of net losses of \$25.8 million from sales and net mark-to-market loss adjustments of \$96.4 million. The securities sold during the year ended December 31, 2013 had \$16.2 million in net cumulative losses from the acquisition price. The gains on trading investments, net, recognized for the year ended December 31, 2012 were primarily the result of net gains of \$4.8 million from sales and net mark-to-market gain adjustments of \$17.5 million. The securities sold during the year ended December 31, 2012 had \$15.3 million in net cumulative gains from the acquisition price.

The gains from derivative instruments recognized for the year ended December 31, 2013 were the result of net realized gains of \$45.4 million and net unrealized mark-to-market gain adjustments of \$12.6 million. The derivative instruments closed during the year ended December 31, 2013 had \$5.9 million in net cumulative gains from the acquisition price. Losses from derivative instruments recognized for the year ended December 31, 2012 were the result of net realized losses of \$2.3 million and net unrealized mark-to-market loss adjustments of \$26.5 million. The derivative instruments closed during the year ended December 31, 2012 had \$14.7 million in net cumulative losses from the acquisition price. The value of our hedge instruments is expected to fluctuate inversely relative to the change in value of the agency-backed MBS portfolio.

Other, net primarily reflects proceeds received from the assignment of a claim that related to an agency-backed MBS under a repurchase agreement maintained with Lehman Brothers Inc. during the Lehman Brothers Holdings Inc. bankruptcy proceedings for the year ended December 31, 2012.

#### *Other Expenses*

Other expenses decreased by \$0.8 million (4.6%) from \$17.4 million for the year ended December 31, 2012 to \$16.6 million for the year ended December 31, 2013. The decrease is primarily a result of decreases in legal expenses offset by increases in compensation expenses.

#### *Income Tax Benefit*

Total income tax benefit decreased from a benefit of \$152.9 million for the year ended December 31, 2012 to a benefit of \$35.3 million for the year ended December 31, 2013. The decrease in income tax benefit was due primarily to: \$91.2 million in release of valuation allowance on certain deferred tax assets offset by an expiration of \$57.3 million of NCL carry-forwards; reversal of \$16.2 million in reserve for federal and state tax benefits and related accrued interest related to an uncertain tax position; and \$14.4 million of other changes in deferred tax assets for the year ended December 31, 2013 as compared to \$162.5 million in release of valuation allowance on certain deferred tax assets for the year ended December 31, 2012. As a result, our effective tax rate during years ended December 31, 2013 and 2012 were lower than the statutory tax rate. The net deferred tax assets, which are partially offset by a valuation allowance, include NOLs, which are available to offset the current and future taxable income. We recorded an expected tax liability for the period due to the expected alternative minimum taxes.







## Liquidity and Capital Resources

Liquidity is a measurement of our ability to meet potential cash requirements including ongoing commitments to repay borrowings, fund investments, and for other general business purposes. Our primary sources of funds for liquidity consist of short-term borrowings (e.g., repurchase agreements), principal and interest payments on MBS and proceeds from sales of MBS. Other sources of liquidity include proceeds from the offering of common stock, preferred stock, debt securities or other securities registered pursuant to our effective shelf registration statement filed with the SEC.

Liquidity, or ready access to funds, is essential to our business. Liquidity is of particular importance to our business and perceived liquidity issues may affect our counterparties' willingness to engage in transactions with us. Our liquidity could be impaired due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects us or third parties. Further, our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time. If we cannot obtain funding from third parties or from our subsidiaries, our results of operations could be negatively impacted.

Potential future sources of liquidity for us include existing cash balances, borrowing capacity through margin accounts and repurchase agreements and cash flows from operations, future issuances of common stock, preferred stock, debt securities or other securities registered pursuant to our shelf registration statement. Funding for agency-backed MBS through repurchase agreements continues to be available to us at rates we consider to be attractive from multiple counterparties, and we have observed increased availability for funding for private-label MBS through repurchase agreements.

To gain additional flexibility in accessing capital markets for, among other things, the acquisition of MBS and other assets, the repayment of outstanding indebtedness, the pursuit of growth initiatives that may include acquisitions, working capital, and for liquidity needs, we filed a shelf registration statement on Form S-3 (File No. 333-193478) with the SEC (the 2014 Shelf Registration) on January 22, 2014. The 2014 Shelf Registration was declared effective by the SEC on February 5, 2014. The 2014 Shelf Registration statement permits us to issue and publicly distribute various types of securities, including Class A common stock, preferred stock, debt securities, warrants and units, or any combination of such securities, from time to time, in one or more offerings, up to an aggregate amount of \$750.0 million.

Pursuant to our 2014 Shelf Registration statement, we completed two public offerings of Class A Common Stock during 2014 raising \$166.9 million in net proceeds after deducting underwriting discounts and commissions and expense. On March 28, 2014, we completed a public offering of 3,062,500 shares of Class A common stock, including 312,500 shares purchased by the underwriters pursuant to an option granted by us to cover over-allotments, at a public offering price of \$27.40 per share, for net proceeds of \$81.7 million, after deducting underwriting discounts and commissions and expenses. On September 8, 2014, we completed a public offering of 3,162,500 shares of Class A



common stock, including 412,500 shares purchased by the underwriters pursuant to an option granted by us to cover over-allotments, at a public offering price of \$27.61 per share, for net proceeds of \$85.2 million, after deducting underwriting discounts and commissions and expenses.

On May 24, 2013, we entered into separate equity distribution agreements (the Equity Distribution Agreements) with each of RBC Capital Markets, LLC, JMP Securities LLC, Ladenburg Thalmann & Co. Inc. and MLV & Co. LLC (Equity Sales Agents), pursuant to which we may offer and sell, from time to time, up to 1,750,000 shares of the Company's Class A common stock. Pursuant to the Equity Distribution Agreements, shares of our common stock may be offered and sold through the Equity Sales Agents in transactions that are deemed to be "at the market" offerings as defined in Rule 415 under the Securities Act of 1933, including sales made directly on the NYSE or sales made to or through a market maker other than on an exchange or, subject to the terms of a written notice from the Company, in privately negotiated transactions. As of December 31, 2014, we had not issued any shares of the Company's Class A common stock under the Equity Distribution Agreements.

### *Sources of Funding*

We believe that our existing cash balances, net investments in MBS, cash flows from operations, borrowing capacity and other sources of liquidity will be sufficient to meet our cash requirements for at least the next 12 months. We have obtained, and believe we will be able to continue to obtain, short-term financing in amounts and at interest rates consistent with our financing objectives. We may, however, seek debt or equity financings, in public or private transactions, to provide capital for corporate purposes and/or strategic business opportunities, including possible acquisitions, joint ventures, alliances or other business arrangements which could require substantial capital outlays. Our policy is to evaluate strategic business opportunities, including acquisitions and divestitures, as they arise. There can be no assurance that we will be able to generate sufficient funds from future operations, or raise sufficient debt or equity on acceptable terms, to take advantage of investment opportunities that become available. Should our needs ever exceed these sources of liquidity, we believe that most of our investments could be sold, in most circumstances, to provide cash. However, we may be required to sell our assets in such instances at depressed prices.

As of December 31, 2014, our liabilities totaled \$3.4 billion. In addition to other payables and accrued expenses, our indebtedness consisted of repurchase agreements and long-term debt. As of December 31, 2014, we had \$40.0 million of total long-term debt. Our trust preferred securities with a principal amount of \$15.0 million outstanding as of December 31, 2014 accrues and requires payment of interest quarterly at annual rates of three-month LIBOR plus 2.25% to 3.00% and matures between 2033 and 2035. Our Senior Notes with a principal amount of \$25.0 million outstanding as of December 31, 2014 accrues and requires payment of interest quarterly at an annual rate of 6.625% and mature on May 1, 2023. As of December 31, 2014, our debt-to-equity leverage ratio was 5.0 to 1.



We also have short-term financing facilities that are structured as repurchase agreements with various financial institutions to primarily fund our portfolio of agency-backed MBS. As of December 31, 2014, the weighted-average interest rate under these agreements was 0.40%. Our repurchase agreements include provisions contained in the standard master repurchase agreement as published by the Securities Industry and Financial Markets Association and may be amended and supplemented in accordance with industry standards for repurchase facilities. Our repurchase agreements include financial covenants, with which the failure to comply would constitute an event of default under the applicable repurchase agreement. Similarly, each repurchase agreement includes events of insolvency and events of default on other indebtedness as similar financial covenants. As provided in the standard master repurchase agreement as typically amended, upon the occurrence of an event of default or termination event, the applicable counterparty has the option to terminate all repurchase transactions under such counterparty's repurchase agreement and to demand immediate payment of any amount due from us to the counterparty.

Under our repurchase agreements, we may be required to pledge additional assets to our repurchase agreement counterparties in the event the estimated fair value of the existing pledged collateral under such agreements declines and such lenders demand additional collateral (*i.e.*, a margin call), which may take the form of additional securities or cash. Margin calls on repurchase agreements collateralized by our MBS investments primarily result from events such as declines in the value of the underlying mortgage collateral caused by factors such as rising interest rates or prepayments.

To date, we have not had any margin calls on our repurchase agreements that we were not able to satisfy with either cash or additional pledged collateral. However, should we encounter increases in interest rates or prepayments, margin calls on our repurchase agreements could result in a material adverse change in our liquidity position.

In the event that market conditions are such that we are unable to obtain financing for our investments in MBS in amounts and at interest rates consistent with our financing objectives, to the extent deemed appropriate, we may use cash to finance our investments or we may liquidate such investments. Accordingly, depending on market conditions, we may incur significant losses on any such sales of MBS.

The following table provides information regarding our outstanding repurchase agreement borrowings as of the dates and periods indicated (dollars in thousands):

	December 31,			
	2014		2013	
Outstanding balance	\$3,179,775		\$1,547,630	
Weighted-average rate	0.40	%	0.45	%
Weighted-average term to maturity	14.1	days	13.2	days
Maximum amount outstanding at any month-end during the period	\$3,183,811		\$1,801,383	



## ***Assets***

Our principal assets consist of MBS, cash and cash equivalents, receivables, deposits, long-term investments and deferred tax assets. As of December 31, 2014, liquid assets consisted primarily of cash and cash equivalents of \$33.8 million and net investments in MBS of \$502.0 million. Cash equivalents consist primarily of money market funds invested in debt obligations of the U.S. government. Our total assets increased from \$2.2 billion at December 31, 2013 to \$4.0 billion as of December 31, 2014. The increase in total assets reflects the deployment of capital raised from our public offerings during the year ended December 31, 2014 on a leveraged basis into our MBS portfolio. As of December 31, 2014, the total par and fair value of the MBS portfolio was \$3.5 billion and \$3.7 billion, respectively. As of December 31, 2014, the weighted average coupon of the portfolio was 3.93%.

## ***Cash Flows***

As of December 31, 2014, our cash and cash equivalents totaled \$33.8 million representing a net decrease in the balance of \$14.8 million from \$48.6 million as of December 31, 2013.

Cash provided by operating activities of \$70.0 million during 2014 was offset by net cash outflows of \$1.8 billion from investing activities and net cash inflows of \$1.7 billion from financing activities. Cash provided by operating activity was attributable primarily to pre-tax net income.

Our investing activities during 2014 included proceeds from sales of, and receipt of principal payments from, MBS totaling \$366.0 million. These cash inflows were offset by \$2.2 billion used to purchase MBS and the payments made for derivatives and related deposits during 2014. Our financing activities during 2014 reflected net proceeds from repurchase agreement borrowings of \$1.6 billion and net proceeds from completed public offerings of \$167.1 million offset by \$69.5 million in dividends paid.

As of December 31, 2013, our cash and cash equivalents totaled \$48.6 million representing a net increase in the balance of \$12.8 million from \$35.8 million as of December 31, 2012.

Cash provided by operating activities of \$61.4 million during 2013 was offset by net cash outflows of \$166.2 million from investing activities and net cash inflows of \$117.6 million from financing activities. Cash provided by operating activity was attributable primarily to net income.



Our investing activities during 2013 included proceeds from sales of, and receipt of principal payments from, MBS totaling \$1.2 billion. These cash inflows were offset by \$1.4 billion used to purchase MBS during 2013. Our financing activities during 2013 reflected net proceeds from repurchase agreement borrowings of \$50.4 million and net proceeds from completed public offerings of \$111.0 million offset by \$43.9 million in dividends paid.

### *Dividends*

Pursuant to our variable dividend policy, our Board of Directors evaluates dividends on a quarterly basis and, in its sole discretion, approves the payment of dividends. Our dividend payments, if any, may vary significantly quarter to quarter. The Board of Directors approved and we declared and paid the following dividends for 2014:

Quarter Ended	Dividend Amount	Declaration Date	Record Date	Pay Date
December 31	\$ 0.875	December 18	December 31	January 30, 2015
September 30	0.875	September 17	September 29	October 31
June 30	0.875	June 11	June 30	July 31
March 31	0.875	March 13	March 31	April 30

The Board of Directors approved and we declared and paid the following dividends for 2013:

Quarter Ended	Dividend Amount	Declaration Date	Record Date	Pay Date
December 31	\$ 0.875	December 19	December 31	January 31, 2014
September 30	0.875	September 18	September 30	October 31
June 30	0.875	June 17	June 28	July 31
March 31	0.875	March 15	March 28	April 30

The Board of Directors approved and we declared and paid the following dividends for 2012:

Quarter Ended	Dividend Amount	Declaration Date	Record Date	Pay Date
December 31	\$ 0.875	December 5	December 17	December 31
September 30	0.875	September 13	September 28	October 31
June 30	0.875	June 15	June 29	July 31
March 31	0.875	March 16	March 26	April 30

### *Contractual Obligations*



We have contractual obligations to make future payments in connection with borrowings and non-cancelable lease agreements and other contractual commitments. The following table sets forth these contractual obligations by fiscal year (in thousands):

	2015	2016	2017	2018	2019	Thereafter	Total
Borrowings <sup>(1)</sup>	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 40,000	\$40,000
Minimum rental and other contractual commitments <sup>(2)</sup>	15	446	458	471	483	497	2,370
	\$ 15	\$ 446	\$ 458	\$ 471	\$ 483	\$ 40,497	\$42,370

This table excludes interest payments to be made on our long-term debt securities. Based on the weighted average interest rate of 3.01%, approximately \$112.7 thousand in accrued interest on the current outstanding principal will be paid for the quarter ending March 31, 2015 on the \$15.0 million of trust preferred debt. Interest on the trust preferred debt is based on the 3-month LIBOR; therefore, actual coupon interest will likely differ from this estimate. The trust preferred debt will mature beginning in October 2033 through July 2035. As of December 31, 2014, approximately \$414.1 thousand in accrued interest on the current outstanding principal will be paid for the quarter ending March 31, 2015 on the \$25.0 million of Senior Notes. The Senior Notes have an annual interest rate of 6.625% and will mature on May 1, 2023.

<sup>(2)</sup> Equipment and office rent expense for 2014, 2013 and 2012 was \$248.8 thousand, \$242.9 thousand and \$262.7 thousand, respectively.

We also have short-term repurchase agreement liabilities of \$3.2 billion as of December 31, 2014. See Note 4 to the financial statements for further information.



### ***Off-Balance Sheet Arrangements and Other Commitments***

From time to time in the ordinary course of our business, we may enter into contractual arrangements with third parties that include indemnification obligations of varying scope and terms. In addition, in the past, we have entered into indemnification agreements with certain of our current and former directors and officers under which we are generally required to indemnify them against liability incurred by them in connection with any action or proceeding to which they are or may be made a party by reason of their service in those or other capacities. Our charter and the Virginia Stock Corporation Act also generally require us to indemnify our directors and officers against any liability incurred by them in connection with any action or proceeding to which they are or may be made a party by reason of their service in those or other capacities, subject to certain exceptions. In the future we may be the subject of indemnification assertions under our charter, Virginia law or these indemnification agreements by our current or former directors and officers who are or may become party to any action or proceeding.

We maintain directors' and officers' insurance policies that may limit our exposure and enable us to recover a portion of any amounts paid with respect to such obligations. However, it is not possible to determine the maximum potential amount of exposure under these indemnification obligations due to the varying terms of such obligations, the limited history of prior indemnification claims, the unique facts and circumstances involved in connection with each particular contractual arrangement and each potential future claim for indemnification and the contingency of any potential liabilities upon the occurrence of events that are not reasonably determinable. Such indemnification agreements may not be subject to maximum loss clauses and the maximum potential amount of future payments we could be required to make under these indemnification obligations could be significant. See "Item 1A — Risk Factors" in this Annual Report on Form 10-K.

As of December 31, 2014 and 2013, we did not maintain any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, or special purpose or variable interest entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, as of December 31, 2014 and 2013, we had not guaranteed any obligations of unconsolidated entities or entered into any commitment or intent to provide funding to any such entities. See Note 9 to our consolidated financial statements under "Item 8 — Financial Statements and Supplementary Data."

### **Quantitative and Qualitative Disclosures about Market Risk**

Market risk generally represents the risk of loss through a change in realizable value that can result from a change in the prices of securities, a change in the value of financial instruments as a result of changes in interest rates, a change in the volatility of interest rates or a change in the credit rating of an issuer. We monitor market and business risk, including credit, interest rate, equity, operations, liquidity, compliance, legal, reputational, and equity ownership risks through a number of control procedures designed to identify and evaluate the various risks to which our business and assets are exposed. See "Item 1 — Business" in this Annual Report on Form 10-K for discussion of our risk management



strategies.

We are exposed to the following market risks as a result of our investments in MBS and equity investments.

### ***Credit Risk***

Although we do not expect to encounter credit risk in our agency-backed MBS portfolio assuming Fannie Mae and Freddie Mac remain solvent, we are exposed to credit risk in our private-label MBS portfolio. With respect to our private-label MBS, credit support contained in these MBS deal structures provides a level of protection from losses, as do the discounted purchase prices in the event of the return of less than 100% of par. We also evaluate the impact of credit risk on our investments through a comprehensive investment review and selection process, which is predominantly focused on quantifying and pricing credit risk. We review our private-label MBS based on quantitative and qualitative analysis of the risk-adjusted returns on such investments. Through modeling and scenario analysis, we seek to evaluate each investment's credit risk. Credit risk is also monitored through our ongoing asset surveillance. Despite these measures to manage credit risk, unanticipated credit losses could nevertheless occur, which could adversely impact our operating results.

Our private-label MBS are generally purchased at a discount. We estimate the future expected cash flows based on our observation of current information and events and applying a number of assumptions related to prepayment rates, interest rates, default rates, and the timing and amount of credit losses on each security. These assumptions are difficult to predict as they are subject to uncertainties and contingencies related to future events that may impact our estimates and interest income.

The following table represents certain statistics of our private-label MBS portfolio as of and for the year ended December 31, 2014:

	Total	
	Private-Label Securities	
Yield (% of amortized cost)	10.1	%
Average cost (% of face value)	53.2	%
Weighted-average coupon	3.0	%
Delinquencies greater than 60 plus days	14.9	%
Credit enhancement	0.2	%
Severity (three months average)	40.9	%
Constant prepayment rate (three months average)	11.4	%

Key credit and prepayment measures in our private-label MBS portfolio had no significant changes during the year ended December 31, 2014. Total 60 day plus delinquencies in our private-label MBS portfolio decreased to 14.9% at



December 31, 2014 from 15.8% at December 31, 2013 and trailing three month average loss severities on liquidated loans increased to 40.9% at December 31, 2014 from 37.3% at December 31, 2013. We will continue to monitor the performance of each security in our portfolio and assess the impact on the overall performance of the portfolio.



The table that follows shows the expected change in fair value for our current private-label MBS related to our principal investing activities under several hypothetical credit loss scenarios. Our private-label MBS are classified as Level 3 assets of the fair value hierarchy as they are valued using present value techniques based on estimated cash flows of the security taking into consideration various assumptions derived by management and used by other market participants. These assumptions include, among others, interest rates, prepayment rates, discount rates, credit loss rates, and the timing of cash flows and credit losses. Credit default and loss severity rates can significantly affect the prices of private-label MBS. While it is impossible to project the exact amount of changes in value, the table below illustrates the impact a 10% increase and a 10% decrease in the credit default and loss severity rates from those used as our valuation assumptions would have on the value of our total assets and our book value as of December 31, 2014. The changes in rates are assumed to occur instantaneously. Actual changes in market conditions are likely to be different from these assumptions (dollars in thousands, except per share amounts).

	December 31, 2014								
	Value	Value with 10% Increase in Default Rate	Percent Change	Value with 10% Decrease in Default Rate	Percent Change	Value with 10% Increase in Loss Severity Rate	Percent Change	Value with 10% Decrease in Loss Severity Rate	Percent Change
Assets									
Private-label MBS	\$267,437	\$263,917	(1.32)%	\$271,054	1.35%	\$263,094	(1.62)%	\$271,784	1.63%
Agency-backed MBS	3,414,340	3,414,340	—	3,414,340	—	3,414,340	—	3,414,340	—
Other	332,712	332,712	—	332,712	—	332,712	—	332,712	—
Total assets	\$4,014,489	\$4,010,969	(0.09)%	\$4,018,106	0.09%	\$4,010,146	(0.11)%	\$4,018,836	0.11%
Liabilities	\$3,372,457	\$3,372,457	—	\$3,372,457	—	\$3,372,457	—	\$3,372,457	—
Equity	642,032	638,512	(0.55)%	645,649	0.56%	637,689	(0.68)%	646,379	0.68%
Total liabilities and equity	\$4,014,489	\$4,010,969	(0.09)%	\$4,018,106	0.09%	\$4,010,146	(0.11)%	\$4,018,836	0.11%
Book value per share	\$27.95	\$27.79	(0.55)%	\$28.10	0.56%	\$27.76	(0.68)%	\$28.14	0.68%

### ***Interest Rate Risk***

#### ***Leveraged MBS***

We are also subject to interest rate risk in our MBS portfolio. Some of our MBS positions are financed with repurchase agreements, which are interest rate sensitive financial instruments. We are exposed to interest rate risk that fluctuates based on changes in the level or volatility of interest rates and mortgage prepayments and in the shape and slope of the yield curve. We attempt to hedge a portion of our exposure to interest rate fluctuations through the use of Eurodollar futures, U.S. Treasury note futures, and swap futures. The counterparties to our derivative agreements at



December 31, 2014 are various exchanges. We assess and monitor the counterparties' non-performance risk and credit risk on a regular basis.

Our primary risk is related to changes in both short- and long-term interest rates, which affect us in several ways. As interest rates increase, the market value of the MBS may be expected to decline, prepayment rates may be expected to go down, and duration may be expected to extend. An increase in interest rates is beneficial to the market value of our derivative instruments. For example, for interest rate swap futures, the cash flows from receiving the floating rate portion increase and the fixed-rate paid remains the same under this scenario. If interest rates decline, the reverse is true for MBS, paying fixed and receiving floating interest rate swaps, interest rate caps, and Eurodollar and U.S. Treasury futures.

The table that follows shows the expected change in fair value for our current MBS and derivatives related to our principal investing activities under several hypothetical interest-rate scenarios. Interest rates are defined by the U.S. Treasury yield curve. The changes in rates are assumed to occur instantaneously. It is further assumed that the changes in rates occur uniformly across the yield curve and that the level of LIBOR changes by the same amount as the yield curve. Actual changes in market conditions are likely to be different from these assumptions.

Changes in value are measured as percentage changes from their respective values presented in the column labeled "Value." Management's estimate of change in value for MBS is based on the same assumptions it uses to manage the impact of interest rates on the portfolio. Actual results could differ significantly from these estimates. For MBS, the estimated change in value of the MBS reflects an effective duration of 4.85 in a rising interest rate environment and 3.00 in a declining interest rate environment.



The effective durations are based on observed market value changes, as well as management's own estimate of the effect of interest rate changes on the fair value of the investments including assumptions regarding prepayments based, in part, on age of and interest rate on the mortgages underlying the MBS, prior exposure to refinancing opportunities, and an overall analysis of historical prepayment patterns under a variety of past interest rate conditions (dollars in thousands, except per share amounts).

	December 31, 2014							
	Value	Value with 100 Basis Point Increase in Interest Rates	Percent Change		Value with 100 Basis Point Decrease in Interest Rates	Percent Change		
Assets								
MBS	\$3,681,777	\$ 3,503,246	(4.85	)%	\$ 3,792,184	3.00	%	
Derivative asset	1,267	(1,850	)	(245.99	)%	(2,353	) (285.71	)%
Other	331,445	331,445	—		331,445	—		
Total assets	\$4,014,489	\$ 3,832,841	(4.52	)%	\$ 4,121,276	2.66	%	
Liabilities								
Repurchase agreements	\$3,179,775	\$ 3,179,775	—		\$ 3,179,775	—		
Derivative liability	124,308	(81,080	)	(165.23	)%	329,696	165.23	%
Other	68,374	68,374	—		68,374	—		
Total liabilities	3,372,457	3,167,069	(6.09	)%	3,577,845	6.09	%	
Equity	642,032	665,772	3.70	%	543,431	(15.36	)%	
Total liabilities and equity	\$4,014,489	\$ 3,832,841	(4.52	)%	\$ 4,121,276	2.66	%	
Book value per share	\$27.95	\$ 28.98	3.70	%	\$ 23.66	(15.36	)%	

### ***Equity Price Risk***

Although limited, we are exposed to equity price risk as a result of our investments in equity securities and investment partnerships. Equity price risk changes as the volatility of equity prices changes or the values of corresponding equity indices change.

While it is impossible to exactly project what factors may affect the prices of equity sectors and how much the effect might be, the table below illustrates the impact a 10% increase and a 10% decrease in the price of the equities held by us would have on the value of our total assets and our book value as of December 31, 2014 (dollars in thousands, except per share amounts).

December 31, 2014				
Value	Value with 10% Increase in Price	Percent Change	Value with 10% Decrease in Price	Percent Change



## Edgar Filing: Arlington Asset Investment Corp. - Form 10-K

Assets							
Equity and cost method investment	\$ 1,625	\$ 1,788	10.00	%	\$ 1,462	(10.00	)%
Other	4,012,864	4,012,864	—		4,012,864	—	
Total assets	\$4,014,489	\$ 4,014,652	0.00	%	\$ 4,014,326	(0.00	)%
Liabilities	\$3,372,457	\$ 3,372,457	—		\$ 3,372,457	—	
Equity	642,032	642,195	0.03	%	641,869	(0.03	)%
Total liabilities and equity	\$4,014,489	\$ 4,014,652	0.00	%	\$ 4,014,326	(0.00	)%
Book value per share	\$27.95	\$ 27.95	0.03	%	\$ 27.94	(0.03	)%

Except to the extent that we sell our equity securities or other investments, or a decrease in their fair value is deemed to be other-than-temporary, an increase or decrease in the fair value of those assets will not directly affect our earnings; however, an increase or decrease in the value of equity method investments will directly affect our earnings.

### ***Inflation Risk***

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more than inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our financial statements are prepared in accordance with GAAP and our distributions are determined by our Board of Directors in its sole discretion pursuant to our variable dividend policy; in each case, our activities and balance sheet are measured with reference to fair value without considering inflation.

### **Critical Accounting Policies**

Our financial statements are prepared in conformity with GAAP and follow general practices within the industries in which we operate. The preparation of our financial statements requires us to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although we base our estimates and assumptions on historical experience, when available, and on various other factors that we believe to be reasonable under the circumstances, management exercises significant judgment in the final determination of our estimates. Actual results may differ from these estimates.



Our significant accounting policies are presented in Note 2 to our consolidated financial statements included under “Item 8 — Financial Statements and Supplementary Data.” Our most critical policies that are both very important to the portrayal of our financial condition and results of operations and require management’s most difficult, subjective or complex judgments or estimates, are discussed below.

### ***Principal Investing Securities***

We account for our investments in MBS as either available-for-sale or trading investments pursuant to accounting principles related to accounting for certain investments in debt and equity securities. Although we generally intend to hold our MBS until maturity, we may, from time to time, sell any of our MBS as part of the overall management of our business. The available-for-sale designation provides us with the flexibility to sell our MBS in order to act on potential market opportunities or changes in economic conditions to ensure future liquidity and to meet other general corporate purposes as they arise. These investments are carried at fair value with resulting unrealized gains and losses on available-for-sale securities reflected in accumulated other comprehensive income (loss) in the consolidated balance sheets and unrealized gains and losses on trading securities reflected in net investment gain (loss) in the consolidated statements of comprehensive income.

The accounting principles related to fair value measurements define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not adjusted for transaction costs. These accounting principles also establish a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels giving the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3) as described below:

Level 1 Inputs — Unadjusted quoted prices in active markets for identical assets or liabilities that are accessible by us;

Level 2 Inputs — Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly; and

Level 3 Inputs — Unobservable inputs for the asset or liability, including significant assumptions by us and other market participants.

Our agency-backed MBS, which are guaranteed by Fannie Mae or Freddie Mac, and AAA-rated private-label MBS, if any, are generally classified within Level 2 of the fair value hierarchy as they are valued after considering quoted market prices provided by a broker or dealer, or alternative pricing sources with reasonable levels of price transparency. We review broker or pricing service quotes to determine whether the quotes are relevant, for example, whether an active market exists to provide price transparency or whether the quote is an indicative price or a binding



offer. The independent brokers and dealers providing market prices are those who make markets in or specialists with expertise in the valuation of these financial instruments.

We classify other private-label MBS within Level 3 of the fair value hierarchy because they trade infrequently and, therefore, have little or no price transparency. We utilize present value techniques based on estimated cash flows of the instrument taking into consideration various assumptions derived by management and other assumptions used by other market participants. These assumptions are corroborated by evidence such as historical data, risk characteristics, transactions in similar instruments, and completed or pending transactions, when available. The significant inputs in our valuation process include default rate, loss severity, prepayment rate and discount rate. In general, significant increases (decreases) in default rate, loss severity or discount rate, in isolation, would result in a significantly lower (higher) fair value measurement. However, significant increases (decreases) in prepayment rate may result in a significantly higher (lower) fair value measurement. It is difficult to generalize the interrelationships between these significant inputs as the actual results could differ considerably on an individual security basis. For example, an increase in the default rate may not increase the loss severity rate if actual losses are lower than the average. Also, changes in discount rates may be greatly influenced by market expectation at any given point based upon many variables not directly related to the MBS market. Therefore, each significant input is closely analyzed to ascertain the reasonableness for our valuation purposes.

Establishing fair value is inherently subjective given the volatile and sometimes illiquid markets for these private-label MBS and requires management to make a number of assumptions, including assumptions about the future of interest rates, prepayment rates, discount rates, credit loss rates, and the timing of cash flows and credit losses. The assumptions we apply are specific to each security. Although we rely on our internal calculations to compute the fair value of these private-label MBS, we request and consider indications of value, or the mark, from third-party dealers and the actual sales of private-label MBS to assist in our valuation process and calibrate our model.

### ***Impairments***

We evaluate available-for-sale securities for OTTI charges at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. In general, when the fair value of an available-for-sale security is less than its amortized cost at the reporting date, the security is considered impaired. In evaluating these available-for-sale securities for OTTI charges, consideration is given to (1) the length of time and the extent to which the fair value has been lower than carrying value, (2) the severity of the decline in fair value, (3) the financial condition and near-term prospects of the issuer, (4) our intent to sell, and (5) whether it is more-likely-than-not we would be required to sell the security before anticipated recovery.



If we intend to sell an impaired security, or it is more-likely-than-not that we will be required to sell the impaired security before its anticipated recovery, then we must recognize an OTTI through charges to earnings equal to the entire difference between the investment security's amortized cost and its fair value at the reporting date. If we do not expect to sell an other-than-temporarily impaired security, only the portion of the OTTI related to credit losses is recognized through charges to earnings with the remainder recognized through other accumulated comprehensive income/(loss) on the consolidated balance sheet. Impairments recognized through other comprehensive income/(loss) do not impact earnings. Following the recognition of an OTTI through earnings, a new cost basis is established for the investment security and may not be adjusted for subsequent recoveries in fair value through earnings. However, OTTI recognized through charges to earnings may be accreted back to the amortized cost basis of the investment security on a prospective basis through interest income. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective, as such determination is based on factual information available at the time of assessment as well as our estimate of the future performance and cash flow projections. As a result, the timing and amount of OTTIs constitute material estimates that are susceptible to significant change.

For available-for-sale, private-label MBS securities that have been acquired at discounts to face value due in part to credit deterioration since origination, we re-evaluate the undiscounted expected future cash flows and the changes in cash flows from those originally projected at the time of purchase or when last revised. The discount rate used to calculate the present value of expected future cash flows is the current yield used for income recognition purposes as compared to the discount rate used to calculate the fair value of the investment security is the current expected market rate. For those securities in an unrealized loss position, the difference between the carrying value and the net present value of expected future cash flows is recorded as OTTI charges through our statement of comprehensive income.

#### ***Accounting for Purchase Premiums and Discounts on MBS Securities and Interest Income***

Our interest income includes the contractual coupon payments and amortization of purchase premiums and accretion of discounts, if any, on our available-for-sale MBS portfolio and contractual coupon payments on our trading MBS portfolio. Purchase premiums or discounts, if any, on our trading MBS portfolio are accounted for under mark-to-market accounting and the changes in value are recorded in investment gain (loss), net, on the statement of comprehensive income.

Interest income on the private-label MBS that were purchased at a discount to face value is recognized based on the security's expected effective interest rate. At acquisition, the accretable yield is calculated as the difference between the undiscounted expected cash flows and the purchase price which is expected to be accreted into interest income over the remaining life of the security on a level-yield basis. The difference between the contractually required payments and the undiscounted expected cash flows represents the non-accretable difference. Based on actual payment activities and changes in estimates of undiscounted expected future cash flows, the accretable yield and the non-accretable difference can change over time. Significant increases in the amount or timing of undiscounted expected future cash flows are recognized prospectively as an adjustment to the accretable yield. As a result, we may recognize higher non-cash interest income over the security's holding period and may not realize the level of interest income recognized using the higher accretion rates. In addition, we may be subject to more frequent and higher



non-cash OTTI charges than actual losses realized on the security as a result.

### ***Accounting for Taxes***

We provided for income taxes using the asset and liability method. Deferred tax assets and liabilities represent the differences between the financial statement and income tax bases of assets and liabilities using enacted tax rates. The measurement of net deferred tax assets is adjusted by a valuation allowance if, based on our evaluation, it is more-likely-than-not that they will not be realized. We recognize tax positions in the financial statements only when it is more-likely-than-not that the position will be sustained upon examination by the relevant taxing authority based on the technical merits of the position. A position that meets this standard is measured at the largest amount of benefit that will more-likely-than-not be realized upon settlement. A liability is established for differences between positions taken in a tax return and the financial statements.

### **Recently Issued Accounting Pronouncements**

On April 10, 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. This standard was effective for us on January 1, 2015. We expect no significant impact on the financial statements upon the implementation of ASU No. 2014-08.

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU No. 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard will be effective for us on January 1, 2017. Early application is not permitted. We are currently evaluating the impact of ASU No. 2014-09.

On August 27, 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements — Going Concern (subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which is intended to define management's responsibility to evaluate whether there is substantial doubt about the Company's ability to continue as a going concern and to provide related footnote disclosures. This standard will be effective for us for the year ending on December 31, 2016. Early application is permitted. We are currently evaluating the impact of ASU No. 2014-15.



## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information set forth under Item 7 — “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Quantitative and Qualitative Disclosures about Market Risk” in this Annual Report on Form 10-K is hereby incorporated by reference into this Item 7A.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The information required by this item appears in a subsequent section of this report. See “Index to Consolidated Financial Statements of Arlington Asset Investment Corp.” on page F-1.

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

## **ITEM 9A. CONTROLS AND PROCEDURES**

### **Disclosure Controls and Procedures**

Our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on that evaluation, our CEO and CFO have concluded that as of December 31, 2014, our disclosure controls and procedures, as designed and implemented, (i) were effective in ensuring that information is made known to our management, including our CEO and CFO, by our officers and employees, as appropriate to allow timely decisions regarding required disclosure and (ii) were effective in ensuring that information the Company must disclose in its reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods prescribed by the SEC’s rules and forms.

### **Management’s Report on Internal Control over Financial Reporting**



Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended, as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2014. In making this assessment, the Company's management used criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework* (2013 version).

Based on management's assessment, the Company's management has concluded that, as of December 31, 2014, the Company's internal control over financial reporting was effective based on criteria in *Internal Control-Integrated Framework issued by the COSO* (2013 version).

The effectiveness of the Company's internal control over financial reporting was audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears on page F-2 of this Annual Report on Form 10-K.



**Changes in Internal Control over Financial Reporting**

There have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.



## **PART III**

### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by Part III, Item 10 of this Annual Report on Form 10-K will be provided in the Definitive Proxy Statement relating to our 2015 Annual Meeting of Shareholders (our 2015 Proxy Statement) and is hereby incorporated by reference.

### **ITEM 11. EXECUTIVE COMPENSATION**

The information required by Part III, Item 11 of this Annual Report on Form 10-K will be provided in our 2015 Proxy Statement and is hereby incorporated by reference.

### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by Part III, Item 12 of this Annual Report on Form 10-K will be provided in our 2015 Proxy Statement and is hereby incorporated by reference.

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by Part III, Item 13 of this Annual Report on Form 10-K will be provided in our 2015 Proxy Statement and is hereby incorporated by reference.

### **ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by Part III, Item 14 of this Annual Report on Form 10-K will be provided in our 2015 Proxy Statement and is hereby incorporated by reference.







## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) *Financial Statements.* The Arlington Asset Investment Corp. consolidated financial statements for the year ended December 31, 2014, included in “Item 8 — Financial Statements and Supplementary Data”, of this Annual Report on Form 10-K, are incorporated by reference into this Part IV, Item 15:

Report of Independent Registered Public Accounting Firm (page F-2)

Consolidated Balance Sheets — Years ended 2014 and 2013 (page F-3)

Consolidated Statements of Comprehensive Income — Years ended 2014, 2013 and 2012 (page F-4)

Consolidated Statements of Changes in Equity — Years ended 2014, 2013 and 2012 (page F-5)

Consolidated Statements of Cash Flows — Years ended 2014, 2013 and 2012 (page F-8)

Notes to Consolidated Financial Statements (page F-9)

(2) *Financial Statement Schedules.* All schedules are omitted because they are not required or because the information is shown in the financial statements or notes thereto.

(3) *Exhibits*

#### Exhibit

#### Exhibit Title

#### Number

- |      |  |
|------|--|
| 3.01 | Amended and Restated Articles of Incorporation, as amended (incorporated by reference to Exhibit 3.1 to the Registrant’s Quarterly Report on Form 10-Q filed on November 9, 2009). |
| 3.02 | Amended and Restated Bylaws, as amended (incorporated by reference to Exhibit 3.1 to the Registrant’s Current Report on Form 8-K filed on July 28, 2011).                          |



- 3.03 Amendment No. 1 to the Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on February 4, 2015).
- 4.01 Indenture dated as of May 1, 2013 between the Company and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed on May 1, 2013).
- 4.02 First Supplemental Indenture dated as of May 1, 2013 between the Company and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.2 of the Registrant's Current Report on Form 8-K filed on May 1, 2013).
- 4.03 Form of Subordinated Indenture (incorporated by reference to Exhibit 4.4 of the Registration Statement on Form S-3 (333-107731) filed by Friedman, Billings, Ramsey Group Inc. on August 7, 2003).
- 4.04 Form of Senior Note (incorporated by reference to the Registrant's Registration Statement on Form S-3 (133-171537)).
- 4.05 Form of 6.625% Senior Notes due 2023 (incorporated by reference to Exhibit 4.3 to the Registrant's Current Report on Form 8-K filed on May 1, 2013).
- 4.06 Form of Certificate for Class A Common Stock (incorporated by reference to Exhibit 4.01 of the Annual Report on Form 10-K filed on February 24, 2010).
- 4.07 Shareholder Rights Agreement, dated June 5, 2009 (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed on June 5, 2009).
- 10.01 Friedman, Billings, Ramsey Group, Inc. 2004 Long-Term Incentive Plan (incorporated by reference to Appendix A to the Registrant's Definitive Proxy Statement on Schedule 14A filed on April 29, 2004).\*
- 10.02 Friedman, Billings, Ramsey Group, Inc. 1997 Stock and Annual Incentive Plan (incorporated by reference to Exhibit 10.06 to Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-39107) filed by Friedman, Billings, Ramsey Group, Inc. on December 19, 1997).\*
- 10.03 Friedman, Billings, Ramsey Group, Inc. Non-Employee Director Stock Compensation Plan (incorporated by reference to Exhibit 10.07 to Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-39107) filed by Friedman, Billings, Ramsey Group, Inc. on December 19, 1997).\*
- 10.04 Friedman, Billings, Ramsey Group, Inc. Amended and Restated Non-Employee Director Stock Compensation Plan (incorporated by reference to Exhibit 10.04 to the Registrant's Annual Report on Form 10-K filed on February 23, 2012).\*
- 10.05 Arlington Asset Investment Corp. 2011 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on June 6, 2011).\*
- 10.06 Arlington Asset Investment Corp. 2014 Long-Term Incentive Plan (incorporated by reference to the Registrant's Registration Statement on Form S-8 filed on July 15, 2014).
- 10.07 Form of Restricted Stock Unit Agreement under Arlington Asset Investment Corp. 2014 Long-Term Incentive Plan (incorporated by reference to the Registrant's Registration Statement on Form S-8 filed on July 15, 2014).
- 10.08 Form of Restricted Stock Award Agreement under Arlington Asset Investment Corp. 2014 Long-Term Incentive Plan (incorporated by reference to the Registrant's Registration Statement on Form S-8 filed on July 15, 2014).
- 10.09 Form of Performance Share Unit Award Agreement under Arlington Asset Investment Corp. 2014 Long-Term Incentive Plan (incorporated by reference to the Registrant's Registration Statement on Form S-8 filed on July 15, 2014).



**Exhibit**

<b>Number</b>	<b>Exhibit Title</b>
10.10	Form of Indemnification Agreement (incorporated by reference to Exhibit 10.08 to the Registrant's Annual Report on Form 10-K, filed on February 23, 2012).*
10.11	Equity Distribution Agreement, dated May 24, 2013, by and between the Company and RBC Capital Markets, LLC (incorporated by reference to Exhibit 1.1 to the Registrant's Current Report on Form 8-K filed on May 28, 2013).
10.12	Equity Distribution Agreement, dated May 24, 2013, by and between the Company and JMP Securities LLC (incorporated by reference to Exhibit 1.2 to the Registrant's Current Report on Form 8-K filed on May 28, 2013).
10.13	Equity Distribution Agreement, dated May 24, 2013, by and between the Company and Ladenburg Thalmann & Co. Inc. (incorporated by reference to Exhibit 1.3 to the Registrant's Current Report on Form 8-K filed on May 28, 2013).
10.14	Equity Distribution Agreement, dated May 24, 2013, by and between the Company and MLV & Co. LLC (incorporated by reference to Exhibit 1.4 to the Registrant's Current Report on Form 8-K filed on May 28, 2013).
11.01	Statement regarding Computation of Per Share Earnings (included in Part II, Item 8, and Note 2 to the Registrant's Consolidated Financial Statements).†
12.01	Computation of Ratio of Earnings to Fixed Charges.†
21.01	List of Subsidiaries of the Registrant.†
23.01	Consent of PricewaterhouseCoopers LLP.†
24.01	Power of Attorney (included on the signature page to this Annual Report on Form 10-K and incorporated by reference herein).†
31.01	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.†
31.02	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.†
32.01	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.†
32.02	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.†
101.INS	INSTANCE DOCUMENT**
101.SCH	SCHEMA DOCUMENT**
101.CAL	CALCULATION LINKBASE DOCUMENT**
101.LAB	LABELS LINKBASE DOCUMENT**
101.PRE	PRESENTATION LINKBASE DOCUMENT**
101.DEF	DEFINITION LINKBASE DOCUMENT**

Filed herewith.

\*Compensatory plan or arrangement.

\*\* Submitted electronically herewith. Attached as Exhibit 101 are the following materials from the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014, formatted in



XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets at December 31, 2014 and December 31, 2013; (ii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2014, 2013 and 2012; (iii) Consolidated Statements of Changes in Equity for the years ended December 31, 2014, 2013 and 2012; and (iv) Consolidated Statements of Cash Flows for the years ended 2014, 2013 and 2012.



## 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.

### ARLINGTON ASSET INVESTMENT CORP.

Date: February 9, 2015 By: /s/ J. ROCK TONKEL, JR.  
**J. Rock Tonkel, Jr.**  
**President and Chief Executive Officer**

## POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints J. Rock Tonkel, Jr. and Kurt R. Harrington and each of them as his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K for the fiscal year ended December 31, 2014, and to file the same, with all exhibits thereto, and any other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ J. ROCK TONKEL, JR. <b>J. ROCK TONKEL, JR.</b>	President, Chief Executive Officer and Director (Principal Executive Officer)	February 9, 2015
/s/ KURT R. HARRINGTON <b>KURT R. HARRINGTON</b>	Executive Vice President, Chief Financial Officer and Treasurer (Principal Financial Officer)	February 9, 2015
/s/ ERIC F. BILLINGS <b>ERIC F. BILLINGS</b>	Executive Chairman of the Board	February 9, 2015



/s/ DANIEL J. ALTOBELLO Director <b>DANIEL J. ALTOBELLO</b>	February 9, 2015
/s/ DANIEL E. BERCE Director <b>DANIEL E. BERCE</b>	February 9, 2015
/s/ DAVID W. FAEDER Director <b>DAVID W. FAEDER</b>	February 9, 2015
/s/ PETER A. GALLAGHER Director <b>PETER A. GALLAGHER</b>	February 9, 2015
/s/ RALPH S. MICHAEL III Director <b>RALPH S. MICHAEL III</b>	February 9, 2015



**FINANCIAL STATEMENTS OF ARLINGTON ASSET INVESTMENT CORP.**

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## Report of Independent Registered Public Accounting Firm

To The Board of Directors and Shareholders of

Arlington Asset Investment Corp.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of comprehensive income, of changes in equity and of cash flows present fairly, in all material respects, the financial position of Arlington Asset Investment Corp. and its subsidiaries at December 31, 2014 and December 31, 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control - Integrated Framework* (2013 framework) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.



Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

McLean, VA

February 9, 2015

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**ARLINGTON ASSET INVESTMENT CORP.****CONSOLIDATED BALANCE SHEETS****(Dollars in thousands, except per share amounts)**

	December 31,	
	2014	2013
<b>ASSETS</b>		
Cash and cash equivalents	\$33,832	\$48,628
Receivables		
Interest	10,701	5,173
Other	1,138	212
Mortgage-backed securities, at fair value		
Available-for-sale	267,477	341,346
Trading	3,414,300	1,576,452
Other investments	1,837	2,065
Derivative assets, at fair value	1,267	8,424
Deferred tax assets, net	122,365	165,851
Deposits	160,427	45,504
Prepaid expenses and other assets	1,145	1,311
Total assets	\$4,014,489	\$2,194,966
<b>LIABILITIES AND EQUITY</b>		
Liabilities:		
Repurchase agreements	\$3,179,775	\$1,547,630
Interest payable	1,106	774
Accrued compensation and benefits	6,067	5,584
Dividend payable	20,195	14,630
Derivative liabilities, at fair value	124,308	33,129
Accounts payable, accrued expenses and other liabilities	1,006	1,391
Long-term debt	40,000	40,000
Total liabilities	3,372,457	1,643,138
Commitments and contingencies (Note 7)	—	—
Equity:		
Preferred stock, \$0.01 par value, 25,000,000 shares authorized, none issued and outstanding	—	—
Class A common stock, \$0.01 par value, 450,000,000 shares authorized, 22,860,922 and 16,047,965 shares issued and outstanding, respectively	229	160
Class B common stock, \$0.01 par value, 100,000,000 shares authorized, 105,869 and 554,055 shares issued and outstanding, respectively	1	6
Additional paid-in capital	1,897,027	1,727,398
Accumulated other comprehensive income, net of taxes of \$4,745 and \$9,436, respectively	42,793	53,190
Accumulated deficit	(1,298,018)	(1,228,926)



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Total equity	642,032	551,828
Total liabilities and equity	\$4,014,489	\$2,194,966

The accompanying notes are an integral part of these consolidated financial statements.

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**ARLINGTON ASSET INVESTMENT CORP.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Dollars in thousands except per share amounts)**

	Year Ended December 31,		
	2014	2013	2012
Interest income	\$123,547	\$87,019	\$64,154
Interest expense			
Interest on short-term debt	9,181	6,899	4,475
Interest on long-term debt	2,210	1,630	490
Total interest expense	11,391	8,529	4,965
Net interest income	112,156	78,490	59,189
Other loss, net			
Investment loss, net	(38,672 )	(47,745 )	(10,723 )
Other loss	(15 )	(15 )	(15 )
Total other loss, net	(38,687 )	(47,760 )	(10,738 )
Operating income before other expenses	73,469	30,730	48,451
Other expenses			
Compensation and benefits	13,467	11,195	10,339
Professional services	1,529	2,561	4,118
Business development	253	145	136
Occupancy and equipment	422	427	467
Communications	201	191	202
Other operating expenses	2,197	2,072	2,184
Total other expenses	18,069	16,591	17,446
Income before income taxes	55,400	14,139	31,005
Income tax provision (benefit)	49,446	(35,322 )	(152,937 )
Net income	\$5,954	\$49,461	\$183,942
Basic earnings per share	\$0.30	\$3.09	\$18.02
Diluted earnings per share	\$0.29	\$3.06	\$17.96
Weighted-average shares outstanding (in thousands)			
Basic	20,043	15,990	10,205
Diluted	20,397	16,189	10,242
Other comprehensive income, net of taxes			
Unrealized gains (losses) for the period on available-for-sale securities (net of taxes of \$432, \$12,664, and \$(1,215), respectively)	\$679	\$19,894	\$(1,909 )
Reclassification			
Included in investment gain (loss), net, in the statement of comprehensive income related to sales of available-for-sale securities (net of taxes of \$(5,293), \$(4,162), and \$(4,488), respectively)	(11,343 )	(6,537 )	(7,050 )
Included in investment gain (loss), net, in the statement of comprehensive income related to other-than-temporary charges on available-for-sale securities (net of	267	827	9,598



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taxes of \$170, \$527, and \$6,110, respectively)

Comprehensive (loss) income	\$(4,443 )	\$63,645	\$184,581
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The accompanying notes are an integral part of these consolidated financial statements.

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**ARLINGTON ASSET INVESTMENT CORP.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY****(Dollars in thousands)**

	Class A Common Stock (#)	Class A Common Amount (\$)	Class B Common Stock (#)	Class B Common Amount (\$)	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
Balances, December 31, 2011	7,099,336	\$ 71	566,112	\$ 6	\$ 1,508,713	\$ 38,367	\$(1,363,785 )	\$ 183,372
Net income	—	—	—	—	—	—	183,942	183,942
Conversion of Class B shares to Class A shares	12,057	—	(12,057 )	—	—	—	—	—
Issuance of Class A common stock	5,493,750	55	—	—	129,194	—	—	129,249
Repurchase of Class A common stock	(41,790 )	—	—	—	(786 )	—	—	(786 )
Forfeitures of Class A common stock	(2,383 )	—	—	—	(55 )	—	—	(55 )
Amortization of Class A common shares issued as stock-based awards	—	—	—	—	995	—	—	995
Other comprehensive income								
Net change in unrealized gain on available-for-sale investment securities, (net of taxes of \$407)	—	—	—	—	—	639	—	639
Dividends declared	—	—	—	—	—	—	(40,063 )	(40,063 )
Balances, December 31, 2012	12,560,970	\$ 126	554,055	\$ 6	\$ 1,638,061	\$ 39,006	\$(1,219,906 )	\$ 457,293

The accompanying notes are an integral part of these consolidated financial statements.



**ARLINGTON ASSET INVESTMENT CORP.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY – (continued)****(Dollars in thousands)**

	Class A Common Stock (#)	Class A Amount (\$)	Class B Common Stock (#)	Class B Amount (\$)	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
Balances, December 31, 2012	12,560,970	\$ 126	554,055	\$ 6	\$ 1,638,061	\$ 39,006	\$(1,219,906 )	\$ 457,293
Net income	—	—	—	—	—	—	49,461	49,461
Issuance of Class A common stock	3,492,667	34	—	—	86,930	—	—	86,964
Forfeitures of Class A common stock	(5,672 )	—	—	—	(142 )	—	—	(142 )
Amortization of Class A common shares issued as stock-based awards	—	—	—	—	2,549	—	—	2,549
Other comprehensive income	—	—	—	—	—	—	—	—
Net change in unrealized gain on available-for-sale investment securities, (net of taxes of \$9,029)	—	—	—	—	—	14,184	—	14,184
Dividends declared	—	—	—	—	—	—	(58,481 )	(58,481 )
Balances, December 31, 2013	16,047,965	\$ 160	554,055	\$ 6	\$ 1,727,398	\$ 53,190	\$(1,228,926 )	\$ 551,828

The accompanying notes are an integral part of these consolidated financial statements.



**ARLINGTON ASSET INVESTMENT CORP.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY – (continued)****(Dollars in thousands)**

	Class A Common Stock (#)	Class A Amount (\$)	Class B Common Stock (#)	Class B Amount (\$)	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
Balances, December 31, 2013	16,047,965	\$ 160	554,055	\$ 6	\$1,727,398	\$ 53,190	\$(1,228,926 )	\$551,828
Net income	—	—	—	—	—	—	5,954	5,954
Conversion of Class B shares to Class A shares	448,186	5	(448,186)	(5 )	—	—	—	—
Issuance of Class A common stock	6,419,247	64	—	—	166,819	—	—	166,883
Forfeitures of Class A common stock	(54,476 )	—	—	—	(1,478 )	—	—	(1,478 )
Amortization of Class A common shares issued as stock-based awards	—	—	—	—	3,813	—	—	3,813
Other comprehensive income								
Net change in unrealized gain on available-for-sale investment securities, (net of taxes of \$(4,691))	—	—	—	—	—	(10,397 )	—	(10,397 )
Dividends declared	—	—	—	—	—	—	(75,046 )	(75,046 )
Income tax benefit from stock-based compensation	—	—	—	—	475	—	—	475
Balances, December 31, 2014	22,860,922	\$ 229	105,869	\$ 1	\$1,897,027	\$ 42,793	\$(1,298,018 )	\$642,032

The accompanying notes are an integral part of these consolidated financial statements.







**ARLINGTON ASSET INVESTMENT CORP.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Dollars in thousands)**

	Year Ended December 31,		
	2014	2013	2012
Cash flows from operating activities			
Net income	\$5,954	\$49,461	\$183,942
Adjustments to reconcile net income to net cash provided by operating activities			
Investment loss, net	38,672	47,745	10,723
Net discount accretion on mortgage-backed securities	(12,570 )	(9,302 )	(9,888 )
Deferred tax provision	48,177	70,727	7,884
Release of valuation allowance on deferred tax assets	—	(91,189 )	(162,281 )
Reversal of unrecognized tax benefit related to uncertain tax position and related accrued interest	—	(16,212 )	—
Other	2,336	2,460	614
Changes in operating assets			
Interest receivable	(5,528 )	(304 )	(2,503 )
Other receivables	(906 )	432	(389 )
Prepaid expenses and other assets	(6,328 )	3,600	750
Changes in operating liabilities			
Accounts payable, accrued expenses and other liabilities and interest payable	(340 )	(92 )	1,457
Accrued compensation and benefits	483	4,042	(4,634 )
Net cash provided by operating activities	69,950	61,368	25,675
Cash flows from investing activities			
Purchases of available-for-sale mortgage-backed securities	—	(167,682 )	(54,709 )
Purchases of trading mortgage-backed securities	(2,030,995)	(1,221,387)	(1,359,536)
Proceeds from sales of available-for-sale mortgage-backed securities	86,318	69,337	34,102
Proceeds from sales of trading mortgage-backed securities	65,251	914,155	352,437
Receipt of principal payments on available-for-sale mortgage-backed securities	2,378	5,238	6,628
Receipt of principal payments on trading mortgage-backed securities	212,049	165,056	83,038
(Payments for) proceeds from derivatives and deposits, net	(150,446 )	42,210	(29,814 )
Payments for purchased securities payable	—	—	(15,820 )
Proceeds from sold securities receivable	—	26,773	41,321
Other	412	132	1,668
Net cash used in investing activities	(1,815,033)	(166,168 )	(940,685 )
Cash flows from financing activities			
Proceeds from repurchase agreements, net	1,632,145	50,439	849,214
Proceeds from stock issuance, net	167,148	86,964	129,249



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Proceeds from long-term debt issuance, net	—	24,038	—
Dividends paid	(69,481 )	(43,850 )	(46,848 )
Repurchase of common stock	—	—	(786 )
Excess tax benefits associated with stock-based awards	475	—	—
Net cash provided by financing activities	1,730,287	117,591	930,829
Net (decrease) increase in cash and cash equivalents	(14,796 )	12,791	15,819
Cash and cash equivalents, beginning of year	48,628	35,837	20,018
Cash and cash equivalents, end of year	\$33,832	\$48,628	\$35,837
Supplemental Cash Flow Information			
Cash payments for interest	\$10,959	\$8,272	\$4,888
Cash payments for taxes	\$2,309	\$667	\$833

The accompanying notes are an integral part of these consolidated financial statements.



**ARLINGTON ASSET INVESTMENT CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Dollars in thousands, except per share amounts)**

**Note 1. Organization and Nature of Operations:**

Arlington Asset Investment Corp. and its consolidated subsidiaries (the Company or AAIC), formerly known as Friedman, Billings, Ramsey Group, Inc. (FBR Group), is a Virginia corporation. The Company acquires and holds mortgage-related and other assets. The Company's portfolio consists primarily of agency-backed mortgage-backed securities (agency-backed MBS) and private-label residential mortgage-backed securities (private-label MBS).

**Note 2. Summary of Significant Accounting Policies:**

***Principles of Consolidation***

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain amounts in the consolidated financial statements and notes for prior periods have been reclassified to conform to the current year's presentation. These reclassifications had no impact on the previously reported net income, other comprehensive income, total assets or total liabilities.

***Use of Estimates***

The preparation of the Company's financial statements, in conformity with accounting principles generally accepted in the United States of America (GAAP), requires the Company to make estimates and assumptions affecting the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although the Company based the estimates and assumptions on historical experience, when available, market information, and on various other factors that the Company believes to be reasonable under the circumstances, management exercises significant judgment in the final determination of the estimates. Actual results may differ from these estimates.



### ***Cash Equivalents***

Cash equivalents include demand deposits with banks, money market accounts and highly liquid investments with original maturities of three months or less that are not held for sale in the ordinary course of business. As of December 31, 2014 and 2013, approximately 99% and 89%, respectively, of the Company's cash equivalents were invested in money market funds that invest primarily in U.S. Treasuries and other securities backed by the U.S. government.

### ***Financial Instruments***

MBS transactions are recorded as purchases and sales on the date the securities are settled unless the transaction qualifies as a regular-way trade, in which case the transactions are accounted for as purchases or sales on a trade date basis. Any amounts payable or receivable for unsettled trades are recorded as "sold securities receivable" or "purchased securities payable" in the consolidated balance sheets.

Investments in MBS and marketable equity securities, if any, are classified as either available-for-sale or trading investments pursuant to accounting principles related to accounting for certain investments in debt and equity securities. These investments are carried at fair value with resulting unrealized gains and losses on available-for-sale securities reflected in accumulated other comprehensive income (loss) in the consolidated balance sheets and unrealized gains and losses on trading securities reflected in investment gain (loss), net, in the consolidated statements of comprehensive income. Investments in equity securities of non-public companies are carried at cost.

Although the Company generally intends to hold its MBS until maturity, it may, from time to time, sell any of its MBS as part of the overall management of its business. The available-for-sale designation provides the Company with the flexibility to sell its MBS in order to act on potential market opportunities or changes in economic conditions to ensure future liquidity and to meet other general corporate purposes as they arise.

### ***Impairments***

The Company evaluates available-for-sale securities for other-than-temporary impairment (OTTI) charges at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. In general, when the fair value of an available-for-sale security is less than its amortized cost at the reporting date, the security is considered impaired. In evaluating these available-for-sale securities for OTTI charges, consideration is given to (1) the length of time and the extent to which the fair value has been lower than carrying value, (2) the severity of the decline in fair value, (3) the financial condition and near-term prospects of the issuer, (4) the Company's intent to sell, and (5) whether it is more-likely-than-not the Company would be required to sell the security before anticipated



recovery.

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If the Company intends to sell an impaired security, or it is more-likely-than-not that it will be required to sell the impaired security before its anticipated recovery, then the Company must recognize OTTI charges through earnings equal to the entire difference between the investment security's amortized cost and its fair value at the reporting date. If the Company does not expect to sell an other-than-temporarily impaired security, only the portion of the OTTI related to credit losses is recognized through charges to earnings with the remainder recognized through other accumulated comprehensive income/(loss) on the consolidated balance sheet. Impairments recognized through other comprehensive income/(loss) do not impact earnings. Following the recognition of an OTTI through earnings, a new cost basis is established for the investment security and may not be adjusted for subsequent recoveries in fair value through earnings. However, OTTI recognized through charges to earnings may be accreted back to the amortized cost basis of the investment security on a prospective basis through interest income. The determination as to whether an OTTI exists and, if so, the amount of credit impairment recognized in earnings is subjective, as such determination is based on factual information available at the time of assessment as well as the Company's estimates of the future performance and cash flow projections. As a result, the timing and amount of OTTIs constitute material estimates that are susceptible to significant change.

For available-for-sale, agency-backed MBS, if it is determined that the impairment is other-than-temporary, then the amount that the fair value is below its amortized cost basis is recorded as an impairment charge and recorded through the Company's earnings. For unrealized losses that are determined to be temporary, a further evaluation is performed to determine the credit portion of the OTTI and the credit portion is recorded through the Company's statement of comprehensive income.

For available-for-sale, private-label MBS securities that have been acquired at discounts to face value due in part to credit deterioration since origination, the Company re-evaluates the undiscounted expected future cash flows and the changes in cash flows from those originally projected at the time of purchase or when last revised. The discount rate used to calculate the present value of expected future cash flows is the current yield used for income recognition purposes as compared to the discount rate used to calculate the fair value of the investment security is the current expected market rate. For those securities in an unrealized loss position, the difference between the carrying value and the net present value of expected future cash flows is recorded as OTTI charges through the Company's statement of comprehensive income.

### ***Fair Value of Financial Instruments***

The accounting principles related to fair value measurements define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not adjusted for transaction costs. Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures* (ASC 820), establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels giving the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3) as described below:



Level 1 Inputs —	Unadjusted quoted prices in active markets for identical assets or liabilities that are accessible by the Company;
Level 2 Inputs —	Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly; and
Level 3 Inputs —	Unobservable inputs for the asset or liability, including significant assumptions of the Company and other market participants.

The Company determines fair values for the following assets and liabilities:

*Mortgage-backed securities (MBS), at fair value —*

Agency-backed MBS — The Company's mortgage-backed securities (MBS), the principal and interest payments on which are guaranteed by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, agency-backed MBS), are generally classified within Level 2 of the fair value hierarchy as they are valued after considering quoted market prices provided by a broker or dealer, or alternative pricing sources with reasonable levels of price transparency. The Company reviews broker or pricing service quotes to determine whether the quotes are relevant, for example, whether an active market exists to provide price transparency or whether the quote is an indicative price or a binding offer. The independent brokers and dealers providing market prices are those who make markets in or specialists with expertise in the valuation of these financial instruments.

Private-label MBS — The Company classifies non-agency-backed, or private-label, MBS within Level 3 of the fair value hierarchy because they trade infrequently and, therefore, have little or no price transparency. The Company utilizes present value techniques based on estimated cash flows of the instrument taking into consideration various assumptions derived by management and other assumptions used by other market participants. These assumptions are corroborated by evidence such as historical data, risk characteristics, transactions in similar instruments, and completed or pending transactions, when available. The significant inputs in the Company's valuation process include default rate, loss severity, prepayment rate and discount rate. In general, significant increases (decreases) in default rate, loss severity or discount rate, in isolation, would result in a significantly lower (higher) fair value measurement. However, significant increases (decreases) in prepayment rate may result in a significantly higher (lower) fair value measurement. It is difficult to generalize the interrelationships between these significant inputs as the actual results could differ considerably on an individual security basis. For example, an increase in the default rate may not increase the loss severity rate if actual losses are lower than the average. Also, changes in discount rates may be greatly influenced by market expectation at any given point based upon many variables not directly related to the MBS market. Therefore, each significant input is closely analyzed to ascertain the reasonableness for the Company's valuation purposes.







Establishing fair value is inherently subjective given the volatile and sometimes illiquid markets for these private-label MBS and requires management to make a number of assumptions, including assumptions about the future of interest rates, prepayment rates, discount rates, credit loss rates, and the timing of cash flows and credit losses. The assumptions the Company applies are specific to each security. Although the Company relies on its internal calculations to compute the fair value of these private-label MBS, the Company requests and considers indications of value, or the mark, from third-party dealers and the actual sales of private-label MBS to assist in the valuation process and calibrate the Company's model.

*Other investments* — The Company's other investments, which are classified within Level 3 of the fair value hierarchy, consist of investments in equity securities, investment funds and other MBS-related securities, such as interest-only MBS.

*Derivative instruments* — In the normal course of the Company's operations, the Company is a party to various financial instruments that are accounted for as derivatives in accordance with ASC 815, *Derivatives and Hedging* (ASC 815). The derivative instruments that trade in active markets or exchanges are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. Other derivative instruments are generally classified within Level 2 of the fair value hierarchy because they are valued using broker or dealer quotations, which are model-based calculations based on market-based inputs, including, but not limited to, contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs.

*Other* — Cash and cash equivalents, interest receivable, deposits, other receivable, interest payable, accounts payable, accrued expenses and other liabilities are reflected in the consolidated balance sheets at their amortized cost (which approximates fair value because of the short term nature of these instruments) and classified within Level 1 of the fair value hierarchy, except for certain cash equivalents that are held in money market funds that are classified within Level 2 of the fair value hierarchy.

Sold securities receivable, repurchase agreements and purchased securities payable are reflected in the consolidated balance sheets at the cost basis, which approximates fair value because of the short term nature of these instruments, and classified within Level 2 of the fair value hierarchy.

Long-term debt represents remaining balances of trust preferred debt and senior debt issued by the Company. Trust preferred debt is classified within Level 3 of the fair value hierarchy as the fair value is determined after considering quoted market prices provided by a broker or dealer. The independent brokers or dealers providing market prices are those who make markets in or specialists with expertise in the valuation of these financial instruments. The Company's senior debt, which is publicly traded on the New York Stock Exchange, is classified within Level 1 of the fair value hierarchy.



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The estimated fair values of the Company's financial instruments are as follows:

	December 31, 2014		December 31, 2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and cash equivalents	\$33,832	\$ 33,832	\$48,628	\$48,628
Interest receivable	10,701	10,701	5,173	5,173
Other receivables	1,138	1,138	212	212
MBS				
Agency-backed MBS	3,414,340	3,414,340	1,576,499	1,576,499
Private-label MBS				
Senior securities	—	—	7,066	7,066
Re-REMIC securities	267,437	267,437	334,233	334,233
Derivative assets	1,267	1,267	8,424	8,424
Other investments	1,837	1,837	2,065	2,065
Deposits	160,427	160,427	45,504	45,504
Financial liabilities				
Repurchase agreements	3,179,775	3,179,775	1,547,630	1,547,630
Interest payable	1,106	1,106	774	774
Long-term debt	40,000	39,200	40,000	36,620
Derivative liabilities	124,308	124,308	33,129	33,129
Accounts payable, accrued expenses and other liabilities	1,006	1,006	1,391	1,391



### ***Repurchase Agreements***

Securities sold under agreements to repurchase, which are treated as financing transactions for financial reporting purposes, are collateralized by MBS and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements. Under the repurchase agreements, the Company pledges its securities as collateral to secure the borrowing, which is equal in value to a specified percentage of the fair value of the pledged collateral, while the Company retains beneficial ownership of the pledged collateral. At the maturity of a repurchase financing, the Company is required to repay the borrowing and receives back its pledged collateral from the counterparty. The counterparty to the repurchase agreements may require that the Company pledge additional securities or cash as additional collateral to secure borrowings when the value of the collateral declines.

### ***Interest Income and Purchase Premiums and Discounts on MBS Securities***

Interest income includes contractual coupon payments and the amortization of purchase premiums and accretion of discounts, if any, on the available-for-sale MBS portfolio. Interest income also includes contractual coupon payments on the trading MBS portfolio. Purchase premiums or discounts, if any, on the trading MBS portfolio are accounted for under mark-to-market accounting and the changes in value are recorded in investment gain (loss), net, on the statement of comprehensive income.

Interest income on the private-label MBS that were purchased at a discount to face value is recognized based on the security's expected effective interest rate. At acquisition, the accretable yield is calculated as the difference between the undiscounted expected cash flows and the purchase price which is expected to be accreted into interest income over the remaining life of the security on a level-yield basis. The difference between the contractually required payments and the undiscounted expected cash flows represents the non-accretable difference. Based on actual payment activities and changes in estimates of undiscounted expected future cash flows, the accretable yield and the non-accretable difference can change over time. Significant increases in the amount or timing of undiscounted expected future cash flows are recognized prospectively as an adjustment to the accretable yield. As a result, the Company may recognize higher non-cash interest income over the security's holding period and may not realize the level of interest income recognized using the higher accretion rates. In addition, the Company may be subject to more frequent and higher non-cash OTTI charges than actual losses realized on the security as a result.

### ***Stock-Based Compensation***

The Company accounts for stock-based compensation in accordance with accounting principles related to share-based payment which requires fair value method of accounting. Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually



the vesting period. Expected forfeitures are included in determining share-based employee compensation cost. Share-based awards that do not require future services are expensed immediately.

Depending on the Company's stock price at the time restricted stock units vest, the actual tax deduction benefit may be more or less than the carrying amount of the previously recorded deferred tax asset. An increase to the tax benefit (windfall) is generated when the tax deduction exceeds the recorded deferred tax asset. This incremental excess tax benefits are recorded as an increase to additional paid-in capital. Conversely, a decrease in tax benefit (shortfall) is generated when the tax deduction is below the recorded deferred tax asset. These incremental expense results in additional income tax expense, unless it can be offset by accumulated windfall tax benefit recorded in additional paid-in capital. The gross windfall tax benefit is presented in the consolidated statements of cash flows as financing cash inflows.

#### *Performance-Based Long-Term Incentive Program*

On August 13, 2012, the Compensation Committee of the Board of Directors of the Company (the Compensation Committee) adopted a performance-based long-term incentive program (Performance-based Program) that provides for the issuance of two types of performance share units (PSUs).

The Compensation Committee established performance goals under the Performance-based Program. Two types of PSUs may be awarded under the Performance-based Program: Book Value PSUs and Total Shareholder Return Units (TSR PSUs). The Book Value PSUs are eligible to vest based on the compound annualized growth in the Company's book value per share (*i.e.*, book value change with such adjustments as determined and approved by the Compensation Committee plus dividends on a reinvested basis) during the applicable performance period. The TSR PSUs are eligible to vest based on the Company's compound annualized total shareholder return (*i.e.*, share price change plus dividends on a reinvested basis) during the applicable performance period.

The Company accounts for the Performance-based Program in accordance with ASC 718. Therefore, the Book Value PSUs are valued at the grant date market value and the estimated compensation cost is recorded over the vesting period. The Company estimates the number of shares to be issued under the Book Value PSUs on a quarterly basis based on the actual and projected results for the remaining vesting period and any adjustments required are recognized retrospectively and over the remaining vesting period.

The TSR PSUs are also valued at the time of grant based on valuation model and the estimated compensation cost is recorded over the vesting period using straight-line basis. The valuation of the TSR PSUs is performed using Monte-Carlo simulation model (Model) using various assumptions including beginning average price, expected volatility, dividend equivalents, dividend yield, and risk-free rate of return. The Model projects stock prices on a daily basis assuming 250 trading days per year. The Model generates many future stock price paths to construct a distribution of where future stock prices might be. No remeasurement of compensation expense is required for the TSR PSUs.



The compensation costs are reversed if an employee is terminated prior to completing the required service period. The estimated shares to be granted under the Performance-based Program are included in the calculation of diluted Earnings Per Share.

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***Income Taxes***

Income taxes are provided for using the asset and liability method. Deferred tax assets and liabilities represent the differences between the financial statement and income tax bases of assets and liabilities using enacted tax rates. The measurement of net deferred tax assets is adjusted by a valuation allowance if, based on the Company's evaluation, it is more-likely-than-not that they will not be realized. The Company recognizes tax positions in the financial statements only when it is more-likely-than-not that the position will be sustained upon examination by the relevant taxing authority based on the technical merits of the position. A position that meets this standard is measured at the largest amount of benefit that will more-likely-than-not be realized upon settlement. A liability is established for differences between positions taken in a tax return and the financial statements.

The Company is subject to federal alternative minimum tax (AMT) and state and local taxes on its taxable income and gains that are not offset by the net operating loss (NOL) and net capital loss (NCL) carry-forwards.

***Other Comprehensive Income***

Comprehensive income includes net income as currently reported by the Company on the consolidated statements of comprehensive income adjusted for other comprehensive income. Other comprehensive income for the Company represents changes in unrealized gains and losses related to the Company's MBS and other mortgage related assets accounted for as available-for-sale with changes in fair value recorded through shareholders' equity.

***Earnings Per Share***

Basic earnings per share includes no dilution and is computed by dividing net income or loss available to common shareholders by the weighted-average number of common shares outstanding for the respective period. Diluted earnings per share includes the impact of dilutive securities such as stock options, unvested shares of restricted stock and performance share units. The following table presents the computations of basic and diluted earnings per share for the years ended December 31, 2014, 2013 and 2012:

	<b>Year Ended December 31,</b>					
	<b>2014</b>		<b>2013</b>		<b>2012</b>	
	<b>Basic</b>	<b>Diluted</b>	<b>Basic</b>	<b>Diluted</b>	<b>Basic</b>	<b>Diluted</b>
Weighted average shares outstanding Common stock (in thousands)	20,043	20,043	15,990	15,990	10,205	10,205



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Stock options, performance share units, and unvested restricted stock (in thousands)	—	354	—	199	—	37
Weighted average common and common equivalent shares outstanding (in thousands)	20,043	20,397	15,990	16,189	10,205	10,242
Net income applicable to common stock	\$5,954	\$5,954	\$49,461	\$49,461	\$183,942	\$183,942
Net income per common share	\$0.30	\$0.29	\$3.09	\$3.06	\$18.02	\$17.96

There were no outstanding options to purchase shares of common stock at December 31, 2014, 2013 and 2012. The diluted earnings per share for the years ended December 31, 2014, 2013 and 2012 did not include the antidilutive effect of 42,570, 26,218 and 27,808 shares, respectively, of awarded restricted stock units, stock options, and restricted stock.

### ***Recent Accounting Pronouncements***

On April 10, 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. This standard was effective for the Company on January 1, 2015. The Company does not expect significant impact to the financial statements upon implementation of ASU No. 2014-08.

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU No. 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard will be effective for the Company on January 1, 2017. Early application is not permitted. The Company is currently evaluating the impact of ASU No. 2014-09.

On August 27, 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements — Going Concern (subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which is intended to define management's responsibility to evaluate whether there is substantial doubt about the Company's ability to continue as a going concern and to provide related footnote disclosures. This standard will be effective for the Company for the year ending on December 31, 2016. Early application is permitted. The Company is currently evaluating the impact of ASU No. 2014-15.



**Note 3. Financial Instruments:*****Fair Value Hierarchy***

The following tables set forth financial instruments accounted for under ASC 820 by level within the fair value hierarchy as of December 31, 2014 and December 31, 2013. As required by ASC 820, assets and liabilities that are measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

***Financial Instruments Measured at Fair Value on a Recurring Basis***

	December 31, 2014			
	Total	Level 1	Level 2	Level 3
MBS, at fair value				
Trading				
Agency-backed MBS	\$3,414,300	\$—	\$3,414,300	\$—
Available-for-sale				
Agency-backed MBS	40	—	40	—
Private-label MBS				
Senior securities	—	—	—	—
Re-REMIC securities	267,437	—	—	267,437
Total available-for-sale	267,477	—	40	267,437
Total MBS	3,681,777	—	3,414,340	267,437
Derivative assets, at fair value	1,267	751	516	—
Derivative liabilities, at fair value	(124,308 )	(124,308)	—	—
Interest-only MBS, at fair value	212	—	—	212
Total	\$3,558,948	\$(123,557)	\$3,414,856	\$267,649

	December 31, 2013			
	Total	Level 1	Level 2	Level 3
MBS, at fair value				
Trading				
Agency-backed MBS	\$1,576,452	\$—	\$1,576,452	\$—
Available-for-sale				
Agency-backed MBS	47	—	47	—
Private-label MBS				
Senior securities	7,066	—	—	7,066
Re-REMIC securities	334,233	—	—	334,233



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Total available-for-sale	341,346	—	47	341,299
Total MBS	1,917,798	—	1,576,499	341,299
Derivative assets, at fair value	8,424	8,088	336	—
Derivative liabilities, at fair value	(33,129 )	(32,156)	(973 )	—
Interest-only MBS, at fair value	298	—	—	298
Total	\$1,893,391	\$(24,068)	\$1,575,862	\$341,597

The total financial assets measured and reported at fair value on a recurring basis and classified within Level 3 were \$267,649, or 6.67% and \$341,597, or 15.56%, of the Company's total assets as of December 31, 2014 and 2013, respectively.

There were no transfers of securities in or out of Levels 1, 2 or 3 during the years ended December 31, 2014 and 2013.

*Level 3 Financial Instruments Measured at Fair Value on a Recurring Basis*

The fair value of the Company's Level 3, available-for-sale, private-label MBS was \$267,437 and \$341,299 as of December 31, 2014 and 2013, respectively. The private-label MBS are primarily senior and re-REMIC tranches in securitization trusts issued between 2005 and 2010. The senior securities represent interests in securitizations that have the first right to cash flows and absorb losses last. The re-REMIC securities represent interests in re-securitizations of senior MBS and pro-rata mezzanine securities. For re-REMIC securities, the cash flows from, and any credit losses absorbed by, the underlying MBS are allocated among the re-REMIC securities issued in the re-securitization transactions based on the re-REMIC structure. For example, prime and non-prime residential senior securities have been resecutitized to create a two-tranche structure with a re-REMIC senior security and a re-REMIC subordinated security. In these re-REMIC securities, all principal payments from the underlying securities are directed to the re-REMIC senior security until the face value is fully paid off. Thereafter, all principal payments are directed to the re-REMIC subordinated security. For pro-rata mezzanine securities, principal payments from the underlying MBS are typically allocated concurrently and proportionally to the mezzanine securities along with senior securities. The re-REMIC subordinated and mezzanine securities absorb credit losses, if any, first; however, these credit losses occur only when credit losses exceed the credit protection provided to the underlying securities. Senior, re-REMIC and mezzanine securities receive interest while any face value is outstanding.



The Company's private-label MBS were collateralized by residential prime and Alt-A mortgage loans and had the following weighted average characteristics, based on face value, as of the dates indicated:

	December 31,	
	2014	2013
Original loan-to-value	68 %	69 %
Original FICO score	722	725
Three-month prepayment rate	11 %	14 %
Three-month loss severities	41 %	37 %
Weighted average coupon	2.96 %	3.34 %

The significant unobservable inputs for the valuation model include the following weighted-averages, based on face value, as of the dates indicated:

	December 31, 2014		December 31, 2013	
	Senior Securities <sup>(1)</sup>	Re-REMIC Securities	Senior Securities	Re-REMIC Securities
Discount rate	<del>%</del> 5.55	% 6.00	% 6.55	%
Default rate	<del>%</del> 3.09	% 9.30	% 3.62	%
Loss severity rate	<del>%</del> 42.25	% 50.00	% 44.82	%
Prepayment rate	<del>%</del> 11.23	% 16.30	% 11.69	%

<sup>(1)</sup>The Company did not own any senior securities on December 31, 2014.

The ranges of the significant unobservable inputs for the valuation model were as follows as of the dates indicated:

	December 31, 2014		December 31, 2013	
	Senior Securities <sup>(1)</sup>	Re-REMIC Securities	Senior Securities	Re-REMIC Securities
Discount rate	<del>%</del> 5.15 – 10.00	% 6.00	% 6.00 – 10.00	%
Default rate	<del>%</del> 1.00 – 8.80	% 9.30	% 0.95 – 9.60	%
Loss severity rate	<del>%</del> 29.23 – 57.50	% 50.00	% 29.15 – 57.50	%
Prepayment rate	<del>%</del> 7.40 – 17.70	% 16.30	% 6.40 – 19.00	%



(1) The Company did not own any senior securities on December 31, 2014.

The tables below set forth a summary of changes in the fair value and gains and losses of the Company's Level 3 financial assets and liabilities that are measured at fair value on a recurring basis for the years ended December 31, 2014 and 2013.

	Year Ended December 31, 2014		
	Senior Securities	Re-REMIC Securities	Total
Beginning balance, January 1, 2014	\$7,066	\$ 334,233	\$ 341,299
Total net gains (losses)			
Included in earnings	1,690	15,553	17,243
Included in other comprehensive income	(1,654)	(13,437)	(15,091)
Purchases	—	—	—
Sales	(7,029)	(79,289)	(86,318)
Payments, net	(319)	(14,994)	(15,313)
Accretion of discount	246	25,371	25,617
Ending balance, December 31, 2014	\$—	\$ 267,437	\$ 267,437
The amount of net gains (losses) for the period included in earnings attributable to the change in unrealized gains (losses) relating to Level 3 assets still held at the reporting date	\$—	\$ (420)	\$ (420)



	Year Ended December 31, 2013		
	Senior Securities	Re-REMIC Securities	Total
Beginning balance, January 1, 2013	\$7,519	\$ 191,567	\$ 199,086
Total net gains (losses)			
Included in earnings	—	16,526	16,526
Included in other comprehensive income	(254 )	23,469	23,215
Purchases	—	167,682	167,682
Sales	—	(69,337 )	(69,337 )
Payments, net	(1,092 )	(21,362 )	(22,454 )
Accretion of discount	893	25,688	26,581
Ending balance, December 31, 2013	\$7,066	\$ 334,233	\$ 341,299
The amount of net gains (losses) for the period included in earnings attributable to the change in unrealized gains (losses) relating to Level 3 assets still held at the reporting date	\$—	\$ (1,270 )	\$ (1,270 )

Gains and losses included in earnings for the years ended December 31, 2014 and 2013 are reported in the following statement of comprehensive income line descriptions:

	Other Loss, Investment Loss, net	
	2014	2013
Total gains (losses) included in earnings for the period	\$ 17,243	\$ 16,526
Change in unrealized gains (losses) relating to Level 3 assets still held at the reporting date	\$ (420 )	\$ (1,270 )

### *Level 3 Financial Instruments Measured at Fair Value on a Non-Recurring Basis*

The Company also measures certain financial assets at fair value on a non-recurring basis. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets due to impairments. Due to the nature of these financial assets, enterprise values are primarily used to value these financial assets. In determining the enterprise value, the Company analyzes various financial, performance and market factors to estimate fair value, including where applicable, market trading activity. As a result, these financial assets are classified within Level 3 of the fair value hierarchy. As of December 31, 2014 and 2013, these financial assets are classified within the other investments category, represent the Company's interest in non-public equity securities and investment funds and are valued at \$1,625 and \$1,767, respectively. For the year ended December 31, 2013, the Company recorded a loss of \$177 in the carrying value of these financial assets. For the year ended December 31, 2014, there were no changes to the carrying value of these financial assets.

### *MBS, at Fair Value*



MBS, at fair value <sup>(1)(2)</sup>, consisted of the following as of the dates indicated:

	December 31, 2014						December 31, 2013					
	Fair Value	Net Unamortized Premium (Discount)	Percent of Total Fair Value	Weighted Average Life	Weighted Average Rating <sup>(3)</sup>		Fair Value	Net Unamortized Premium (Discount)	Percent of Total Fair Value	Weighted Average Life	Weighted Average Rating	
Trading												
Fannie Mae	\$2,064,465	\$—	56.07 %	8.1	AAA		\$997,488	\$—	52.01 %	9.4	AAA	
Freddie Mac	1,349,835	—	36.66 %	8.2	AAA		578,964	—	30.19 %	9.6	AAA	
Available-for-sale:												
Agency-backed												
Fannie Mae	40	—	—	4.9	AAA		47	—	—	5.8	AAA	
Private-label												
Senior securities	—	—	—	—	—		7,066	(4,789 )	0.37 %	4.8	C-	
Re-REMIC securities	267,437	(133,333)	7.27 %	10.4	NR		334,233	(202,450)	17.43 %	11.4	NR	
	\$3,681,777	\$(133,333)	100.00 %				\$1,917,798	\$(207,239)	100.00 %			

The Company's MBS portfolio was primarily comprised of fixed-rate MBS at December 31, 2014 and 2013. The <sup>(1)</sup>weighted-average coupon of the MBS portfolio at December 31, 2014 and 2013 was 3.93% and 3.90%, respectively.

As of December 31, 2014 and 2013, the Company's MBS investments with a fair value of \$3,376,025 and <sup>(2)</sup>\$1,673,911, respectively, were pledged as collateral for repurchase agreements.



The securities issued by Fannie Mae and Freddie Mac are not rated by any rating agency; however, they are commonly thought of as having an implied rating of “AAA.” There is no assurance, particularly given the downgrade of the U.S. credit rating to “AA+” by Standard & Poor’s during the quarter ended September 30, 2011 and Fitch Ratings Inc.’s announcement on October 15, 2013 that it had placed the U.S. credit rating on negative watch, that these securities would receive such a rating if they were ever rated by a rating agency. The weighted-average rating of the Company’s private-label senior securities is calculated based on face value of the securities.

The Company has generally purchased private-label MBS at a discount. The Company, at least on a quarterly basis, estimates the future expected cash flows based on the Company’s observation of current information and events and applies a number of assumptions related to prepayment rates, interest rates, default rates, loss severity rates, and the timing and amount of cash flows and credit losses. These assumptions are difficult to predict as they are subject to uncertainties and contingencies related to future events that may impact the Company’s estimates and its interest income.

Interest income on the private-label MBS that were purchased at a discount to face value is recognized based on the security’s expected effective interest rate. At acquisition, the accretable yield is calculated as the difference between the undiscounted expected cash flows and the purchase price which is expected to be accreted into interest income over the remaining life of the security on a level-yield basis. The difference between the contractually required payments and the undiscounted expected cash flows represents the non-accretable difference. Based on actual payment activities and changes in estimates of undiscounted expected future cash flows, the accretable yield and the non-accretable difference can change over time. Significant increases in the amount or timing of undiscounted expected future cash flows are recognized prospectively as an adjustment to the accretable yield.

The following table presents the changes in the accretable yield on available-for-sale, private-label MBS for the years ended December 31, 2014 and 2013:

	Year Ended December 31,	
	2014	2013 <sup>(1)</sup>
Beginning balance	\$ 326,330	\$ 207,853
Accretion of discount	(25,617 )	(26,581 )
Reclassifications, net	(21,848 )	62,141
Acquisitions	—	150,646
Sales	(76,757 )	(67,729 )
Ending balance	\$ 202,108	\$ 326,330

<sup>(1)</sup> The reclassification, net, and ending balance as of December 31, 2013 were revised from the previously reported balances of \$46,319 and \$310,508, respectively, to correct an immaterial error.



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The Company acquired no available-for-sale, private-label MBS during 2014. For the available-for-sale, private-label MBS acquired during the year ended December 31, 2013, the contractually required payments receivable, the cash flow expected to be collected, and the fair value at the acquisition date were as follows:

	Year Ended December 31, 2013
Contractually required payments receivable	\$ 420,500
Cash flows expected to be collected	318,328
Basis in acquired securities	167,682

The Company's available-for-sale MBS are carried at fair value in accordance with ASC 320, *Debt and Equity Securities* (ASC 320), the securities with resulting unrealized gains and losses reflected as other comprehensive income or loss. Gross unrealized gains and losses on these securities were the following as of the dates indicated:

	December 31, 2014			
	<b>Amortized Cost/Cost Basis <sup>(1)</sup></b>	<b>Unrealized Gains</b>	<b>Losses</b>	<b>Fair Value</b>
Agency-backed MBS	\$36	\$4	\$ —	\$ 40
Private-label MBS				
Senior securities	—	—	—	—
Re-REMIC securities	219,904	47,533	—	267,437
Total	\$219,940	\$47,537	\$ —	\$ 267,477

<sup>(1)</sup>The amortized cost of MBS includes unamortized net discounts of \$133,333 at December 31, 2014.



	December 31, 2013			
	Amortized Cost/Cost Basis <sup>(1)</sup>	Unrealized Gains	Unrealized Losses	Fair Value
Agency-backed MBS	\$43	\$4	\$ —	\$ 47
Private-label MBS				
Senior securities	5,412	1,654	—	7,066
Re-REMIC securities	273,264	60,970	(1 )	334,233
Total	\$278,719	\$62,628	\$ (1 )	\$ 341,346

(1) The amortized cost of MBS includes unamortized net discounts of \$207,239 at December 31, 2013.

For the years ended December 31, 2014 and 2013, the Company recorded other-than-temporary impairment charges of \$420 and \$1,270, respectively, as a component of investment loss, net, on the consolidated statements of comprehensive income related to deterioration in credit quality on available-for-sale, private-label MBS with a cost basis of \$2,174 and \$11,688, respectively, prior to recognizing the other-than-temporary impairment charges.

The following table presents a summary of other-than-temporary impairment charges included in earnings for the periods indicated and cumulative other-than-temporary impairment charges recognized on the MBS held as of the dates indicated:

	Year Ended December 31,	
	2014	2013
Cumulative other-than-temporary impairment, beginning balance	\$ 23,663	\$ 23,768
Additions		
Other-than-temporary impairments not previously recognized	420	380
Increases related to other-than-temporary impairments on securities with previously recognized other-than-temporary impairments	—	890
Reductions		
Decreases related to other-than-temporary impairments on sold securities with previously recognized other-than-temporary impairments	(5,180 )	(1,375 )
Cumulative other-than-temporary impairment ending balance	\$ 18,903	\$ 23,663

The following table presents the results of sales of MBS for the periods indicated:

Year Ended December 31,	
2014	2013



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	Agency-Backed MBS		Private-Label MBS		Agency-Backed MBS		Private-Label MBS	
Proceeds from sales	\$65,251	\$	86,318		\$914,155	\$	69,337	
Gross gains	1,351		17,397		1,619		17,458	
Gross losses	—		140		27,406		—	

***Other Investments***

The Company's other investments consisted of the following as of the dates indicated:

	December 31,	
	2014	2013
Interest-only MBS	\$212	\$298
Non-public equity securities	975	975
Investments funds	650	792
Total other investments	\$1,837	\$2,065

For the years ended December 31, 2014 and 2013, the Company recorded other-than-temporary impairment charges of \$29 and \$84, respectively, as a component of investment loss, net, on the consolidated statements of comprehensive income on an investment in interest-only MBS.



**Note 4. Borrowings:*****Repurchase Agreements***

The Company has entered into repurchase agreements to fund its investments in MBS. Securities sold under agreements to repurchase, which are treated as financing transactions for financial reporting purposes, are collateralized by MBS and are carried at their contractual amounts, including accrued interest, as specified in the respective agreements. Under the repurchase agreements, the Company pledges its securities as collateral to secure the borrowing, which is equal in value to a specified percentage of the fair value of the pledged collateral, while the Company retains beneficial ownership of the pledged collateral. The counterparty to the repurchase agreements may require that the Company pledge additional securities or cash as additional collateral to secure borrowings when the value of the collateral declines.

As of December 31, 2014 and December 31, 2013, the Company had no amount at risk with a single repurchase agreement counterparty or lender greater than 10% of equity. The following table provides information regarding the Company's outstanding repurchase agreement borrowings as of the dates and periods indicated:

	December 31,			
	2014		2013	
Outstanding balance	\$3,179,775		\$1,547,630	
Value of assets pledged as collateral				
Agency-backed MBS	3,300,383		1,556,763	
Private-label MBS	75,642		117,148	
Net amount <sup>(1)</sup>	196,250		126,281	
Weighted-average rate	0.40	%	0.45	%
Weighted-average term to maturity	14.1 days		13.2 days	
Weighted-average outstanding balance during the year ended	\$2,438,479		\$1,515,137	
Weighted-average rate during the year ended	0.37	%	0.45	%

<sup>(1)</sup> Net amount represents the value of collateral in excess of corresponding repurchase obligation. The amount of collateral at-risk is limited to the outstanding repurchase obligation and not the entire collateral balance.

***Long-Term Debt***



As of December 31, 2014 and 2013, the Company had \$40,000 of outstanding long-term debentures. On May 1, 2013, the Company completed a public offering of \$25,000 of its 6.625% Senior Notes due in 2023 and received net proceeds of \$24,038 after payment of underwriting discounts and commissions and expenses. These Senior Notes will mature on May 1, 2023, and may be redeemed in whole or in part at any time and from time to time at the Company's option on or after May 1, 2016, at a redemption price equal to the principal amount redeemed plus accrued and unpaid interest. The interest payments on these Senior Notes are payable quarterly on February 1, May 1, August 1, and November 1 of each year, beginning on August 1, 2013. These Senior Notes are publicly traded on the New York Stock Exchange under the ticker symbol "AIW". The Company's long-term debentures consisted of the following as of the dates indicated:

	<b>December 31, 2014</b>		<b>December 31, 2013</b>	
	<b>Senior Notes</b>	<b>Trust Preferred Debt</b>	<b>Senior Notes</b>	<b>Trust Preferred Debt</b>
Outstanding Principal	\$25,000	\$15,000	\$25,000	\$15,000
Annual Interest Rate	6.625 %	LIBOR+2.25-3.00 %	6.625 %	LIBOR+2.25-3.00 %
Interest Payment Frequency	Quarterly	Quarterly	Quarterly	Quarterly
Weighted-Average Interest Rate	6.625 %	2.98 %	6.625 %	2.99 %
Maturity	May 1, 2023	2033 – 2035	May 1, 2023	2033 – 2035
Early Redemption Date	May 1, 2016	2008 – 2010	May 1, 2016	2008 – 2010

#### **Note 5. Derivative Financial Instruments and Hedging Activities:**

In the normal course of its operations, the Company is a party to financial instruments that are accounted for as derivative financial instruments in accordance with ASC 815. These instruments may include interest rate swaps, Eurodollar futures, swap futures, and U.S. Treasury futures contracts, put options and certain commitments to purchase and sell MBS. The exchange traded derivatives such as Eurodollar futures and swap futures are cash settled on a daily basis. The Company may be required to pledge collateral for margin requirements with third-party custodians in connection with certain derivative transactions. These transactions are not under master netting agreements. In addition, certain features of the securitization structures of the Company's private-label MBS are considered derivatives under ASC 815. The Company determined that these embedded derivatives have de minimis value, if any.



During the years ended December 31, 2014 and 2013, the Company entered into various financial contracts to hedge certain MBS and related borrowings and other long-term debt. These financial contracts are not designated as hedges under ASC 815. The changes in fair value on these derivatives are recorded to net investment (loss) gain, net, in the statement of comprehensive income. For the years ended December 31, 2014 and 2013, the Company recorded net (losses) gains of \$(140,353) and \$58,003, respectively, on these derivatives. The Company held the following derivative instruments as of the dates indicated:

	December 31, 2014		December 31, 2013	
	Notional Amount	Fair Value	Notional Amount	Fair Value
No hedge designation				
Eurodollar futures				
Derivative assets	\$2,445,000	\$751	\$8,758,000	\$4,361
Derivative liabilities	38,645,000	(76,848)	6,787,000	(30,638)
Total Eurodollar futures <sup>(1)</sup>	41,090,000	(76,097)	15,545,000	(26,277)
10-year swap futures				
Derivative assets	—	—	635,500	3,727
Derivative liabilities	1,145,000	(47,460)	31,000	(18 )
Total 10-year swap futures <sup>(2)</sup>	1,145,000	(47,460)	666,500	3,709
5-year U.S. Treasury note futures	—	—	100,000	(1,500 )
Commitment to purchase MBS <sup>(3)</sup>	200,000	516	169,511	(973 )
Commitment to sell MBS	—	—	125,000	336

The \$41,090,000 total notional amount of Eurodollar futures contracts as of December 31, 2014 represents the accumulation of Eurodollar futures contracts that mature on a quarterly basis between 2015 and 2019. As of <sup>(1)</sup> December 31, 2014, the Company maintained \$96,147 as a deposit and margin against the open Eurodollar futures contracts.

The \$1,145,000 represents the total notional amount of 10-year swap futures as of December 31, 2014, of which <sup>(2)</sup> \$780,000 of notional amount matures in March 2015 and \$365,000 in notional amount matures in March 2024. As of December 31, 2014, the Company maintained \$64,280 as a deposit and margin against the open 10-year swap futures contracts.

<sup>(3)</sup> The total notional amount of commitment to purchase MBS represents forward commitments to purchase fixed-rate MBS securities.

## Note 6. Income Taxes:



The Company is taxed as a C corporation for federal income tax purposes.

The provision (benefit) for income taxes from operations consists of the following for the years ended December 31, 2014, 2013 and 2012:

	2014	2013	2012
Federal	\$41,819	\$(20,075)	\$(115,321)
State	7,627	(15,247)	(37,616 )
	\$49,446	\$(35,322)	\$(152,937)
Current	\$796	\$(14,860)	\$1,889
Deferred	48,650	(20,462)	(154,826)
	\$49,446	\$(35,322)	\$(152,937)

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Deferred tax assets and (liabilities) consisted of the following as of December 31, 2014 and 2013:

	2014	2013
Net operating loss carry-forward	\$57,225	\$71,214
Unrealized gains and losses on investments and derivatives, net	24,434	70,221
AMT credit	7,244	6,328
Accrued compensation	1,515	436
Realized gains and losses on designated derivatives, net	2,733	8,681
Other, net	582	4,303
Capital loss carry-forward	54,659	19,743
Valuation allowance on capital loss carry-forward	(26,027 )	(15,075 )
Net deferred tax asset	\$122,365	\$165,851

The provision (benefit) for income taxes results in effective tax rates that differ from the federal statutory rates. The reconciliation of the Company and its subsidiaries income tax attributable to net income computed at federal statutory rates to income tax expense was:

	December 31,		
	2014	2013	2012
Federal income tax at statutory rate	\$19,390	\$4,949	\$10,852
State income taxes, net of federal benefit	2,161	849	1,813
Expiration of capital loss carryover	4,668	57,254	37,935
Reversal of unrecognized tax benefit related to uncertain tax position and related accrued interest, and related AMT credits	—	(11,028)	—
Federal liability on state deferred tax assets	—	1,237	7,884
Losses on MBS acquired prior to 2012	(1,178 )	—	—
Tax basis adjustments	(1,656 )	—	—
Other, net	34	2,606	945
Valuation allowance	26,027	(91,189)	(212,366)
Total income tax provision (benefit)	\$49,446	\$(35,322)	\$(152,937)

During the year ended December 31, 2012, the Company recorded \$152,937 of income tax benefit as a result of releasing \$162,519 of valuation allowance previously provided for certain deferred tax assets. The amount of the valuation allowance released by the Company represents a portion of deferred tax assets that was deemed more-likely-than-not that the Company will realize the benefits based on the analysis where the positive evidences outweighed the negative evidences. The Company's framework for assessing the recoverability of deferred tax assets required consideration of all available evidence, including:

• the sustainability of recent operating profitability;



- the predictability of future operating profitability of the character necessary to realize the deferred tax assets; and
- the carry-forward periods for the net operating loss and capital loss carry-forwards.

The determination to release valuation allowance as of December 31, 2012 was based upon the Company meeting the criteria in the framework.

Effective December 31, 2013, the Company contributed 40 of its private-label MBS with \$367,642 in face value in a taxable contribution (Contribution) to Rosslyn REIT Trust. Rosslyn REIT Trust (formerly known as FBR REIT Asset Trust) was formed on December 27, 2007 as a Maryland real estate investment trust and elected to be taxed as a REIT for U.S. federal income tax purposes effective January 1, 2014, upon filing its federal income tax return for that year. The Company owns all the common shares of Rosslyn REIT Trust and all of the preferred shares are owned by outside investors. The Contribution resulted in taxable capital gains of \$68,041. The Company utilized net capital loss carry-forwards to offset the capital gain recognized on the Contribution for tax purposes.

With the completion of IRS examination of the Company's tax years 2009 and 2010 without any adjustment and the expiration of the statute of limitation on 2009 state tax return, the Company reversed \$12,810 of unrecognized tax benefits related to an uncertain tax position and \$3,402 of related accrued interest during the year ended December 31, 2013. The Company also reversed deferred taxes associated with accrued interest and AMT credits of \$5,184 related to the unrecognized tax benefits previously recorded.

As of December 31, 2014, the Company had an NCL carry-forward of \$140,512 that can be used to offset future capital gains. \$50,754 of capital losses expired in 2014. In addition, as of December 31, 2014, the Company had an NOL carry-forward of \$147,107, which can be used to offset future taxable income. The NOL carry-forward will begin to expire in 2027. The valuation allowance relates to the estimated amount of NCLs that are more-likely-than-not to expire unused in 2019.



As of December 31, 2014 and 2013, the Company had no unrecognized tax benefits.

As of December 31, 2014, the Company has assessed the need for recording a provision for any uncertain tax position and has made the determination that such provision is not necessary.

The Company is subject to examination by the U.S. Internal Revenue Service (IRS), and state and local authorities in jurisdictions where the Company has significant business operations.

## Note 7. Commitments and Contingencies:

### *Contractual Obligations*

The Company has contractual obligations to make future payments in connection with borrowings and non-cancelable lease agreements and other contractual commitments. The following table sets forth these contractual obligations by fiscal year:

	2015	2016	2017	2018	2019	Thereafter	Total
Borrowings <sup>(1)</sup>	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 40,000	\$40,000
Minimum rental and other contractual commitments <sup>(2)</sup>	15	446	458	471	483	497	2,370
	\$ 15	\$ 446	\$ 458	\$ 471	\$ 483	\$ 40,497	\$42,370

This table excludes interest payments to be made on the Company's long-term debt securities. Based on the weighted average interest rate of 3.01%, approximately \$113 in accrued interest on the current outstanding principal will be paid for the quarter ending March 31, 2015 on the \$15,000 of trust preferred debt. Interest on the trust preferred debt is based on the 3-month LIBOR; therefore, actual coupon interest will likely differ from this estimate. The trust preferred debt will mature beginning in October 2033 through July 2035. As of December 31, 2014, approximately \$414 in accrued interest on the current outstanding principal will be paid for the quarter ending March 31, 2015 on the \$25,000 of Senior Notes. The Senior Notes have an annual interest rate of 6.625% and will mature on May 1, 2023.

<sup>(2)</sup>Equipment and office rent expense for 2014, 2013 and 2012 was \$249, \$243 and \$263, respectively.



The Company also has short-term repurchase agreement liabilities of \$3,179,775 as of December 31, 2014. See Note 4 for further information.

**Note 8. Shareholders' Equity:**

The Company has authorized share capital of 450,000,000 shares of Class A common stock, par value \$0.01 per share; 100,000,000 shares of Class B common stock, par value \$0.01 per share; and 25,000,000 shares of undesignated preferred stock. Holders of the Class A and Class B common stock are entitled to one vote and three votes per share, respectively, on all matters voted upon by the shareholders. Shares of Class B common stock convert to shares of Class A common stock at the option of the Company in certain circumstances including (i) upon sale or other transfer, (ii) at the time the holder of such shares of Class B common stock ceases to be affiliated with the Company and (iii) upon the sale of such shares in a registered public offering. The Company's Board of Directors has the authority, without further action by the shareholders, to issue preferred stock in one or more series and to fix the terms and rights of the preferred stock. Such actions by the Board of Directors could adversely affect the voting power and other rights of the holders of common stock. Preferred stock could thus be issued quickly with terms that could delay or prevent a change in control of the Company or make removal of management more difficult. At present, the Company has no plans to issue any preferred stock.

***Conversion of Class B Common Stock to Class A Common Stock***

During the year ended December 31, 2014, several holders of the Company's Class B common stock converted an aggregate of 448,186 shares of Class B common stock into 448,186 shares of Class A common stock. There were no conversions of shares of Class B common stock into shares of Class A common stock during the year ended December 31, 2013. Holders of shares of Class A common stock are entitled to one vote for each share on all matters voted on by shareholders, and the holders of shares of Class B common stock are entitled to three votes per share on all matters voted on by shareholders. Under the Company's Articles of Incorporation, shares of Class B common stock are convertible into shares of Class A common stock on a one-for-one basis.



## *Share Repurchases*

From time to time, the Company repurchases shares of its Class A common stock under a share repurchase program authorized by the Board of Directors in July 2010 (Repurchase Program), pursuant to which the Company is authorized to repurchase up to 500,000 shares of its Class A common stock.

Repurchases under the Repurchase Program may be made from time to time on the open market and in private transactions at management's discretion in accordance with applicable federal securities laws. The timing of repurchases and the exact number of shares of Class A common stock to be repurchased will depend upon market conditions and other factors. The Repurchase Program is funded using the Company's cash on hand and cash generated from operations. The Repurchase Program has no expiration date and may be suspended or terminated at any time without prior notice.

The Company had no share repurchase activities during the years ended December 31, 2014 and 2013. During the year ended December 31, 2012, the Company repurchased 41,790 shares of its Class A common stock with an average price of \$18.79 per share, resulting in total cost of \$786.

As of December 31, 2014, and 2013, 205,485 shares of Class A common stock remain available for repurchases under the Repurchase Program.

## *Equity Offerings*

During the years ended December 31, 2014 and 2013, the Company completed public offerings as follows:

Closing date of the offering	March 13, 2013	March 28, 2014	September 8, 2014
Shares sold to public	3,000,000	2,750,000	2,750,000
Shares sold pursuant to the underwriter over-allotment	450,000	312,500	412,500
Total shares of Class A common stock	3,450,000	3,062,500	3,162,500
Public offering price per share	\$ 25.50	\$ 27.40	\$ 27.61
Net proceeds <sup>(1)</sup>	\$ 86,964	\$ 81,669	\$ 85,214



(1) Net of underwriting discounts and commissions and expenses.

### ***Dividends***

Pursuant to the Company's variable dividend policy, the Board of Directors evaluates dividends on a quarterly basis and, in its sole discretion, approves the payment of dividends. The Company's dividend payments, if any, may vary significantly from quarter to quarter. The Board of Directors has approved and the Company has declared the following dividends to date in 2014:

Quarter Ended	Dividend Amount	Declaration Date	Record Date	Pay Date
December 31	\$ 0.875	December 18	December 31	January 30, 2015
September 30	0.875	September 17	September 29	October 31
June 30	0.875	June 11	June 30	July 31
March 31	0.875	March 13	March 31	April 30

The Board of Directors has approved and the Company declared and paid the following dividends for 2013:

Quarter Ended	Dividend Amount	Declaration Date	Record Date	Pay Date
December 31	\$ 0.875	December 19	December 31	January 31, 2014
September 30	0.875	September 18	September 30	October 31
June 30	0.875	June 17	June 28	July 31
March 31	0.875	March 15	March 28	April 30

### ***Long-Term Incentive Plan***

On April 7, 2014, the Board of Directors adopted the Arlington Asset Investment Corp. 2014 Long-Term Incentive Plan (2014 Plan). The 2014 Plan was approved by the Company's shareholders and became effective on July 15, 2014.

Under the 2014 Plan, a maximum number of 2,000,000 shares of Class A common stock of the Company, subject to adjustment as set forth in the 2014 Plan, were authorized for issuance and may be issued to employees, directors, consultants and advisors of the Company and its affiliates. As of December 31, 2014, 1,998,774 shares remained available for issuance under the 2014 Plan. The 2014 Plan replaced the Arlington Asset Investment Corp. 2011 Long-Term Incentive Plan (2011 Plan). No additional grants will be made under the 2011 Plan. However, previous grants under the 2011 Plan will remain in effect subject to the terms of the 2011 Plan and the applicable award agreement, and shares of Class A common stock may be issued under the 2011 Plan. The shares of Class A common stock to be issued under the 2011 Plan are subject to the achievement of performance measures and/or vesting. As of December 31, 2014 and December 31, 2013, 308,934 and 443,504 shares, respectively, remained available for issuance under the 2011 Plan.



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Under the 2014 Plan, the Compensation Committee of the Company's Board of Directors may grant options, stock appreciation rights (SARs), restricted stock and restricted stock units (RSUs), performance awards and/or other stock-based awards. However, no participant may be granted (i) options or SARs during any twelve month period covering more than 300,000 shares or (ii) restricted stock, RSUs, performance awards and/or other stock-based awards denominated in shares that are intended to qualify as performance based compensation under Section 162(m) that permit the participant to earn more than 300,000 shares for each twelve months in the vesting or period on which performance is measured (Performance Period). These share limits are subject to adjustment in the event of any merger, reorganization, consolidation, recapitalization, stock dividend, stock split, reverse stock split, spin-off, extraordinary cash dividend or similar transaction or other change in corporate structure affecting the share. In addition, during any calendar year no participant may be granted performance awards that are denominated in cash and that are intended to qualify as performance based compensation under Section 162(m) under which more than \$10,000 may be earned for each twelve months in the Performance Period. Each of the individual award limits described in this paragraph will be multiplied by two during the first calendar year in which the participant commences employment with the Company and its affiliates. The 2014 Plan will terminate on the tenth anniversary of its effective date unless sooner terminated by the Board of Directors. The Company uses a fair value based measurement method in accounting for all share based payment transactions.

#### *Performance-Based Long-Term Incentive Program*

On August 13, 2012, the Compensation Committee of the Board of Directors of the Company adopted a performance-based long-term incentive program (Performance-based Program) that provides for the issuance of two types of performance share units (PSUs).

The Compensation Committee established performance goals under the Performance-based Program. Two types of PSUs may be awarded under the Performance-based Program: Book Value PSUs and Total Shareholder Return Units (TSR PSUs). The Book Value PSUs are eligible to vest based on the compound annualized growth in the Company's book value per share (*i.e.*, book value change with such adjustments as determined and approved by the Compensation Committee plus dividends on a reinvested basis) during the applicable performance period. The TSR PSUs are eligible to vest based on the Company's compound annualized total shareholder return (*i.e.*, share price change plus dividends on a reinvested basis) during the applicable performance period.

PSUs do not have any voting rights. No dividends are paid on outstanding PSUs during the applicable performance period. Instead, dividend equivalents are accrued on outstanding PSUs during the applicable performance period, deemed invested in shares of Class A common stock and are paid out in shares of Class A common stock at the end of the performance period to the extent that the underlying PSUs vest. Upon settlement, vested PSUs are converted into shares of the Company's Class A common stock on a one-for-one basis. The PSUs and dividend equivalents are settled in whole shares of Class A common stock with a cash payment in lieu of any fractional share.



The right to receive shares of Class A common stock upon vesting of PSUs at the end of the applicable performance period is subject to both continued employment and the achievement of the Company performance goals established by the Compensation Committee. The employment requirement, but not the performance requirement, is waived in the event the awardee dies, becomes disabled or retires; provided, however, that if the awardee dies, becomes disabled or retires before the first anniversary of the grant date, the number of PSUs that are earned under the performance targets are pro-rated. If an awardee is terminated without “cause,” the Compensation Committee, in the exercise of its discretion, determines whether any of the PSUs have been earned, provided that the Compensation Committee may not approve a payout that exceeds the number of PSUs earned under the performance targets. In the event of a change of control, the number of PSUs that are earned for each performance period are determined immediately prior to the change of control based on actual performance and vests subject to continued employment for the remainder of the original performance period, subject to accelerated vesting in certain circumstances.

Except as described above or as the Compensation Committee at any time may otherwise determine, an awardee will forfeit the right to any PSUs if he or she terminates employment before the payment date.

The Compensation Committee of the Board of Directors of the Company approved the following grants to the participants in the Performance-based Program:

	Year Ended December 31,		
	2012	2013	2014
Grant date	August 13, 2012	July 1, 2013	July 1, 2014
Shares granted			
Book Value PSUs	30,177	34,221	35,126
TSR PSUs	41,735	34,567	35,593



For the grants made in 2012 (2012 PSU Grants), the Compensation Committee awarded PSUs with an aggregate grant date fair value equal to 75% of the awardee's base salary, with 50% of the total grant date fair value represented by Book Value PSUs and 50% of the total grant date fair value represented by TSR PSUs. To facilitate the implementation of the Performance-based Program, the Compensation Committee established both a two-year and three-year performance period for the initial grant of PSUs. A portion of the Book Value PSUs and TSR PSUs are eligible for vesting at the end of the second year following the grant date, and a portion of the Book Value PSUs and TSR PSUs are eligible for vesting at the end of the third year following the grant date. The actual number of shares of Class A common stock that will be issued to each participant at the end of the applicable performance period will vary between 0% and 200% of the number of PSUs granted, depending on performance results. If the threshold level of performance goals are not achieved, no PSUs are earned. If the initial performance threshold is met, participants will be eligible to receive 50% of the granted PSUs for Company performance at the threshold level, 100% of the granted PSUs for Company performance at the target level and 200% of the granted PSUs for Company performance at the maximum level, with linear interpolation for achievement falling between the performance levels. During 2014, the Company issued 37,725 and 52,424 shares for the vesting of Book Value PSUs and TSR PSUs, respectively, related to the 2012 PSU Grants.

For the grants made in 2013 (2013 PSU Grants) and 2014 (2014 PSU Grants), the Compensation Committee awarded PSUs with an aggregate grant date fair value equal to 100% of the awardee's base salary, with 50% of the total grant date fair value represented by Book Value PSUs and 50% of the total grant date fair value represented by TSR PSUs. The Compensation Committee established a three-year performance period. The Book Value PSUs and TSR PSUs will be eligible for vesting at the end of the third year following the respective grant dates. The actual number of shares of Class A common stock that will be issued to each participant at the end of the applicable performance period will vary between 0% and 250% of the number of PSUs granted, depending on performance results. If the threshold level of performance goals are not achieved, no PSUs are earned. If the initial performance threshold is met, participants will be eligible to receive 50% of the granted PSUs for Company performance at the threshold level, 100% of the granted PSUs for Company performance at the target level and 250% of the granted PSUs for Company performance at the maximum level, with linear interpolation for achievement falling between the performance levels.

The Company recorded \$2,457 and \$1,485 in compensation expenses related to the Performance-based Program during the years ended December 31, 2014 and 2013, respectively.

#### *Restricted Stock*

The Company grants restricted common shares to employees that vest ratably over a three year period or cliff-vest after two to four years for various purposes based on continued employment over these specified periods. As of December 31, 2014 and 2013, a total of 117,112 and 57,673 shares, respectively, of such restricted Class A common stock were outstanding with unamortized deferred compensation of \$2,181 and \$838, respectively. A summary of these unvested restricted stock awards is presented below:



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	Number of Shares	Weighted-average Grant-date Fair Value	Weighted- average Remaining Vested Period
Share Balance as of December 31, 2011	15,206	\$ 35.40	2.0
Granted	25,500	22.99	—
Forfeitures	—	—	—
Vestitures	(5,871 )	47.60	—
Share Balance as of December 31, 2012	34,835	24.24	2.2
Granted	36,000	26.74	—
Forfeitures	—	—	—
Vestitures	(13,162 )	24.65	—
Share Balance as of December 31, 2013	57,673	25.71	2.0
Granted	84,602	26.84	—
Forfeitures	—	—	—
Vestitures	(25,163 )	25.64	—
Share Balance as of December 31, 2014	117,112	26.54	1.9

For the years ended December 31, 2014, 2013, and 2012, the Company recognized \$927, \$632 and \$279, respectively, of compensation expense related to this restricted stock plan.

In addition, as part of the Company's satisfaction of incentive compensation earned for past service under the Company's variable compensation programs, employees may receive restricted Class A common stock in lieu of cash payments. These restricted Class A common stock shares are issued to an irrevocable trust and are not returnable to the Company. No such shares were issued in 2014, 2013 and 2012. As of December 31, 2014, 2013, and 2012, the Company had 9,155 vested shares with an weighted-average grant-date fair value of \$310.40 of the undistributed restricted stock issued to the trust.



### *Director Stock Compensation Plan*

The Company also grants options, stock or restricted stock units (RSUs) in lieu of or in addition to annual director fees to non-employee directors. The Board approved annual awards of RSUs equal in value to \$80 to each director to be made in conjunction with the annual shareholders meeting. On June 6, 2014, the non-employee directors received an annual grant of an aggregate of 14,440 RSUs having an aggregate grant date fair value of \$400 based on the closing sale price of the Class A common stock on the New York Stock Exchange on June 11, 2014 of \$27.70. In addition to the annual grant of RSUs, the Company also granted 1,081 additional RSUs to the non-employee directors in lieu of certain cash payments for services as Lead Independent Director or as a chairman of one of the Board's standing committees. Vested RSUs are convertible to Class A common stock upon the director ceasing to be a member of the Board. All options, stock and RSUs awarded to non-employee directors are non-transferable other than by will or the laws of descent and distribution. During 2014, 2013, and 2012, the Company granted 15,521, 15,616 and 20,204 RSUs, respectively. For the years ended December 31, 2014, 2013, and 2012, the Company recognized \$430, \$430 and \$431, respectively, of director fees related to these RSUs.

### **Note 9. Financial Instruments with Off-Balance-Sheet Risk and Credit Risk:**

As of December 31, 2014 and 2013, the Company had not entered into any transactions involving financial instruments that would expose the Company to significant related off-balance-sheet risk.

### **Note 10. Revisions to Previously Reported Financial Statements:**

During the preparation of the 2013 consolidated financial statements, the Company concluded that the federal tax rate used to calculate deferred tax assets as of December 31, 2012 was incorrect and should have been lower than the statutory rate given the effects of recognizing a U.S. federal deferred income tax liability associated with state deferred tax assets. Although the impact of this change was not material to the consolidated financial statements as of and for the year ended December 31, 2012, the Company revised its previously reported consolidated financial statements and disclosures as of and for the year ended December 31, 2012. The following tables set forth the effected line items within the Company's previously reported consolidated financial statements for the year ended December 31, 2012.

Year Ended December 31, 2012
As
Previously Reported
Adjustment
As Revised

Consolidated Statement of Comprehensive Income



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Income tax benefit	\$(160,821)	\$ 7,884	\$(152,937 )
Net income	191,826	(7,884 )	183,942
Earnings per share – Basic	18.80	(0.78 )	18.02
Earnings per share – Diluted	18.73	(0.77 )	17.96
Other comprehensive income, net of taxes			
Unrealized gains (losses) for the period on available-for-sale securities, net of taxes	(1,843 )	(66 )	(1,909 )
Comprehensive income	192,444	(7,863 )	184,581

	Year Ended December 31, 2012		
	As		
	Previously Reported	Adjustment	As Revised
Consolidated Statement of Changes in Equity			
Net income	\$ 191,826	\$ (7,884 )	\$ 183,942
Net change in unrealized gain on available-for-sale securities, net of taxes	618	21	639
Accumulated other comprehensive income, net of taxes	38,985	21	39,006
Accumulated deficit	(1,212,022)	(7,884 )	(1,219,906)
Total equity	465,156	(7,863 )	457,293

	Year Ended December 31, 2012		
	As		
	Previously Reported	Adjustment	As Revised
Consolidated Statement of Cash Flows			
Net income	\$ 191,826	\$ (7,884 )	\$ 183,942
Deferred tax provision	—	7,884	7,884

**Note 11. Quarterly Data (Unaudited):**

The following tables set forth selected information for each of the fiscal quarters during the years ended December 31, 2014 and 2013. The selected quarterly data is derived from unaudited financial statements of the Company and has been prepared on the same basis as the annual, audited financial statements to include, in the opinion of management, all adjustments (consisting of only normal recurring adjustments) necessary for fair statement of the results for such periods.

Note: The sum of quarterly earnings per share amounts may not equal full year earnings per share amounts due to differing average outstanding shares amounts for the respective periods.



	Net Interest Income	Net Income (Loss)	Basic Earnings (Loss) Per Share	Diluted Earnings (Loss) Per Share
2014				
First Quarter	\$ 21,582	\$ 7,033	\$ 0.42	\$ 0.41
Second Quarter	27,387	18,839	0.95	0.94
Third Quarter	30,325	12,847	0.62	0.61
Fourth Quarter	32,862	(32,765 )	(1.43 )	(1.43 )
Total Year	\$ 112,156	\$ 5,954	0.30	0.29

	Net Interest Income	Net Income	Basic Earnings Per Share	Diluted Earnings Per Share
2013				
First Quarter	\$ 16,724	\$3,177	\$ 0.23	\$ 0.23
Second Quarter	20,925	3,194	0.19	0.19
Third Quarter	20,681	3,093	0.19	0.18
Fourth Quarter	20,160	39,997 <sup>(1)</sup>	2.40	2.36
Total Year	\$ 78,490	\$49,461	3.09	3.06

Reflects \$185 increase in net income as a result of an out of period adjustment (that is related to the immaterial<sup>(1)</sup> revision as disclosed in Note 10, Revisions to Previously Reported Financial Statements) for the first three quarters of the year ended December 31, 2013.