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American Capital Agency Corp  
Form 10-Q  
August 05, 2015

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

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FORM 10-Q

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

For the quarterly period ended June 30, 2015

OR

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

Commission file number 001-34057

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AMERICAN CAPITAL AGENCY CORP.  
(Exact name of registrant as specified in its charter)

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|  |                     |
|--|---------------------|
| Delaware   | 26-1701984          |
| (State or Other Jurisdiction of                      | (I.R.S. Employer    |
| Incorporation or Organization)                       | Identification No.) |
| 2 Bethesda Metro Center, 14th Floor                  |                     |
| Bethesda, Maryland 20814                             |                     |
| (Address of principal executive offices)             |                     |
| (301) 968-9300                                       |                     |
| (Registrant's telephone number, including area code) |                     |

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Indicate by check mark whether the registrant (1) has filed all reports 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 earlier period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant 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 ☒ No ☐

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.

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller Reporting Company ☐

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

The number of shares of the issuer's common stock, \$0.01 par value, outstanding as of July 31, 2015 was 348,802,157.

AMERICAN CAPITAL AGENCY CORP.  
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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

AMERICAN CAPITAL AGENCY CORP.  
CONSOLIDATED BALANCE SHEETS  
(in millions, except per share data)

|   | June 30, 2015<br>(Unaudited) | December 31,<br>2014 |
|---|------------------------------|----------------------|
| Assets:   |                              |                      |
| Agency securities, at fair value (including pledged securities of \$48,128 and \$51,629, respectively)                      | \$50,976                     | \$55,482             |
| Agency securities transferred to consolidated variable interest entities, at fair value (pledged securities)                | 1,142                        | 1,266                |
| U.S. Treasury securities, at fair value (including pledged securities of \$4,756 and \$2,375, respectively)                 | 5,124                        | 2,427                |
| REIT equity securities, at fair value   | 60                           | 68                   |
| Cash and cash equivalents   | 1,510                        | 1,720                |
| Restricted cash   | 778                          | 713                  |
| Derivative assets, at fair value  | 164                          | 408                  |
| Receivable for securities sold (including pledged securities of \$221 and \$79, respectively)                               | 221                          | 239                  |
| Receivable under reverse repurchase agreements  | 2,741                        | 5,218                |
| Other assets  | 169                          | 225                  |
| Total assets  | \$62,885                     | \$67,766             |
| Liabilities:  |                              |                      |
| Repurchase agreements   | \$50,178                     | \$50,296             |
| Debt of consolidated variable interest entities, at fair value  | 674                          | 761                  |
| Payable for securities purchased  | 90                           | 843                  |
| Derivative liabilities, at fair value   | 844                          | 890                  |
| Dividends payable   | 77                           | 85                   |
| Obligation to return securities borrowed under reverse repurchase agreements, at fair value                                 | 2,230                        | 5,363                |
| Accounts payable and other accrued liabilities  | 74                           | 100                  |
| Total liabilities   | 54,167                       | 58,338               |
| Stockholders' equity:   |                              |                      |
| Preferred stock - \$0.01 par value; 10.0 shares authorized:   |                              |                      |
| Redeemable Preferred Stock; \$0.01 par value; 6.9 shares issued and outstanding (aggregate liquidation preference of \$348) | 336                          | 336                  |
| Common stock - \$0.01 par value; 600.0 shares authorized; 348.8 and 352.8 shares issued and outstanding, respectively       | 4                            | 4                    |
| Additional paid-in capital  | 10,253                       | 10,332               |
| Retained deficit  | (1,879)                      | (1,674)              |
| Accumulated other comprehensive income  | 4                            | 430                  |
| Total stockholders' equity  | 8,718                        | 9,428                |
| Total liabilities and stockholders' equity  | \$62,885                     | \$67,766             |
| See accompanying notes to consolidated financial statements.  |                              |                      |



AMERICAN CAPITAL AGENCY CORP.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)  
(in millions, except per share data)

|   | Three months ended<br>June 30, |         | Six months ended<br>June 30, |           |
|---|--------------------------------|---------|------------------------------|-----------|
|   | 2015                           | 2014    | 2015                         | 2014      |
| Interest income:  |                                |         |                              |           |
| Interest income   | \$414                          | \$385   | \$797                        | \$784     |
| Interest expense  | 81                             | 95      | 167                          | 203       |
| Net interest income   | 333                            | 290     | 630                          | 581       |
| Other gain (loss), net:   |                                |         |                              |           |
| (Loss) gain on sale of agency securities, net                               | (22                            | ) 22    | 14                           | 3         |
| Gain (loss) on derivative instruments and other securities, net             | 237                            | (244    | ) (312                       | ) (621    |
| Total other gain (loss), net  | 215                            | (222    | ) (298                       | ) (618    |
| Expenses:   |                                |         |                              |           |
| Management fees   | 29                             | 30      | 59                           | 59        |
| General and administrative expenses   | 7                              | 6       | 13                           | 12        |
| Total expenses  | 36                             | 36      | 72                           | 71        |
| Net income (loss)   | 512                            | 32      | 260                          | (108      |
| Dividend on preferred stock   | 7                              | 5       | 14                           | 9         |
| Net income (loss) available (attributable) to common stockholders           | \$505                          | \$27    | \$246                        | \$(117    |
| Net income (loss)   | \$512                          | \$32    | \$260                        | \$(108    |
| Other comprehensive (loss) income:  |                                |         |                              |           |
| Unrealized (loss) gain on available-for-sale securities, net                | (872                           | ) 790   | (481                         | ) 1,312   |
| Unrealized gain on derivative instruments, net                              | 26                             | 40      | 55                           | 83        |
| Other comprehensive (loss) income   | (846                           | ) 830   | (426                         | ) 1,395   |
| Comprehensive (loss) income   | (334                           | ) 862   | (166                         | ) 1,287   |
| Dividend on preferred stock   | 7                              | 5       | 14                           | 9         |
| Comprehensive (loss) income (attributable) available to common stockholders | \$(341                         | ) \$857 | \$(180                       | ) \$1,278 |
| Weighted average number of common shares outstanding - basic and diluted    | 352.1                          | 352.8   | 352.5                        | 353.8     |
| Net income (loss) per common share - basic and diluted                      | \$1.43                         | \$0.08  | \$0.70                       | \$(0.33   |
| Dividends declared per common share   | \$0.62                         | \$0.65  | \$1.28                       | \$1.30    |
| See accompanying notes to consolidated financial statements.                |                                |         |                              |           |

AMERICAN CAPITAL AGENCY CORP.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
(Unaudited)  
(in millions)

|   | Preferred Stock |        | Common Stock |        | Additional Paid-in Capital | Retained Deficit | Accumulated Other Comprehensive Income (Loss) | Total    |
|---|-----------------|--------|--------------|--------|----------------------------|------------------|---|----------|
|   | Shares          | Amount | Shares       | Amount |                            |                  |   |          |
| Balance, December 31, 2013                            | 6.9             | \$ 167 | 356.2        | \$ 4   | \$ 10,406                  | \$(497 )         | \$ (1,383 )                                   | \$ 8,697 |
| Net loss  | —               | —      | —            | —      | —                          | (108 )           | —   | (108 )   |
| Other comprehensive income:                           |                 |        |              |        |                            |                  |   |          |
| Unrealized gain on available-for-sale securities, net | —               | —      | —            | —      | —                          | —                | 1,312   | 1,312    |
| Unrealized gain on derivative instruments, net        | —               | —      | —            | —      | —                          | —                | 83  | 83       |
| Issuance of preferred stock                           | —               | 169    | —            | —      | —                          | —                | —   | 169      |
| Repurchase of common stock                            | —               | —      | (3.4 )       | —      | (74 )                      | —                | —   | (74 )    |
| Preferred dividends declared                          | —               | —      | —            | —      | —                          | (9 )             | —   | (9 )     |
| Common dividends declared                             | —               | —      | —            | —      | —                          | (459 )           | —   | (459 )   |
| Balance, June 30, 2014                                | 6.9             | \$ 336 | 352.8        | \$ 4   | \$ 10,332                  | \$(1,073 )       | \$ 12   | \$ 9,611 |
| Balance, December 31, 2014                            | 6.9             | \$ 336 | 352.8        | \$ 4   | \$ 10,332                  | \$(1,674 )       | \$ 430  | \$ 9,428 |
| Net income  | —               | —      | —            | —      | —                          | 260              | —   | 260      |
| Other comprehensive (loss) income:                    |                 |        |              |        |                            |                  |   |          |
| Unrealized loss on available-for-sale securities, net | —               | —      | —            | —      | —                          | —                | (481 )  | (481 )   |
| Unrealized gain on derivative instruments, net        | —               | —      | —            | —      | —                          | —                | 55  | 55       |
| Repurchase of common stock                            | —               | —      | (4.0 )       | —      | (79 )                      | —                | —   | (79 )    |
| Preferred dividends declared                          | —               | —      | —            | —      | —                          | (14 )            | —   | (14 )    |
| Common dividends declared                             | —               | —      | —            | —      | —                          | (451 )           | —   | (451 )   |
| Balance, June 30, 2015                                | 6.9             | \$ 336 | 348.8        | \$ 4   | \$ 10,253                  | \$(1,879 )       | \$ 4  | \$ 8,718 |

See accompanying notes to consolidated financial statements.

AMERICAN CAPITAL AGENCY CORP.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(in millions)

|  | Six months ended June 30, |           |
|--|---------------------------|-----------|
|  | 2015                      | 2014      |
| Operating activities:  |                           |           |
| Net income (loss)  | \$260                     | \$(108)   |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities:                       |                           |           |
| Amortization of agency securities premiums and discounts, net  | 202                       | 251       |
| Amortization of accumulated other comprehensive loss on interest rate swaps de-designated as qualifying hedges | 55                        | 83        |
| Gain on sale of agency securities, net   | (14)                      | (3)       |
| Loss on derivative instruments and other securities, net   | 312                       | 621       |
| Decrease in other assets   | 56                        | 64        |
| (Decrease) increase in accounts payable and other accrued liabilities  | (3)                       | 24        |
| Accretion of discounts on debt of consolidated variable interest entities                                      | 3                         | —         |
| Net cash provided by operating activities  | 871                       | 932       |
| Investing activities:  |                           |           |
| Purchases of agency securities   | (18,882)                  | (6,677)   |
| Proceeds from sale of agency securities  | 18,006                    | 15,660    |
| Principal collections on agency securities   | 4,106                     | 3,713     |
| Purchases of U.S. Treasury securities  | (36,811)                  | (16,640)  |
| Proceeds from sale of U.S. Treasury securities   | 30,854                    | 23,324    |
| Net proceeds from (payments on) reverse repurchase agreements  | 2,477                     | (4,740)   |
| Net (payments on) proceeds from other derivative instruments   | (3)                       | 225       |
| Purchases of REIT equity securities  | (11)                      | (204)     |
| Proceeds from sale of REIT equity securities   | 11                        | 238       |
| Increase in restricted cash  | (65)                      | (682)     |
| Other investing cash flows, net  | (13)                      | (277)     |
| Net cash (used in) provided by investing activities  | (331)                     | 13,940    |
| Financing activities:  |                           |           |
| Proceeds from repurchase arrangements  | 232,533                   | 143,771   |
| Repayments on repurchase agreements  | (232,651)                 | (158,590) |
| Repayments on debt of consolidated variable interest entities  | (80)                      | (76)      |
| Net proceeds from preferred stock issuance   | —                         | 169       |
| Payments for common stock repurchases  | (79)                      | (74)      |
| Cash dividends paid  | (473)                     | (468)     |
| Net cash used in financing activities  | (750)                     | (15,268)  |
| Net change in cash and cash equivalents  | (210)                     | (396)     |
| Cash and cash equivalents at beginning of period   | 1,720                     | 2,143     |
| Cash and cash equivalents at end of period   | \$1,510                   | \$1,747   |
| See accompanying notes to consolidated financial statements.   |                           |           |

AMERICAN CAPITAL AGENCY CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Unaudited Interim Consolidated Financial Statements

The unaudited interim consolidated financial statements of American Capital Agency Corp. (referred throughout this report as the "Company", "we", "us" and "our") are prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Our unaudited interim consolidated financial statements include the accounts of our wholly-owned subsidiaries, American Capital Agency TRS, LLC and Old Georgetown Insurance Co., LLC, and variable interest entities for which the Company is the primary beneficiary. Significant intercompany accounts and transactions have been eliminated. In the opinion of management, all adjustments, consisting solely of normal recurring accruals, necessary for the fair presentation of financial statements for the interim period have been included. The current period's results of operations are not necessarily indicative of results that ultimately may be achieved for the year.

Note 2. Organization

We were organized in Delaware on January 7, 2008, and commenced operations on May 20, 2008 following the completion of our initial public offering ("IPO"). Our common stock is traded on The NASDAQ Global Select Market under the symbol "AGNC."

We are externally managed by American Capital AGNC Management, LLC (our "Manager"), an affiliate of American Capital, Ltd. ("American Capital").

We operate so as to qualify to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"). As a REIT, we are required to distribute annually 90% of our taxable net income. As long as we continue to qualify as a REIT, we will generally not be subject to U.S. federal or state corporate taxes on our taxable net income to the extent that we distribute all of our annual taxable net income to our stockholders. It is our intention to distribute 100% of our taxable net income, after application of available tax attributes, within the limits prescribed by the Internal Revenue Code, which may extend into the subsequent taxable year.

We earn income primarily from investing on a leveraged basis in agency mortgage-backed securities ("agency MBS"). These investments consist of residential mortgage pass-through securities and collateralized mortgage obligations ("CMOs") for which the principal and interest payments are guaranteed by a government-sponsored enterprise, such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), or by a U.S. Government agency, such as the Government National Mortgage Association ("Ginnie Mae") (collectively referred to as "GSEs"). We may also invest in agency debenture securities issued by Freddie Mac, Fannie Mae or the Federal Home Loan Bank ("FHLB") and in other assets reasonably related to agency securities. Our principal objective is to generate attractive risk-adjusted returns for distribution to our stockholders through regular monthly dividends from the combination of our net interest income and net realized gains and losses on our investments and hedging activities while preserving our net asset value (also referred to as "net book value," "NAV" and "stockholders' equity"). We fund our investments primarily through short-term borrowings structured as repurchase agreements.

Note 3. Summary of Significant Accounting Policies

Investment Securities

ASC Topic 320, Investments—Debt and Equity Securities ("ASC 320"), requires that at the time of purchase, we designate a security as held-to-maturity, available-for-sale or trading, depending on our ability and intent to hold such security to maturity. Securities classified as trading and available-for-sale are reported at fair value, while securities



classified as held-to-maturity are reported at amortized cost. We may sell any of our agency securities as part of our overall management of our investment portfolio. Accordingly, we typically designate our agency securities as available-for-sale. All securities classified as available-for-sale are reported at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss) ("OCI"), a

separate component of stockholders' equity. Upon the sale of a security, we determine the cost of the security and the amount of unrealized gains or losses to reclassify out of accumulated OCI into earnings based on the specific identification method.

Interest-only securities and inverse interest-only securities (collectively referred to as "interest-only securities") represent our right to receive a specified proportion of the contractual interest flows of specific agency CMO securities. Principal-only securities represent our right to receive the contractual principal flows of specific agency CMO securities. Interest and principal-only securities are measured at fair value through earnings in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. Our investments in interest and principal-only securities are included in agency securities, at fair value on the accompanying consolidated balance sheets.

REIT equity securities represent investments in the common stock of other publicly traded mortgage REITs that invest predominantly in agency MBS. We designate our investments in REIT equity securities as trading securities and report them at fair value on the accompanying consolidated balance sheets.

We estimate the fair value of our agency securities based on valuations obtained from third-party pricing services and non-binding dealer quotes derived from common market pricing methods using observable (or "Level 2") inputs. Such methods incorporate, but are not limited to, reported trades and executable bid and asked prices for similar securities, benchmark interest rate curves, such as the spread to the U.S. Treasury rate and interest rate swap curves, convexity, duration and the underlying characteristics of the particular security, including coupon, periodic and life caps, rate reset period, issuer, additional credit support and expected life of the security. We estimate the fair value of our REIT equity securities based on a market approach using quoted market prices (or "Level 1" inputs). Refer to Note 8 for further discussion of fair value measurements.

We evaluate our agency securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis. The determination of whether a security is other-than-temporarily impaired may involve judgments and assumptions based on subjective and objective factors. When a security is impaired, an OTTI is considered to have occurred if any one of the following three conditions exists as of the financial reporting date: (i) we intend to sell the security (that is, a decision has been made to sell the security), (ii) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis or (iii) we do not expect to recover the security's amortized cost basis, even if we do not intend to sell the security and it is not more likely than not that we will be required to sell the security. A general allowance for unidentified impairments in a portfolio of securities is not permitted.

The liquidity of the agency securities market allows us to obtain competitive bids and execute on a sale transaction typically within a day of making the decision to sell a security and, therefore, we generally do not make decisions to sell specific agency securities until shortly prior to initiating a sell order. In some instances, we may sell specific agency securities by delivering such securities into existing short to-be-announced ("TBA") contracts. TBA market conventions require the identification of the specific securities to be delivered no later than 48 hours prior to settlement. If we settle a short TBA contract through the delivery of securities, we will generally identify the specific securities to be delivered within one to two days of the 48-hour deadline.

#### Interest Income

Interest income is accrued based on the outstanding principal amount of the investment securities and their contractual terms. Premiums or discounts associated with the purchase of investment securities are amortized or accreted into interest income, respectively, over the projected lives of the securities, including contractual payments and estimated prepayments using the effective interest method in accordance with ASC Subtopic 310-20, Receivables—Nonrefundable Fees and Other Costs ("ASC 310-20").

We estimate long-term prepayment speeds of our agency securities using a third-party service and market data. The third-party service estimates prepayment speeds using models that incorporate the forward yield curve, current mortgage rates and mortgage rates of the outstanding loans, age and size of the outstanding loans, loan-to-value ratios, volatility and other factors. We review the prepayment speeds estimated by the third-party service and compare the results to market consensus prepayment speeds, if available. We also consider historical prepayment speeds and current market conditions to validate the reasonableness of the prepayment speeds estimated by the third-party service. As market conditions may change rapidly, we may make adjustments for different securities based on our

Manager's judgment. Various market participants could use materially different assumptions.

Actual and anticipated prepayment experience is reviewed quarterly and effective yields are recalculated when differences arise between (i) our previously estimated future prepayments and (ii) the actual prepayments to date plus our currently estimated future prepayments. If the actual and estimated future prepayment experience differs from our prior estimate of prepayments, we are required to record an adjustment in the current period to the amortization or accretion of premiums and discounts for the cumulative difference in the effective yield through the reporting date.

## Derivative Instruments

We use a variety of derivative instruments to hedge a portion of our exposure to market risks, including interest rate risk, prepayment risk and extension risk. The objective of our risk management strategy is to reduce fluctuations in net book value over a range of interest rate scenarios. In particular, we attempt to mitigate the risk of the cost of our variable rate liabilities increasing during a period of rising interest rates. The principal instruments that we use are interest rate swaps and options to enter into interest rate swaps ("swaptions"). We also utilize forward contracts for the purchase or sale of agency MBS securities in the "to-be-announced" market on a generic pool basis ("TBA securities") and U.S. Treasury securities and U.S. Treasury futures contracts, primarily through short sales. We may also purchase or write put or call options on TBA securities and we may invest in mortgage derivatives, such as interest and principal-only securities, and other types of derivative instruments.

We may also enter into TBA contracts as a means of investing in and financing agency securities (thereby increasing our "at risk" leverage) or as a means of disposing of or reducing our exposure to agency securities (thereby reducing our "at risk" leverage). Pursuant to TBA contracts, we agree to purchase or sell, for future delivery, agency securities with certain principal and interest terms and certain types of collateral, but the particular agency securities to be delivered are not identified until shortly before the TBA settlement date. We may also choose, prior to settlement, to move the settlement of these securities out to a later date by entering into an offsetting short or long position (referred to as a "pair off"), net settling the paired off positions for cash, and simultaneously purchasing or selling a similar TBA contract for a later settlement date. This transaction is commonly referred to as a "dollar roll." The agency securities purchased or sold for a forward settlement date are typically priced at a discount to agency securities for settlement in the current month. This difference (or discount) is referred to as the "price drop." The price drop is the economic equivalent of net interest carry income on the underlying agency securities over the roll period (interest income less implied financing cost) and is commonly referred to as "dollar roll income/loss." Consequently, forward purchases of agency securities and dollar roll transactions represent a form of off-balance sheet financing.

We account for derivative instruments in accordance with ASC Topic 815, Derivatives and Hedging ("ASC 815"). ASC 815 requires an entity to recognize all derivatives as either assets or liabilities in the balance sheet and to measure those instruments at fair value.

Our derivative agreements generally contain provisions that allow for netting or setting off derivative assets and liabilities with the counterparty; however, we report related assets and liabilities on a gross basis in our consolidated balance sheets. Derivative instruments in a gain position are reported as derivative assets at fair value and derivative instruments in a loss position are reported as derivative liabilities at fair value in our consolidated balance sheets. Changes in fair value of derivative instruments and periodic settlements related to our derivative instruments are recorded in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. Cash receipts and payments related to derivative instruments are classified in our consolidated statements of cash flows according to the underlying nature or purpose of the derivative transaction, generally in the investing section.

The use of derivative instruments creates exposure to credit risk relating to potential losses that could be recognized in the event that the counterparties to these instruments fail to perform their obligations under the contracts. We attempt to minimize this risk by limiting our counterparties to major financial institutions with acceptable credit ratings, monitoring positions with individual counterparties and adjusting posted collateral as required.

### Discontinuation of hedge accounting for interest rate swap agreements

Prior to September 30, 2011, we entered into interest rate swap agreements typically with the intention of qualifying for hedge accounting under ASC 815. However, as of September 30, 2011, we elected to discontinue hedge accounting for our interest rate swaps. Upon discontinuation of hedge accounting, the net deferred loss related to our de-designated interest rate swaps remained in accumulated OCI and is being reclassified from accumulated OCI into interest expense on a straight-line basis over the remaining term of each interest rate swap.

### Interest rate swap agreements

We use interest rate swaps to hedge the variable cash flows associated with borrowings made under our repurchase agreement facilities. Under our interest rate swap agreements, we typically pay a fixed rate and receive a floating rate based on one, three or six-month LIBOR ("payer swaps") with terms up to 20 years. The floating rate we receive

under our swap agreements has the effect of offsetting the repricing characteristics of our repurchase agreements and cash flows on such liabilities. Our swap agreements are privately negotiated in the over-the-counter ("OTC") market, with swap agreements entered into subsequent to May 2013 subject to central clearing through a registered commodities exchange ("centrally cleared swaps").

We estimate the fair value of our centrally cleared interest rate swaps using the daily settlement price determined by the respective exchange. Centrally cleared swaps are valued by the exchange using a pricing model that references the underlying rates including the overnight index swap rate and LIBOR forward rate to produce the daily settlement price.

We estimate the fair value of our "non-centrally cleared" interest rate swaps based on valuations obtained from third-party pricing services and the swap counterparty (collectively, "third-party valuations"). The third-party valuations are model-driven using observable inputs consisting of LIBOR and the forward yield curve. We also consider the creditworthiness of both us and our counterparties and the impact of netting and credit enhancement provisions contained in each derivative agreement, such as collateral postings. All of our "non-centrally cleared" interest rate swaps are subject to bilateral collateral arrangements. Consequently, no credit valuation adjustment was made in determining the fair value of such instruments.

#### Interest rate swaptions

We purchase interest rate swaptions generally to help mitigate the potential impact of larger, more rapid changes in interest rates on the performance of our investment portfolio. Interest rate swaptions provide us the option to enter into an interest rate swap agreement for a predetermined notional amount, stated term and pay and receive interest rates in the future. Our swaption agreements typically provide us the option to enter into a pay fixed rate interest rate swap, which we refer as "payer swaptions." We may also enter into swaption agreements that provide us the option to enter into a receive fixed interest rate swap, which we refer to as "receiver swaptions." The premium paid for interest rate swaptions is reported as an asset in our consolidated balance sheets. The premium is valued at an amount equal to the fair value of the swaption that would have the effect of closing the position adjusted for nonperformance risk, if any. The difference between the premium and the fair value of the swaption is reported in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. If a swaption expires unexercised, the realized loss on the swaption would be equal to the premium paid. If we sell or exercise a swaption, the realized gain or loss on the swaption would be equal to the difference between the cash or the fair value of the underlying interest rate swap received and the premium paid.

Our interest rate swaption agreements are privately negotiated in the OTC market and are not subject to central clearing. We estimate the fair value of our interest rate swaption agreements based on model-driven valuations obtained from third-party pricing services and the swaption counterparty using observable inputs, taking into account the fair value of the future interest rate swap that we have the option to enter into as well as the remaining length of time that we have to exercise the option, adjusted for non-performance risk, if any.

#### TBA securities

A TBA security is a forward contract for the purchase ("long position") or sale ("short position") of agency MBS at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date. The specific agency MBS delivered into the contract upon the settlement date, published each month by the Securities Industry and Financial Markets Association, are not known at the time of the transaction. We may enter into TBA contracts as a means of hedging against short-term changes in interest rates. We may also enter into TBA contracts as a means of acquiring or disposing of agency securities and we may from time to time utilize TBA dollar roll transactions to finance agency MBS purchases.

We account for TBA contracts as derivative instruments since either the TBA contracts do not settle in the shortest period of time possible or we cannot assert that it is probable at inception and throughout the term of the TBA contract that we will take physical delivery of the agency security upon settlement of the contract. We account for TBA dollar roll transactions as a series of derivative transactions. Gains, losses and dollar roll income associated with our TBA contracts and dollar roll transactions are recognized in our consolidated statements of comprehensive income in gain (loss) on derivative instruments and other securities, net.

We estimate the fair value of TBA securities based on similar methods used to value our agency MBS securities.

#### U.S. Treasury securities

We purchase or sell short U.S. Treasury securities and U.S. Treasury futures contracts to help mitigate the potential impact of changes in interest rates on the performance of our portfolio. We borrow securities to cover short sales of U.S. Treasury securities under reverse repurchase agreements. We account for these as securities borrowing

transactions and recognize an obligation to return the borrowed securities at fair value on the balance sheet based on the value of the underlying borrowed securities as of the reporting date. Gains and losses associated with purchases and short sales of U.S. Treasury securities and U.S. Treasury futures contracts are recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

#### Note 4. Investment Securities

As of June 30, 2015 and December 31, 2014, our investment portfolio consisted of \$52.1 billion and \$56.7 billion of agency MBS, respectively, and a \$7.1 billion and \$14.8 billion net long TBA position, at fair value, respectively. Our TBA positions are reported at their net carrying value of \$(46) million and \$192 million as of June 30, 2015 and December 31, 2014, respectively, in derivative assets/(liabilities) on our accompanying consolidated balance sheets. The net carrying value of our TBA position represents the difference between the fair value of the underlying agency security in the TBA contract and the cost basis or the forward price to be paid or received for the underlying agency security. (See Note 6 for further details of our net TBA position as of June 30, 2015 and December 31, 2014.)

As of June 30, 2015 and December 31, 2014, the net unamortized premium balance on our agency MBS was \$2.3 billion and \$2.5 billion, respectively, including interest and principal-only strips.

The following tables summarize our investments in agency MBS as of June 30, 2015 and December 31, 2014 (dollars in millions):

|   | June 30, 2015     |                             |                             |            |
|---|-------------------|-----------------------------|-----------------------------|------------|
|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gain | Gross<br>Unrealized<br>Loss | Fair Value |
| Agency MBS                              |                   |                             |                             |            |
| Fixed rate                              | \$50,019          | \$444                       | \$(393)                     | \$50,070   |
| Adjustable rate                         | 584               | 15                          | —                           | 599        |
| CMO                                     | 1,056             | 23                          | (1)                         | 1,078      |
| Interest-only and principal-only strips | 335               | 38                          | (2)                         | 371        |
| Total agency MBS                        | \$51,994          | \$520                       | \$(396)                     | \$52,118   |

  

|   | December 31, 2014 |                             |                             |            |
|---|-------------------|-----------------------------|-----------------------------|------------|
|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gain | Gross<br>Unrealized<br>Loss | Fair Value |
| Agency MBS                              |                   |                             |                             |            |
| Fixed rate                              | \$53,945          | \$715                       | \$(187)                     | \$54,473   |
| Adjustable rate                         | 659               | 19                          | —                           | 678        |
| CMO                                     | 1,172             | 24                          | (1)                         | 1,195      |
| Interest-only and principal-only strips | 372               | 33                          | (3)                         | 402        |
| Total agency MBS                        | \$56,148          | \$791                       | \$(191)                     | \$56,748   |



|   | June 30, 2015 |             |            |          |
|---|---------------|-------------|------------|----------|
|   | Fannie Mae    | Freddie Mac | Ginnie Mae | Total    |
| Agency MBS  |               |             |            |          |
| Available-for-sale agency MBS:  |               |             |            |          |
| Agency MBS, par   | \$38,954      | \$10,374    | \$136      | \$49,464 |
| Unamortized discount  | (35 )         | (4 )        | —          | (39 )    |
| Unamortized premium   | 1,706         | 525         | 3          | 2,234    |
| Amortized cost  | 40,625        | 10,895      | 139        | 51,659   |
| Gross unrealized gains  | 371           | 109         | 2          | 482      |
| Gross unrealized losses   | (287 )        | (107 )      | —          | (394 )   |
| Total available-for-sale agency MBS, at fair value                      | 40,709        | 10,897      | 141        | 51,747   |
| Agency MBS remeasured at fair value through earnings:                   |               |             |            |          |
| Interest-only and principal-only strips, amortized cost <sup>1</sup>    | 313           | 22          | —          | 335      |
| Gross unrealized gains  | 34            | 4           | —          | 38       |
| Gross unrealized losses   | (1 )          | (1 )        | —          | (2 )     |
| Total agency MBS remeasured at fair value through earnings              | 346           | 25          | —          | 371      |
| Total agency MBS, at fair value   | \$41,055      | \$10,922    | \$141      | \$52,118 |
| Weighted average coupon as of June 30, 2015 <sup>2</sup>                | 3.60          | % 3.72      | % 3.28     | % 3.62   |
| Weighted average yield as of June 30, 2015 <sup>3</sup>                 | 2.75          | % 2.77      | % 1.86     | % 2.75   |
| Weighted average yield for the quarter ended June 30, 2015 <sup>3</sup> | 2.94          | % 3.01      | % 2.26     | % 2.95   |

The underlying unamortized principal balance ("UPB" or "par value") of our interest-only agency MBS strips was \$1.1 billion and the weighted average contractual interest we are entitled to receive was 5.43% of this amount as of June 30, 2015. The par value of our principal-only agency MBS strips was \$224 million as of June 30, 2015.

The weighted average coupon includes the interest cash flows from our interest-only agency MBS strips taken together with the interest cash flows from our fixed rate, adjustable-rate and CMO agency MBS as a percentage of the par value of our agency MBS (excluding the UPB of our interest-only securities) as of June 30, 2015.

<sup>3</sup> Incorporates a weighted average future constant prepayment rate assumption of 8% based on forward rates as of June 30, 2015.

|  | December 31, 2014 |             |            |          |
|--|-------------------|-------------|------------|----------|
|  | Fannie Mae        | Freddie Mac | Ginnie Mae | Total    |
| Agency MBS   |                   |             |            |          |
| Available-for-sale agency MBS:   |                   |             |            |          |
| Agency MBS, par  | \$42,749          | \$10,566    | \$107      | \$53,422 |
| Unamortized discount   | (37 )             | (5 )        | —          | (42 )    |
| Unamortized premium  | 1,880             | 514         | 2          | 2,396    |
| Amortized cost   | 44,592            | 11,075      | 109        | 55,776   |
| Gross unrealized gains   | 610               | 145         | 3          | 758      |
| Gross unrealized losses  | (127 )            | (61 )       | —          | (188 )   |
| Total available-for-sale agency MBS, at fair value                       | 45,075            | 11,159      | 112        | 56,346   |
| Agency MBS remeasured at fair value through earnings:                    |                   |             |            |          |
| Interest-only and principal-only strips, amortized cost <sup>1</sup>     | 348               | 24          | —          | 372      |
| Gross unrealized gains   | 30                | 3           | —          | 33       |
| Gross unrealized losses  | (2 )              | (1 )        | —          | (3 )     |
| Total agency MBS remeasured at fair value through earnings               | 376               | 26          | —          | 402      |
| Total agency MBS, at fair value  | \$45,451          | \$11,185    | \$112      | \$56,748 |
| Weighted average coupon as of December 31, 2014 <sup>2</sup>             | 3.63              | % 3.70      | % 3.52     | % 3.65   |
| Weighted average yield as of December 31, 2014 <sup>3</sup>              | 2.75              | % 2.73      | % 1.87     | % 2.74   |
| Weighted average yield for the year ended December 31, 2014 <sup>3</sup> | 2.62              | % 2.64      | % 1.66     | % 2.63   |

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The underlying UPB of our interest-only agency MBS strips was \$1.2 billion and the weighted average contractual interest we are entitled to receive was 5.46% of this amount as of December 31, 2014. The par value of our principal-only agency MBS strips was \$242 million as of December 31, 2014.

The weighted average coupon includes the interest cash flows from our interest-only agency MBS strips taken together with the interest cash flows from our fixed rate, adjustable-rate and CMO agency MBS as a percentage of the par value of our agency MBS (excluding the UPB of our interest-only securities) as of December 31, 2014. Incorporates a weighted average future constant prepayment rate assumption of 9% based on forward rates as of December 31, 2014.

The actual maturities of our agency MBS are generally shorter than the stated contractual maturities. Actual maturities are affected by the contractual lives of the underlying mortgages, periodic contractual principal payments and principal prepayments. As of June 30, 2015 and December 31, 2014, our weighted average expected constant prepayment rate ("CPR") over the remaining life of our aggregate agency MBS portfolio was 8% and 9%, respectively. Our estimates differ materially for different types of securities and thus individual holdings have a wide range of projected CPRs.

The following table summarizes our agency MBS classified as available-for-sale as of June 30, 2015 and December 31, 2014 according to their estimated weighted average life classification (dollars in millions):

| Estimated Weighted<br>Average Life of Agency<br>MBS Classified as<br>Available-for-Sale <sup>1</sup> | June 30, 2015 |                   |                               |                              | December 31, 2014 |                   |                               |                              |
|--|---------------|-------------------|-------------------------------|------------------------------|-------------------|-------------------|-------------------------------|------------------------------|
|  | Fair<br>Value | Amortized<br>Cost | Weighted<br>Average<br>Coupon | Weighted<br>Average<br>Yield | Fair<br>Value     | Amortized<br>Cost | Weighted<br>Average<br>Coupon | Weighted<br>Average<br>Yield |
| ≥ 1 year and ≤ 3 years   | 297           | 295               | 3.63%                         | 2.10%                        | 289               | 280               | 4.08%                         | 2.62%                        |
| > 3 years and ≤ 5 years  | 19,708        | 19,456            | 3.27%                         | 2.39%                        | 22,153            | 21,820            | 3.26%                         | 2.40%                        |
| > 5 years and ≤ 10 years   | 30,905        | 31,073            | 3.70%                         | 2.93%                        | 33,271            | 33,055            | 3.73%                         | 2.92%                        |
| > 10 years   | 837           | 835               | 3.11%                         | 3.06%                        | 633               | 621               | 3.28%                         | 3.15%                        |
| Total  | \$51,747      | \$51,659          | 3.52%                         | 2.72%                        | \$56,346          | \$55,776          | 3.54%                         | 2.72%                        |

1. Excludes interest and principal-only strips.

The weighted average life of our interest-only strips was 6.2 and 6.0 years as of June 30, 2015 and December 31, 2014, respectively. The weighted average life of our principal-only strips was 8.3 and 8.1 years as of June 30, 2015 and December 31, 2014, respectively.

Our agency securities classified as available-for-sale are reported at fair value, with unrealized gains and losses excluded from earnings and reported in accumulated OCI, a separate component of stockholders' equity. Refer to Note 9 for a summary of changes in accumulated OCI for our available-for-sale securities for the three and six months ended June 30, 2015 and 2014.

The following table presents the gross unrealized loss and fair values of our available-for-sale agency securities by length of time that such securities have been in a continuous unrealized loss position as of June 30, 2015 and December 31, 2014 (in millions):

| Agency Securities Classified as<br>Available-for-Sale | Unrealized Loss Position For                      |                    |  |                    | Total<br>Estimated<br>Fair<br>Value | Unrealized<br>Loss |
|---|---|--------------------|--|--------------------|-------------------------------------|--------------------|
|   | Less than 12 Months<br>Estimated<br>Fair<br>Value | Unrealized<br>Loss | 12 Months or More<br>Estimated<br>Fair Value | Unrealized<br>Loss |                                     |                    |
| June 30, 2015   | \$17,613  | \$(258)            | \$7,512                                      | \$(136)            | \$25,125                            | \$(394)            |
| December 31, 2014                                     | \$778   | \$(2)              | \$11,679                                     | \$(186)            | \$12,457                            | \$(188)            |

As of the end of each respective reporting period, a decision had not been made to sell any of these agency securities and we do not believe it is more likely than not we will be required to sell the agency securities before recovery of their amortized cost basis. The unrealized losses on these agency securities are not due to credit losses given the GSE guarantees, but are rather due to changes in interest rates and prepayment expectations. We did not recognize any OTTI charges on our investment securities for the three and six months ended June 30, 2015 and 2014. However, as we continue to actively manage our portfolio, we may recognize additional realized losses on our agency securities upon selecting specific securities to sell.

## Gains and Losses

The following table is a summary of our net gain (loss) from the sale of agency securities classified as available-for-sale for the three and six months ended June 30, 2015 and 2014 (in millions):

| Agency Securities Classified as Available-for-Sale | Three Months Ended June 30, |            | Six Months Ended June 30, |             |
|--|-----------------------------|------------|---------------------------|-------------|
|  | 2015                        | 2014       | 2015                      | 2014        |
| Agency MBS sold, at cost                           | \$(10,241                   | ) \$(7,166 | ) \$(17,974               | ) \$(16,877 |
| Proceeds from agency MBS sold <sup>1</sup>         | 10,219                      | 7,188      | 17,988                    | 16,880      |
| Net (loss) gain on sale of agency MBS              | \$(22                       | ) \$22     | \$14                      | \$3         |
| Gross gain on sale of agency MBS                   | \$22                        | \$49       | \$79                      | \$91        |
| Gross loss on sale of agency MBS                   | (44                         | ) (27      | ) (65                     | ) (88       |
| Net (loss) gain on sale of agency MBS              | \$(22                       | ) \$22     | \$14                      | \$3         |

<sup>1</sup> Proceeds include cash received during the period, plus receivable for agency MBS sold during the period as of period end.

For the three and six months ended June 30, 2015, we recognized an unrealized loss of \$7 million and an unrealized gain of \$4 million, respectively, and for the three and six months ended June 30, 2014 we recognized an unrealized gain of \$15 million and \$27 million, respectively, for the change in value of investments in interest and principal-only strips in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. Over the same periods, we did not recognize any realized gains or losses on our interest or principal-only securities.

## Securitizations and Variable Interest Entities

As of June 30, 2015 and December 31, 2014, we held investments in CMO trusts, which are variable interest entities ("VIEs"). We have consolidated certain of these CMO trusts in our consolidated financial statements where we have determined we are the primary beneficiary of the trusts. All of our CMO securities are backed by fixed or adjustable-rate agency MBS. Fannie Mae or Freddie Mac guarantees the payment of interest and principal and acts as the trustee and administrator of their respective securitization trusts. Accordingly, we are not required to provide the beneficial interest holders of the CMO securities any financial or other support. Our maximum exposure to loss related to our involvement with CMO trusts is the fair value of the CMO securities and interest and principal-only securities held by us, less principal amounts guaranteed by Fannie Mae and Freddie Mac.

In connection with our consolidated CMO trusts, we recognized agency securities with a total fair value of \$1.1 billion and \$1.3 billion as of June 30, 2015 and December 31, 2014, respectively, and debt, at fair value, of \$674 million and \$761 million, respectively, in our accompanying consolidated balance sheets. As of June 30, 2015 and December 31, 2014, the agency securities had an aggregate unpaid principal balance of \$1.1 billion and \$1.2 billion, respectively, and the debt had an aggregate unpaid principal balance of \$662 million and \$742 million, respectively. We re-measure our consolidated debt at fair value through earnings in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. For the three and six months ended June 30, 2015, we recorded a gain of \$9 million associated with our consolidated debt. For the three and six months ended June 30, 2014, we recognized a loss of \$9 million and \$12 million associated with our consolidated debt, respectively. Our involvement with the consolidated trusts is limited to the agency securities transferred by us upon the formation of the trusts and the CMO securities subsequently held by us. There are no arrangements that could require us to provide financial support to the trusts.

As of June 30, 2015 and December 31, 2014, the fair value of our CMO securities and interest and principal-only securities was \$1.4 billion and \$1.6 billion, respectively, excluding the consolidated CMO trusts discussed above, or \$1.9 billion and \$2.1 billion, respectively, including the net asset value of our consolidated CMO trusts. Our maximum exposure to loss related to our CMO securities and interest and principal-only securities, including our consolidated CMO trusts, was \$250 million and \$274 million as of June 30, 2015 and December 31, 2014,

respectively.

**Note 5. Repurchase Agreements and Other Debt**

We pledge certain of our securities as collateral under repurchase and other financing arrangements with financial institutions, the terms and conditions of which are typically negotiated on a transaction-by-transaction basis. For additional information regarding our pledged assets please refer to Note 7. Interest rates on these borrowings are generally based on LIBOR plus or minus a margin and amounts available to be borrowed are dependent upon the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, type of security and liquidity conditions within the banking, mortgage finance and

real estate industries. If the fair value of our pledged securities declines, lenders will typically require us to post additional collateral or pay down borrowings to re-establish agreed upon collateral requirements, referred to as "margin calls." Similarly, if the fair value of our pledged securities increases, lenders may release collateral back to us. As of June 30, 2015, we had met all margin call requirements.

#### Repurchase Agreements

The following table summarizes our borrowings under repurchase arrangements and weighted average interest rates classified by remaining maturities as of June 30, 2015 and December 31, 2014 (dollars in millions):

| Remaining Maturity        | June 30, 2015                      |                                |                                   | December 31, 2014     |                                |                                   |
|---------------------------|------------------------------------|--------------------------------|-----------------------------------|-----------------------|--------------------------------|-----------------------------------|
|                           | Repurchase Agreements <sup>1</sup> | Weighted Average Interest Rate | Weighted Average Days to Maturity | Repurchase Agreements | Weighted Average Interest Rate | Weighted Average Days to Maturity |
| Agency MBS:               |                                    |                                |                                   |                       |                                |                                   |
| ≤ 1 month                 | \$22,061                           | 0.40                           | % 15                              | \$14,157              | 0.37                           | % 15                              |
| > 1 to ≤ 3 months         | 11,879                             | 0.40                           | % 55                              | 20,223                | 0.38                           | % 61                              |
| > 3 to ≤ 6 months         | 3,084                              | 0.53                           | % 132                             | 6,654                 | 0.42                           | % 120                             |
| > 6 to ≤ 9 months         | 1,829                              | 0.49                           | % 239                             | 1,575                 | 0.50                           | % 225                             |
| > 9 to ≤ 12 months        | 1,763                              | 0.57                           | % 300                             | 2,678                 | 0.54                           | % 313                             |
| > 12 to ≤ 24 months       | 803                                | 0.63                           | % 493                             | 600                   | 0.57                           | % 551                             |
| > 24 to ≤ 36 months       | 717                                | 0.64                           | % 894                             | 952                   | 0.60                           | % 999                             |
| > 36 to ≤ 48 months       | 750                                | 0.70                           | % 1,257                           | 650                   | 0.64                           | % 1,266                           |
| > 48 to < 60 months       | 2,300                              | 0.72                           | % 1,601                           | 900                   | 0.68                           | % 1,542                           |
| Total agency MBS          | 45,186                             | 0.45                           | % 177                             | 48,389                | 0.41                           | % 143                             |
| U.S. Treasury securities: |                                    |                                |                                   |                       |                                |                                   |
| 1 day                     | 4,992                              | 0.17                           | % 2                               | 1,907                 | 0.09                           | % 1                               |
| Total / Weighted Average  | \$50,178                           | 0.42                           | % 160                             | \$50,296              | 0.40                           | % 138                             |

1. Includes \$20 million of Federal Home Loan Bank advances as of June 30, 2015

#### Debt of Consolidated Variable Interest Entities

As of June 30, 2015 and December 31, 2014, debt of consolidated VIEs, at fair value ("other debt") was \$674 million and \$761 million, respectively. As of June 30, 2015 and December 31, 2014, our other debt had a weighted average interest rate of LIBOR plus 43 basis points and a principal balance of \$662 million and \$742 million, respectively. The actual maturities of our other debt are generally shorter than the stated contractual maturities. The actual maturities are affected by the contractual lives of the underlying agency MBS securitizing our other debt and periodic principal prepayments of such underlying securities. The estimated weighted average life of our other debt as of June 30, 2015 and December 31, 2014 was 5.2 and 5.8 years, respectively.

#### TBA Dollar Roll Financing Transactions

As of June 30, 2015 and December 31, 2014, we also had outstanding forward commitments to purchase and sell agency securities through the TBA market of \$7.1 billion and \$14.6 billion (cost basis), respectively (see Notes 3 and 6). These transactions, also referred to as TBA dollar roll transactions, represent a form of "off-balance sheet" financing and serve to either increase, in the case of forward purchases, or decrease, in the case of forward sales, our total "at risk" leverage. However, pursuant to ASC 815, we account for such transactions as one or more series of derivative transactions and, consequently, they are not recognized as debt on our consolidated balance sheet and are excluded from commensurate measurements of our balance sheet debt to equity leverage ratios.

#### Federal Home Loan Bank of Des Moines Advances

In April 2015, our wholly owned subsidiary, Old Georgetown Insurance Co., LLC, was accepted for membership in the Federal Home Loan Bank ("FHLB") of Des Moines. As a member of the FHLB, our subsidiary has access to a variety of products and services offered by the FHLB, including secured advances. As of June 30, 2015, our subsidiary had \$20 million in outstanding



secured advances, with a weighted average borrowing rate of 0.29% and a weighted average term to maturity of  $\leq 1$  month. Our outstanding FHLB advances are reported under repurchase agreements on our consolidated balance sheet.

The ability to borrow from the FHLB is subject to our subsidiary's continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with the FHLB. Each advance requires approval by the FHLB and is secured by collateral in accordance with the FHLB's credit and collateral guidelines, as may be revised from time to time by the FHLB.

#### Note 6. Derivative and Other Hedging Instruments

In connection with our risk management strategy, we hedge a portion of our interest rate risk by entering into derivative and other hedging instrument contracts. We typically enter into agreements for interest rate swaps and interest rate swaptions and purchase or short TBA and U.S. Treasury securities. We may also purchase or write put or call options on TBA securities or we may invest in mortgage derivatives, such as interest and principal-only securities, and other types of derivative instruments. Our risk management strategy attempts to manage the overall risk of the portfolio, reduce fluctuations in book value and generate additional income distributable to stockholders. For additional information regarding our derivative instruments and our overall risk management strategy, please refer to the discussion of derivative and other hedging instruments in Note 3.

Prior to September 30, 2011, our interest rate swaps were typically designated as cash flow hedges under ASC 815; however, as of September 30, 2011, we elected to discontinue hedge accounting for our interest rate swaps in order to increase our funding flexibility. For the three and six months ended June 30, 2015, we reclassified \$26 million and \$55 million, respectively, and for the three and six months ended June 30, 2014, we reclassified, \$40 million and \$83 million, respectively, of net deferred losses from accumulated OCI into interest expense related to our de-designated interest rate swaps and recognized an equal, but offsetting, amount in other comprehensive income. Our total net periodic interest costs on our swap portfolio was \$125 million and \$238 million for the three and six months ended June 30, 2015, respectively, and \$127 million and \$253 million for the three and six months ended June 30, 2014, respectively. The difference between our total net periodic interest costs on our swap portfolio and the amount recorded in interest expense related to our de-designated hedges is reported in our accompanying consolidated statements of comprehensive income in gain (loss) on derivative instruments and other securities, net (totaling \$99 million and \$183 million for the three and six months ended June 30, 2015, respectively, and \$87 million and \$170 million for the three and six months ended June 30, 2014, respectively). As of June 30, 2015, the remaining net deferred loss in accumulated OCI related to de-designated interest rate swaps was \$85 million and will be reclassified from OCI into interest expense over a remaining weighted average period of 1.0 years. As of June 30, 2015, the net deferred loss expected to be reclassified from OCI into interest expense over the next twelve months was \$77 million.

# Derivative and Other Hedging Instrument Assets (Liabilities), at Fair Value

The table below summarizes fair value information about our derivative and other hedging instrument assets and liabilities as of June 30, 2015 and December 31, 2014 (in millions):

| Derivative and Other Hedging Instruments | Balance Sheet Location   | June 30, 2015 | December 31, 2014 |
|--|--|---------------|-------------------|
| Interest rate swaps                      | Derivative assets, at fair value   | \$ 104        | \$ 136            |
| Swaptions                                | Derivative assets, at fair value   | 45            | 75                |
| TBA securities                           | Derivative assets, at fair value   | 11            | 197               |
| U.S. Treasury futures - short            | Derivative assets, at fair value   | 4             | —                 |
| Total                                    |  | \$ 164        | \$ 408            |
| Interest rate swaps                      | Derivative liabilities, at fair value  | \$(784)       | \$(880)           |
| TBA securities                           | Derivative liabilities, at fair value  | (57)          | (5)               |
| U.S. Treasury futures - short            | Derivative liabilities, at fair value  | —             | (5)               |
| Other                                    | Derivative liabilities, at fair value  | (3)           | —                 |
| Total                                    |  | \$(844)       | \$(890)           |
| U.S. Treasury securities - long          | U.S. Treasury securities, at fair value  | \$5,124       | \$2,427           |
| U.S. Treasury securities - short         | Obligation to return securities borrowed under reverse repurchase agreements, at fair value <sup>1</sup> | (2,230)       | (5,363)           |
| Total - (short)/long, net                |  | \$2,894       | \$(2,936)         |

Our obligation to return securities borrowed under reverse repurchase agreements as of June 30, 2015 and December 31, 2014 relates to securities borrowed to cover short sales of U.S. Treasury securities from which we received total sale proceeds of \$2.2 billion and \$5.4 billion, respectively. The change in fair value of the borrowed securities is recorded in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

The following tables summarize our interest rate swap agreements outstanding as of June 30, 2015 and December 31, 2014 (dollars in millions):

| Payer Interest Rate Swaps       | June 30, 2015                |                                     |                                   |                          |                          |
|---------------------------------|------------------------------|-------------------------------------|-----------------------------------|--------------------------|--------------------------|
|                                 | Notional Amount <sup>1</sup> | Average Fixed Pay Rate <sup>2</sup> | Average Receive Rate <sup>3</sup> | Net Estimated Fair Value | Average Maturity (Years) |
| ≤ 3 years                       | \$15,925                     | 1.21%                               | 0.26%                             | \$(91)                   | 1.8                      |
| > 3 to ≤ 5 years                | 10,200                       | 1.84%                               | 0.28%                             | (107)                    | 4.2                      |
| > 5 to ≤ 7 years                | 7,725                        | 2.51%                               | 0.28%                             | (168)                    | 6.2                      |
| > 7 to ≤ 10 years               | 9,050                        | 2.60%                               | 0.28%                             | (226)                    | 8.3                      |
| > 10 years                      | 2,025                        | 3.16%                               | 0.28%                             | (88)                     | 13.1                     |
| Total Payer Interest Rate Swaps | \$44,925                     | 1.94%                               | 0.27%                             | \$(680)                  | 4.9                      |

<sup>1</sup> Notional amount includes forward starting swaps of \$8.8 billion with an average forward start date of 0.8 years and an average maturity of 6.6 years from June 30, 2015.

<sup>2</sup> Average fixed pay rate includes forward starting swaps. Excluding forward starting swaps, the average fixed pay rate was 1.69% as of June 30, 2015.

<sup>3</sup> Average receive rate excludes forward starting swaps.



|                                 | December 31, 2014            |                                     |                                   |                          |                          |
|---------------------------------|------------------------------|-------------------------------------|-----------------------------------|--------------------------|--------------------------|
|                                 | Notional Amount <sup>1</sup> | Average Fixed Pay Rate <sup>2</sup> | Average Receive Rate <sup>3</sup> | Net Estimated Fair Value | Average Maturity (Years) |
| Payer Interest Rate Swaps       |                              |                                     |                                   |                          |                          |
| ≤ 3 years                       | \$12,300                     | 1.33%                               | 0.21%                             | \$(87 )                  | 2.0                      |
| > 3 to ≤ 5 years                | 8,975                        | 1.63%                               | 0.24%                             | (4 )                     | 4.2                      |
| > 5 to ≤ 7 years                | 7,250                        | 2.47%                               | 0.23%                             | (139 )                   | 6.1                      |
| > 7 to ≤ 10 years               | 10,775                       | 2.48%                               | 0.24%                             | (223 )                   | 8.3                      |
| > 10 years                      | 4,400                        | 3.19%                               | 0.23%                             | (291 )                   | 12.6                     |
| Total Payer Interest Rate Swaps | \$43,700                     | 2.05%                               | 0.23%                             | \$(744 )                 | 5.8                      |

1. Notional amount includes forward starting swaps of \$12.4 billion with an average forward start date of 1.1 years and an average maturity of 7.9 years from December 31, 2014.

2. Average fixed pay rate includes forward starting swaps. Excluding forward starting swaps, the average fixed pay rate was 1.68% as of December 31, 2014.

3. Average receive rate excludes forward starting swaps.

The following table summarizes our interest rate payer swaption agreements outstanding as of June 30, 2015 and December 31, 2014 (dollars in millions):

| Payer Swaptions       | Option |            | Underlying Payer Swap        |                 |                        |                              |                      |
|-----------------------|--------|------------|------------------------------|-----------------|------------------------|------------------------------|----------------------|
|                       | Cost   | Fair Value | Average Months to Expiration | Notional Amount | Average Fixed Pay Rate | Average Receive Rate (LIBOR) | Average Term (Years) |
| June 30, 2015         |        |            |                              |                 |                        |                              |                      |
| ≤ 1 year              | \$126  | \$44       | 5                            | \$5,100         | 3.35%                  | 3M                           | 7.2                  |
| > 1 to ≤ 2 years      | 10     | 1          | 14                           | 350             | 3.95%                  | 3M                           | 5.0                  |
| Total Payer Swaptions | \$136  | \$45       | 6                            | \$5,450         | 3.39%                  | 3M                           | 7.1                  |
| December 31, 2014     |        |            |                              |                 |                        |                              |                      |
| ≤ 1 year              | \$113  | \$36       | 6                            | \$5,600         | 3.15%                  | 3M                           | 6.4                  |
| > 1 to ≤ 2 years      | 32     | 10         | 16                           | 1,200           | 3.87%                  | 3M                           | 5.1                  |
| Total Payer Swaptions | \$145  | \$46       | 8                            | \$6,800         | 3.28%                  | 3M                           | 6.2                  |

The following table summarizes our interest rate receiver swaption agreements outstanding as of December 31, 2014 (dollars in millions). We had no interest rate receiver swaptions outstanding as of June 30, 2015.

| Receiver Swaptions | Option |            | Underlying Receiver Swap     |                 |                            |                          |                      |
|--------------------|--------|------------|------------------------------|-----------------|----------------------------|--------------------------|----------------------|
|                    | Cost   | Fair Value | Average Months to Expiration | Notional Amount | Average Fixed Receive Rate | Average Pay Rate (LIBOR) | Average Term (Years) |
| December 31, 2014  |        |            |                              |                 |                            |                          |                      |
| ≤ 1 year           | \$18   | \$29       | 5                            | \$4,250         | 1.78%                      | 3M                       | 6.4                  |

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The following table summarizes our U.S. Treasury securities as of June 30, 2015 and December 31, 2014 (in millions):

| Maturity                            | June 30, 2015                  |            |              | December 31, 2014              |             |              |
|-------------------------------------|--------------------------------|------------|--------------|--------------------------------|-------------|--------------|
|                                     | Face Amount Net Long / (Short) | Cost Basis | Market Value | Face Amount Net Long / (Short) | Cost Basis  | Market Value |
| 3 years                             | \$ (900 )                      | \$ (899 )  | \$ (902 )    | \$ —                           | \$ —        | \$ —         |
| 5 years                             | 808                            | 803        | 804          | (4,674 )                       | (4,650 )    | (4,645 )     |
| 7 years                             | 2,109                          | 2,084      | 2,085        | (717 )                         | (717 )      | (718 )       |
| 10 years                            | 925                            | 913        | 907          | 2,410                          | 2,422       | 2,427        |
| Total U.S. Treasury securities, net | \$ 2,942                       | \$ 2,901   | \$ 2,894     | \$ (2,981 )                    | \$ (2,945 ) | \$ (2,936 )  |

The following tables summarize our TBA securities as of June 30, 2015 and December 31, 2014 (in millions):

| TBA Securities by Coupon | June 30, 2015                               |                         |                           |                                 | December 31, 2014                           |                         |                           |                                 |
|--------------------------|---|-------------------------|---------------------------|---------------------------------|---|-------------------------|---------------------------|---------------------------------|
|                          | Notional Amount - Long (Short) <sup>1</sup> | Cost Basis <sup>2</sup> | Market Value <sup>3</sup> | Net Carrying Value <sup>4</sup> | Notional Amount - Long (Short) <sup>1</sup> | Cost Basis <sup>2</sup> | Market Value <sup>3</sup> | Net Carrying Value <sup>4</sup> |
| 15-Year TBA securities:  |   |                         |                           |                                 |   |                         |                           |                                 |
| 2.5%                     | \$ (644 )                                   | \$ (649 )               | \$ (651 )                 | \$ (2 )                         | \$ 962                                      | \$ 968                  | \$ 980                    | \$ 12                           |
| 3.0%                     | (82 )                                       | (84 )                   | (85 )                     | (1 )                            | 2,779                                       | 2,889                   | 2,888                     | (1 )                            |
| 3.5%                     | 826   | 870                     | 871                       | 1                               | (468 )                                      | (495 )                  | (494 )                    | 1                               |
| 4.0%                     | —   | —                       | —                         | —                               | (13 )                                       | (14 )                   | (14 )                     | —                               |
| Total 15-Year TBAs       | 100   | 137                     | 135                       | (2 )                            | 3,260                                       | 3,348                   | 3,360                     | 12                              |
| 30-Year TBA securities:  |   |                         |                           |                                 |   |                         |                           |                                 |
| 3.0%                     | 3,794                                       | 3,820                   | 3,781                     | (39 )                           | 5,254                                       | 5,259                   | 5,313                     | 54                              |
| 3.5%                     | 3,206                                       | 3,309                   | 3,308                     | (1 )                            | 7,902                                       | 8,151                   | 8,232                     | 81                              |
| 4.0%                     | (159 )                                      | (162 )                  | (166 )                    | (4 )                            | (1,853 )                                    | (2,019 )                | (1,974 )                  | 45                              |
| 4.5%                     | —   | —                       | —                         | —                               | (151 )                                      | (163 )                  | (163 )                    | —                               |
| Total 30-Year TBAs       | 6,841                                       | 6,967                   | 6,923                     | (44 )                           | 11,152                                      | 11,228                  | 11,408                    | 180                             |
| Total net TBA securities | \$ 6,941                                    | \$ 7,104                | \$ 7,058                  | \$ (46 )                        | \$ 14,412                                   | \$ 14,576               | \$ 14,768                 | \$ 192                          |

| TBA Securities by Issuer | June 30, 2015                               |                         |                           |                                 | December 31, 2014                           |                         |                           |                                 |
|--------------------------|---|-------------------------|---------------------------|---------------------------------|---|-------------------------|---------------------------|---------------------------------|
|                          | Notional Amount - Long (Short) <sup>1</sup> | Cost Basis <sup>2</sup> | Market Value <sup>3</sup> | Net Carrying Value <sup>4</sup> | Notional Amount - Long (Short) <sup>1</sup> | Cost Basis <sup>2</sup> | Market Value <sup>3</sup> | Net Carrying Value <sup>4</sup> |
| Fannie Mae               | \$ 4,379                                    | \$ 4,473                | \$ 4,444                  | \$ (29 )                        | \$ 15,127                                   | \$ 15,316               | \$ 15,509                 | \$ 193                          |
| Freddie Mac              | 437   | 426                     | 423                       | (3 )                            | (715 )                                      | (740 )                  | (741 )                    | (1 )                            |
| Ginnie Mae               | 2,125                                       | 2,205                   | 2,191                     | (14 )                           | —   | —                       | —                         | —                               |
| TBA securities, net      | \$ 6,941                                    | \$ 7,104                | \$ 7,058                  | \$ (46 )                        | \$ 14,412                                   | \$ 14,576               | \$ 14,768                 | \$ 192                          |

1. Notional amount represents the par value (or principal balance) of the underlying agency security.

2. Cost basis represents the forward price to be paid / (received) for the underlying agency security.

3. Market value represents the current market value of the TBA contract (or of the underlying agency security) as of period-end.

4. Net carrying value represents the difference between the market value and the cost basis of the TBA contract as of period-end and is reported in derivative assets / (liabilities), at fair value in our consolidated balance sheets.

Gain (Loss) From Derivative Instruments and Other Securities, Net

The tables below summarize changes in our derivative and other hedge portfolio and their effect on our consolidated statements of comprehensive income for the three and six months ended June 30, 2015 and 2014 (in millions):

| Derivative and Other Hedging Instruments         | Three Months Ended June 30, 2015            |           |   |  | Amount of Gain/(Loss) Recognized in Income on Derivatives <sup>1</sup> |
|--|---|-----------|---|--|--|
|  | Notional Amount Long/(Short) March 31, 2015 | Additions | Settlement, Termination, Expiration or Exercise | Notional Amount Long/(Short) June 30, 2015 |  |
| TBA securities, net                              | \$4,873                                     | 18,367    | (16,299 )                                       | \$6,941                                    | \$ (110 )  |
| Interest rate swaps                              | \$(44,925 )                                 | —         | —   | \$(44,925 )                                | 434  |
| Payer swaptions                                  | \$(5,200 )                                  | (500 )    | 250   | \$(5,450 )                                 | 13   |
| Receiver swaptions                               | \$750                                       | —         | (750 )  | \$—  | (13 )  |
| U.S. Treasury securities - short position        | \$(3,353 )                                  | (2,224 )  | 3,327   | \$(2,250 )                                 | 18   |
| U.S. Treasury securities - long position         | \$4,261                                     | 11,649    | (10,718 )                                       | \$5,192                                    | (116 )   |
| U.S. Treasury futures contracts - short position | \$(730 )                                    | (730 )    | 730   | \$(730 )                                   | 15   |
|  |   |           |   |  | \$ 241   |

Excludes a net loss of \$6 million from investments in REIT equity securities, a net gain of \$9 million from debt of consolidated VIEs and a net loss of \$7 million from interest and principal-only securities recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

| Derivative and Other Hedging Instruments         | Three Months Ended June 30, 2014            |           |   |  | Amount of Gain/(Loss) Recognized in Income on Derivatives <sup>1</sup> |
|--|---|-----------|---|--|--|
|  | Notional Amount Long/(Short) March 31, 2014 | Additions | Settlement, Termination, Expiration or Exercise | Notional Amount Long/(Short) June 30, 2014 |  |
| TBA securities, net                              | \$13,909                                    | 65,946    | (62,044 )                                       | \$17,811                                   | \$ 543   |
| Interest rate swaps                              | \$(46,400 )                                 | (2,800 )  | 1,300   | \$(47,900 )                                | (587 )   |
| Payer swaptions                                  | \$(8,000 )                                  | (1,250 )  | 1,600   | \$(7,650 )                                 | (41 )  |
| Receiver swaptions                               | \$1,000                                     | 750       | —   | \$1,750                                    | —  |
| U.S. Treasury securities - short position        | \$(6,786 )                                  | (8,615 )  | 9,413   | \$(5,988 )                                 | (173 )   |
| U.S. Treasury securities - long position         | \$200                                       | 3,035     | (1,985 )  | \$1,250                                    | 8  |
| U.S. Treasury futures contracts - short position | \$(730 )                                    | (730 )    | 730   | \$(730 )                                   | (19 )  |
| TBA put option                                   | \$—   | (100 )    | —   | \$(100 )                                   | —  |
|  |   |           |   |  | \$ (269 )  |

Excludes a net gain of \$24 million from investments in REIT equity securities, a net loss of \$9 million from debt of consolidated VIEs, a net gain of \$15 million from interest and principal-only securities and other miscellaneous net losses of \$5 million recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

| Derivative and Other Hedging Instruments | Six Months Ended June 30, 2015                 |           |   |  | Amount of Gain/(Loss) Recognized in Income on Derivatives <sup>1</sup> |
|--|--|-----------|---|--|--|
|  | Notional Amount Long/(Short) December 31, 2014 | Additions | Settlement, Termination, Expiration or Exercise | Notional Amount Long/(Short) June 30, 2015 |  |
| TBA securities, net                      | \$14,412                                       | 63,867    | (71,338 )                                       | \$6,941                                    | \$ 124   |
| Interest rate swaps                      | \$(43,700 )                                    | (3,500 )  | 2,275   | \$(44,925 )                                | (312 )   |

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|  |           |          |         |            |         |   |
|--|-----------|----------|---------|------------|---------|---|
| Payer swaptions                                  | \$ (6,800 | ) (500   | ) 1,850 | \$ (5,450  | ) (4    | ) |
| Receiver swaptions                               | \$ 4,250  | —        | (4,250  | ) \$ —     | 4       | ) |
| U.S. Treasury securities - short position        | \$ (5,392 | ) (6,397 | ) 9,539 | \$ (2,250  | ) (64   | ) |
| U.S. Treasury securities - long position         | \$ 2,411  | 27,211   | (24,430 | ) \$ 5,192 | (64     | ) |
| U.S. Treasury futures contracts - short position | \$ (730   | ) (1,460 | ) 1,460 | \$ (730    | ) (5    | ) |
|  |           |          |         |            | \$ (321 | ) |

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Excludes a net loss of \$4 million from investments in REIT equity securities, a net gain of \$9 million from debt of 1. consolidated VIEs and a net gain of \$4 million from interest and principal-only securities recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.



| Derivative and Other Hedging Instruments         | Six Months Ended June 30, 2014                 |           |   |  | Amount of Gain/(Loss) Recognized in Income on Derivatives <sup>1</sup> |
|--|--|-----------|---|--|--|
|  | Notional Amount Long/(Short) December 31, 2013 | Additions | Settlement, Termination, Expiration or Exercise | Notional Amount Long/(Short) June 30, 2014 |  |
| TBA securities, net                              | \$2,119  | 90,322    | (74,630 )                                       | \$17,811                                   | \$ 604   |
| Interest rate swaps                              | \$(43,250 )                                    | (8,700 )  | 4,050   | \$(47,900 )                                | (967 )   |
| Payer swaptions                                  | \$(14,250 )                                    | (2,250 )  | 8,850   | \$(7,650 )                                 | (146 )   |
| Receiver swaptions                               | \$—  | 1,750     | —   | \$1,750                                    | —  |
| U.S. Treasury securities - short position        | \$(2,007 )                                     | (15,856 ) | 11,875  | \$(5,988 )                                 | (218 )   |
| U.S. Treasury securities - long position         | \$3,927  | 4,935     | (7,612 )  | \$1,250                                    | 80   |
| U.S. Treasury futures contracts - short position | \$(1,730 )                                     | (1,460 )  | 2,460   | \$(730 )                                   | (55 )  |
| TBA put option                                   | \$—  | (150 )    | 50  | \$(100 )                                   | —  |
|  |  |           |   |  | \$ (702 )  |

<sup>1</sup> Excludes a net gain of \$73 million from investments in REIT equity securities, a net loss of \$12 million from debt of consolidated VIEs, a net gain of \$27 million from interest and principal-only securities and other miscellaneous net losses of \$7 million recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

#### Note 7. Pledged Assets

Our repurchase agreements, FLHB funding agreement and derivative contracts require us to fully collateralize our obligations under the agreements based upon our counterparties' collateral requirements and their determination of the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, credit quality and liquidity conditions within the investment banking, mortgage finance and real estate industries. In addition, obligations under our derivative agreements will typically vary over time based on similar factors as well as the remaining term of the derivative contract. We are also typically required to post initial collateral upon execution of derivative transactions, such as interest rate swap agreements and TBA contracts. If we breach any of these provisions, we will be required to fully settle our obligations under the agreements, which could include a forced liquidation of our pledged collateral.

Our counterparties also apply a "haircut" to our pledged collateral, which means our collateral is valued at slightly less than market value and limits the amount we can borrow against our securities. This haircut reflects the underlying risk of the specific collateral and protects our counterparty against a change in its value. Our agreements do not specify the haircut; rather haircuts are determined on an individual transaction basis.

Consequently, the use of repurchase agreements and derivative instruments exposes us to credit risk relating to potential losses that could be recognized in the event that our counterparties fail to perform their obligations under such agreements. We minimize this risk by limiting our counterparties to major financial institutions with acceptable credit ratings or to registered clearinghouses, and we monitor our positions with individual counterparties. In the event of a default by a counterparty we may have difficulty obtaining our assets pledged as collateral to such counterparty and may not receive payments provided for under the terms of our derivative agreements. In the case of centrally cleared instruments, we could be exposed to credit risk if the central clearing agency or a clearing member defaults on its respective obligation to perform under the contract. However, we believe that the risk is minimal due to the clearing exchanges' initial and daily mark to market margin requirements and clearinghouse guarantee funds and other resources that are available in the event of a clearing member default.

Further, each of our International Swaps and Derivatives Association ("ISDA") Master Agreements also contains a cross default provision under which a default under certain of our other indebtedness in excess of a certain threshold

causes an event of default under the agreement. Threshold amounts vary by lender. Following an event of default, we could be required to settle our obligations under the agreements. Additionally, under certain of our ISDA Master Agreements, we could be required to settle our obligations under the agreements if we fail to maintain certain minimum stockholders' equity thresholds or our REIT status or if we fail to comply with limits on our leverage above certain specified levels. As of June 30, 2015, the fair value of additional collateral that could be required to be posted as a result of the credit-risk-related contingent features being triggered was not material to our financial statements. As of June 30, 2015, our amount at risk with any counterparty related to our repurchase agreements was less than 5% of our stockholders' equity and our amount at risk with any counterparty related to our interest rate swap and swaption agreements, excluding centrally cleared swaps, was less than 1% of our stockholders' equity.

# Assets Pledged to Counterparties

The following tables summarize our assets pledged as collateral under our financing, derivative and prime broker agreements by type, including securities pledged related to securities sold but not yet settled, as of June 30, 2015 and December 31, 2014 (in millions):

| Assets Pledged to Counterparties                   | June 30, 2015                            |                                 |                          |                               |          |
|--|--|---------------------------------|--------------------------|-------------------------------|----------|
|  | Repurchase<br>Agreements<br><sup>1</sup> | Debt of<br>Consolidated<br>VIEs | Derivative<br>Agreements | Prime<br>Broker<br>Agreements | Total    |
| Agency MBS - fair value                            | \$47,594                                 | \$ 1,142                        | \$57                     | \$477                         | \$49,270 |
| U.S. Treasury securities - fair value <sup>2</sup> | 5,023                                    | —                               | 449                      | —                             | 5,472    |
| Accrued interest on pledged securities             | 144                                      | 3                               | 1                        | —                             | 148      |
| Restricted cash                                    | 5  | —                               | 768                      | 5                             | 778      |
| Total  | \$52,766                                 | \$ 1,145                        | \$1,275                  | \$482                         | \$55,668 |

1. Includes \$21 million of collateral pledged to the FHLB of Des Moines under our secured advance agreement.

2. Includes \$495 million of repurchased collateral received from counterparties.

| Assets Pledged to Counterparties       | December 31, 2014        |                                 |                          |                               |          |
|--|--------------------------|---------------------------------|--------------------------|-------------------------------|----------|
|  | Repurchase<br>Agreements | Debt of<br>Consolidated<br>VIEs | Derivative<br>Agreements | Prime<br>Broker<br>Agreements | Total    |
| Agency MBS - fair value                | \$50,858                 | \$ 1,266                        | \$69                     | \$702                         | \$52,895 |
| U.S. Treasury securities - fair value  | 1,904                    | —                               | 550                      | —                             | 2,454    |
| Accrued interest on pledged securities | 147                      | 4                               | 2                        | —                             | 153      |
| Restricted cash                        | 6                        | —                               | 698                      | 9                             | 713      |
| Total                                  | \$52,915                 | \$ 1,270                        | \$1,319                  | \$711                         | \$56,215 |

The cash and cash equivalents and agency securities pledged as collateral under our derivative agreements are included in restricted cash and agency securities, at fair value, respectively, on our consolidated balance sheets.

The following table summarizes our securities pledged as collateral under our financing agreements by remaining maturity of our borrowings, including securities pledged related to sold but not yet settled securities, as of June 30, 2015 and December 31, 2014 (in millions). For the corresponding borrowings associated with the following amounts and the interest rates thereon, refer to Note 5.

| Agency Securities Pledged by<br>Remaining Maturity of Repurchase<br>Agreements and Debt of Consolidated<br>VIEs | June 30, 2015                          |   |   | December 31, 2014                      |   |   |
|---|--|---|---|--|---|---|
|   | Fair Value<br>of Pledged<br>Securities | Amortized<br>Cost of<br>Pledged<br>Securities | Accrued<br>Interest on<br>Pledged<br>Securities | Fair Value<br>of Pledged<br>Securities | Amortized<br>Cost of<br>Pledged<br>Securities | Accrued<br>Interest on<br>Pledged<br>Securities |
| Agency MBS:   |  |   |   |  |   |   |
| ≤ 30 days   | \$22,449                               | \$22,423                                      | \$63  | \$14,605                               | \$14,453                                      | \$41  |
| > 30 and ≤ 60 days  | 9,436                                  | 9,417   | 27  | 10,912                                 | 10,789  | 30  |
| > 60 and ≤ 90 days  | 3,420                                  | 3,387   | 9   | 10,205                                 | 10,109  | 28  |
| > 90 days   | 13,431                                 | 13,442  | 38  | 16,402                                 | 16,227  | 47  |
| Total agency MBS  | 48,736                                 | 48,669  | 137   | 52,124                                 | 51,578  | 146   |
| U.S. Treasury securities:   |  |   |   |  |   |   |
| 1 day   | 5,023                                  | 5,035   | 11  | 1,904                                  | 1,899   | 5   |
| Total   | \$53,759                               | \$53,704                                      | \$ 148  | \$54,028                               | \$53,477                                      | \$ 151  |

As of June 30, 2015 and December 31, 2014, none of our borrowings backed by agency MBS were due on demand or mature overnight.



# Assets Pledged from Counterparties

As of June 30, 2015 and December 31, 2014, we had assets pledged to us from counterparties as collateral under our reverse repurchase and derivative agreements summarized in the tables below (in millions).

|                                       | June 30, 2015                 |                       |         | December 31, 2014             |                       |         |
|---------------------------------------|-------------------------------|-----------------------|---------|-------------------------------|-----------------------|---------|
| Assets Pledged to AGNC                | Reverse Repurchase Agreements | Derivative Agreements | Total   | Reverse Repurchase Agreements | Derivative Agreements | Total   |
| Agency MBS - fair value               | \$—                           | \$ 11                 | \$ 11   | \$—                           | \$ 43                 | \$ 43   |
| U.S. Treasury securities - fair value | 2,725                         | 10                    | 2,735   | 5,363                         | 47                    | 5,410   |
| Cash                                  | —                             | 15                    | 15      | —                             | 28                    | 28      |
| Total                                 | \$2,725                       | \$ 36                 | \$2,761 | \$5,363                       | \$ 118                | \$5,481 |

U.S Treasury securities received as collateral under our reverse repurchase agreements are accounted for as securities borrowing transactions and are used to cover short sales of the same securities. We recognize a corresponding obligation to return the borrowed securities at fair value on the accompanying consolidated balance sheets based on the value of the underlying borrowed securities as of the reporting date.

Cash collateral received is recognized in cash and cash equivalents with a corresponding amount recognized in accounts payable and other accrued liabilities on the accompanying consolidated balance sheets.

## Offsetting Assets and Liabilities

Certain of our repurchase agreements and derivative transactions are governed by underlying agreements that generally provide for a right of setoff under master netting arrangements (or similar agreements), including in the event of default or in the event of bankruptcy of either party to the transactions. We present our assets and liabilities subject to such arrangements on a gross basis in our consolidated balance sheets.

The following tables present information about our assets and liabilities that are subject to such arrangements and can potentially be offset on our consolidated balance sheets as of June 30, 2015 and December 31, 2014 (in millions):

### Offsetting of Financial Assets and Derivative Assets

|  | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Consolidated Balance Sheets | Net Amounts of Assets Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets |                                  | Net Amount |
|--|------------------------------------|---|--|---|----------------------------------|------------|
|  |                                    |   |  | Financial Instruments                                       | Collateral Received <sup>2</sup> |            |
| June 30, 2015  |                                    |   |  |   |                                  |            |
| Interest rate swap and swaption agreements, at fair value <sup>1</sup> | \$ 149                             | \$ —  | \$ 149   | \$(70 )   | \$(36 )                          | \$ 43      |
| Receivable under reverse repurchase agreements                         | 2,741                              | —   | 2,741  | (2,741 )  | —                                | —          |
| Total derivative, other hedging instruments and other assets           | \$2,890                            | \$ —  | \$ 2,890   | \$(2,811 )  | \$(36 )                          | \$ 43      |
| December 31, 2014  |                                    |   |  |   |                                  |            |
| Interest rate swap and swaption agreements, at fair value <sup>1</sup> | \$ 211                             | \$ —  | \$ 211   | \$(94 )   | \$(83 )                          | \$ 34      |
| Receivable under reverse repurchase agreements                         | 5,218                              | —   | 5,218  | (4,690 )  | (528 )                           | —          |
| Total derivative, other hedging instruments and other assets           | \$5,429                            | \$ —  | \$ 5,429   | \$(4,784 )  | \$(611 )                         | \$ 34      |



|   | Offsetting of Financial Liabilities and Derivative Liabilities |   |   |   |                                 |      | Net Amount |
|---|--|---|---|---|---------------------------------|------|------------|
|   | Gross Amounts of Recognized Liabilities                        | Gross Amounts Offset in the Consolidated Balance Sheets | Net Amounts of Liabilities Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets |                                 |      |            |
|   |  |   |   | Financial Instruments                                       | Collateral Pledged <sup>2</sup> |      |            |
| June 30, 2015   |  |   |   |   |                                 |      |            |
| Interest rate swap agreements, at fair value <sup>1</sup>         | \$784  | \$—   | \$ 784  | \$(70 )   | \$(714 )                        | \$—  |            |
| Repurchase agreements   | 50,178   | —   | 50,178  | (2,741 )  | (47,344 )                       | 93   |            |
| Total derivative, other hedging instruments and other liabilities | \$50,962   | \$—   | \$ 50,962   | \$(2,811 )  | \$(48,058 )                     | \$93 |            |
| December 31, 2014   |  |   |   |   |                                 |      |            |
| Interest rate swap agreements, at fair value <sup>1</sup>         | \$880  | \$—   | \$ 880  | \$(94 )   | \$(782 )                        | \$4  |            |
| Repurchase agreements   | 50,296   | —   | 50,296  | (4,690 )  | (45,606 )                       | —    |            |
| Total derivative, other hedging instruments and other liabilities | \$51,176   | \$—   | \$ 51,176   | \$(4,784 )  | \$(46,388 )                     | \$4  |            |

<sup>1</sup> Reported under derivative assets / liabilities, at fair value in the accompanying consolidated balance sheets. Refer to Note 6 for a reconciliation of derivative assets / liabilities, at fair value to their sub-components.

<sup>2</sup> Includes cash and securities received / pledged as collateral, at fair value. Amounts presented are limited to collateral pledged sufficient to reduce the net amount to zero for individual counterparties, as applicable.

#### Note 8. Fair Value Measurements

We determine the fair value of our agency securities and debt of consolidated VIEs based upon fair value estimates obtained from multiple third party pricing services and dealers. In determining fair value, third party pricing sources use various valuation approaches, including market and income approaches. Factors used by third party sources in estimating the fair value of an instrument may include observable inputs such as coupons, primary and secondary mortgage rates, pricing information, credit data, volatility statistics, and other market data that are current as of the measurement date. The availability of observable inputs can vary by instrument and is affected by a wide variety of factors, including the type of instrument, whether the instrument is new and not yet established in the marketplace and other characteristics particular to the instrument. Third party pricing sources may also use certain unobservable inputs, such as assumptions of future levels of prepayment, defaults and foreclosures, especially when estimating fair values for securities with lower levels of recent trading activity. We make inquiries of third party pricing sources to understand the significant inputs and assumptions they used to determine their prices. For further information regarding valuation of our derivative instruments, please refer to the discussion of derivative and other hedging instruments in Note 3.

We review the various third party fair value estimates and perform procedures to validate their reasonableness, including an analysis of the range of third party estimates for each position, comparison to recent trade activity for similar securities, and management review for consistency with market conditions observed as of the measurement date. While we do not adjust prices we obtain from third party pricing sources, we will exclude third party prices for securities from our determination of fair value if we determine (based on our validation procedures and our market knowledge and expertise) that the price is significantly different from observable market data would indicate and we

cannot obtain an understanding from the third party source as to the significant inputs used to determine the price.

The validation procedures described above also influence our determination of the appropriate fair value measurement classification. We utilize a three-level valuation hierarchy for disclosure of fair value measurement. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. There were no transfers between hierarchy levels during the three and six months ended June 30, 2015. The three levels of hierarchy are defined as follows:

Level 1 Inputs —Quoted prices (unadjusted) for identical unrestricted assets and liabilities in active markets that are accessible at the measurement date.

Level 2 Inputs —Quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.



**Level 3 Inputs** — Instruments with primarily unobservable market data that cannot be corroborated.

The following table provides a summary of our assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2015 and December 31, 2014 (in millions):

|  | June 30, 2015  |                 |            | December 31, 2014 |                 |            |
|--|----------------|-----------------|------------|-------------------|-----------------|------------|
|  | Level 1        | Level 2         | Level 3    | Level 1           | Level 2         | Level 3    |
| <b>Assets:</b>   |                |                 |            |                   |                 |            |
| Agency securities  | \$—            | \$50,976        | \$—        | \$—               | \$55,482        | \$—        |
| Agency securities transferred to consolidated VIEs   | —              | 1,142           | —          | —                 | 1,266           | —          |
| U.S. Treasury securities   | 5,124          | —               | —          | 2,427             | —               | —          |
| Interest rate swaps  | —              | 104             | —          | —                 | 136             | —          |
| Swaptions  | —              | 45              | —          | —                 | 75              | —          |
| REIT equity securities   | 60             | —               | —          | 68                | —               | —          |
| TBA securities   | —              | 11              | —          | —                 | 197             | —          |
| U.S. Treasury futures  | 4              | —               | —          | —                 | —               | —          |
| <b>Total</b>   | <b>\$5,188</b> | <b>\$52,278</b> | <b>\$—</b> | <b>\$2,495</b>    | <b>\$57,156</b> | <b>\$—</b> |
| <b>Liabilities:</b>  |                |                 |            |                   |                 |            |
| Debt of consolidated VIEs  | \$—            | \$674           | \$—        | \$—               | \$761           | \$—        |
| Obligation to return U.S. Treasury securities borrowed under reverse repurchase agreements | 2,230          | —               | —          | 5,363             | —               | —          |
| Interest rate swaps  | —              | 784             | —          | —                 | 880             | —          |
| TBA securities   | —              | 57              | —          | —                 | 5               | —          |
| U.S. Treasury futures  | —              | —               | —          | 5                 | —               | —          |
| Other  | —              | 3               | —          | —                 | —               | —          |
| <b>Total</b>   | <b>\$2,230</b> | <b>\$1,518</b>  | <b>\$—</b> | <b>\$5,368</b>    | <b>\$1,646</b>  | <b>\$—</b> |

We elected the option to account for debt of consolidated VIEs at fair value with changes in fair value reflected in earnings during the period in which they occur, because we believe this election more appropriately reflects our financial position as both the consolidated agency securities and consolidated debt are presented in a consistent manner, at fair value, on our consolidated balance sheets. We estimate the fair value of the consolidated debt based on the fair value of the agency MBS transferred to consolidated VIEs, less the fair value of our retained interests, which are based on valuations obtained from third-party pricing services and non-binding dealer quotes derived from common market pricing methods using "Level 2" inputs.

Excluded from the table above are financial instruments, including cash and cash equivalents, restricted cash, receivables, payables and borrowings under repurchase agreements, which are presented in our consolidated financial statements at cost, which is determined to approximate fair value, primarily due to the short duration of these instruments. The cost basis of repo borrowings with initial terms of greater than one year is also determined to approximate fair value, primarily since such agreements have floating rates based on an index plus or minus a fixed spread and the fixed spread is generally consistent with those demanded in the market. We estimate the fair value of these instruments using "Level 2" inputs.

## Note 9. Stockholders' Equity

### Preferred Stock

Pursuant to our amended and restated certificate of incorporation, we are authorized to designate and issue up to 10.0 million shares of preferred stock in one or more classes or series. Our Board of Directors has designated 6.9 million shares as 8.000% Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock") and 8,050 shares as 7.750% Series B Cumulative Redeemable Preferred Stock ("Series B Preferred Stock"). As of June 30, 2015, we had 3.1 million shares of authorized but unissued shares of preferred stock. Our Board of Directors may designate additional series of authorized preferred stock ranking junior to or in parity with the Series A or Series B Preferred

Stock or designate additional shares of the Series A or Series B Preferred Stock and authorize the issuance of such shares.

In April 2012, we completed a public offering in which 6.9 million shares of our Series A Preferred Stock were sold to the underwriters at a price of \$24.2125 per share for proceeds, net of offering expenses, of \$167 million. In May 2014, we completed

a public offering in which 7.0 million depositary shares were sold to the underwriters at a price of \$24.2125 per depositary share for proceeds, net of offering expenses, of \$169 million. Each depositary share represents a 1/1,000th interest in a share of our Series B Preferred Stock.

Our Series A and Series B Preferred Stock have no stated maturity, are not subject to any sinking fund or mandatory redemption and rank on parity with each other. Under certain circumstances upon a change of control, our Series A and Series B Preferred Stock are convertible to shares of our common stock. Holders of our Series A Preferred Stock and depositary shares underlying our Series B Preferred Stock have no voting rights, except under limited conditions, and are entitled to receive cumulative cash dividends at a rate of 8.000% and 7.750% per annum, respectively, of their \$25.00 per share and \$25.00 per depositary share liquidation preference, respectively, before holders of our common stock are entitled to receive any dividends. Shares of our Series A Preferred Stock and depositary shares underlying our Series B Preferred Stock are each redeemable at \$25.00 per share, plus accumulated and unpaid dividends (whether or not declared) exclusively at our option commencing on April 5, 2017 and May 8, 2019, respectively, or earlier under certain circumstances intended to preserve our qualification as a REIT for federal income tax purposes. Dividends are payable quarterly in arrears on the 15th day of each January, April, July and October. As of June 30, 2015, we had declared all required quarterly dividends on our Series A and Series B Preferred Stock.

#### Common Stock Repurchase Program

Our Board of Directors adopted a program that authorizes repurchases of our common stock through December 31, 2015, up to a specified amount. Shares of our common stock may be purchased in the open market, including through block purchases, or through privately negotiated transactions, or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended. The timing, manner, price and amount of any repurchases will be determined at our discretion and the program may be suspended, terminated or modified at any time for any reason. Among other factors, we intend to only consider repurchasing shares of our common stock when the purchase price is less than our estimate of our current net asset value per common share. Generally, when we repurchase our common stock at a discount to our net asset value, the net asset value of our remaining shares of common stock outstanding increases. In addition, we do not intend to repurchase any shares from directors, officers or other affiliates. The program does not obligate us to acquire any specific number of shares, and all repurchases will be made in accordance with Rule 10b-18, which sets certain restrictions on the method, timing, price and volume of stock repurchases.

During the three and six months ended June 30, 2015, we repurchased approximately 4.0 million shares of our common stock at an average repurchase price of \$19.86 per share, including expenses, totaling \$79 million. During the six months ended June 30, 2014, we repurchased approximately 3.4 million shares of our common stock at an average repurchase price of \$22.10 per share, including expenses, totaling \$74 million. We did not repurchase any shares of our common stock during the three months ended June 30, 2014. As of June 30, 2015, the total remaining amount authorized for repurchases of our common stock was \$913 million.

# Accumulated Other Comprehensive Income (Loss)

The following tables summarize changes to accumulated OCI for the three and six months ended June 30, 2015 and 2014 (in millions):

| Accumulated Other Comprehensive Income (Loss) | Net Unrealized<br>Gain (Loss) on<br>Available-for-Sale<br>MBS | Net<br>Unrealized<br>Gain (Loss)<br>on Swaps | Total<br>Accumulated<br>OCI<br>Balance |
|---|---|--|--|
| <b>Three Months Ended June 30, 2015</b>       |   |  |  |
| Balance as of March 31, 2015                  | \$ 961  | \$(111 )                                     | \$ 850                                 |
| OCI before reclassifications                  | (894 )  | —  | (894 )                                 |
| Amounts reclassified from accumulated OCI     | 22  | 26   | 48                                     |
| Balance as of June 30, 2015                   | \$ 89   | \$(85 )                                      | \$ 4                                   |
| <b>Three Months Ended June 30, 2014</b>       |   |  |  |
| Balance as of March 31, 2014                  | \$ (565 )   | \$(253 )                                     | \$(818 )                               |
| OCI before reclassifications                  | 812   | —  | 812                                    |
| Amounts reclassified from accumulated OCI     | (22 )   | 40   | 18                                     |
| Balance as of June 30, 2014                   | \$ 225  | \$(213 )                                     | \$ 12                                  |
| <b>Six Months Ended June 30, 2015</b>         |   |  |  |
| Balance as of December 31, 2014               | \$ 570  | \$(140 )                                     | \$ 430                                 |
| OCI before reclassifications                  | (467 )  | —  | (467 )                                 |
| Amounts reclassified from accumulated OCI     | (14 )   | 55   | 41                                     |
| Balance as of June 30, 2015                   | \$ 89   | \$(85 )                                      | \$ 4                                   |
| <b>Six Months Ended June 30, 2014</b>         |   |  |  |
| Balance as of December 31, 2013               | \$ (1,087 )   | \$(296 )                                     | \$(1,383 )                             |
| OCI before reclassifications                  | 1,315   | —  | 1,315                                  |
| Amounts reclassified from accumulated OCI     | (3 )  | 83   | 80                                     |
| Balance as of June 30, 2014                   | \$ 225  | \$(213 )                                     | \$ 12                                  |

The following tables summarize reclassifications out of accumulated OCI for the three and six months ended June 30, 2015 and 2014 (in millions):

|  | Three Months Ended June<br>30,<br>2015 | 2014    | Line Item in the Consolidated<br>Statements of Comprehensive Income<br>Where Net Income is Presented |
|--|--|---------|--|
| Amounts Reclassified from Accumulated OCI<br>(Gain) loss amounts reclassified from<br>accumulated OCI for available-for-sale MBS<br>upon realization | \$22                                   | \$(22 ) | Gain (loss) on sale of agency<br>securities, net   |
| Periodic interest costs of interest rate swaps<br>previously designated as hedges under GAAP,<br>net   | 26                                     | 40      | Interest expense   |
| Total reclassifications  | \$48                                   | \$18    |  |

| Amounts Reclassified from Accumulated OCI   | Six months ended June 30, |        | Line Item in the Consolidated<br>Statements of Comprehensive Income<br>Where Net Income is Presented |
|---|---------------------------|--------|--|
|   | 2015                      | 2014   |  |
| (Gain) loss amounts reclassified from<br>accumulated OCI for available-for-sale MBS<br>upon realization | \$(14                     | ) \$(3 | ) Gain (loss) on sale of agency<br>securities, net   |
| Periodic interest costs of interest rate swaps<br>previously designated as hedges under GAAP,<br>net    | 55                        | 83     | Interest expense   |
| Total reclassifications   | \$41                      | \$80   |  |

Note 10. Subsequent Events

On July 13, 2015, our Board of Directors declared a monthly dividend of \$0.20 per common share, which will be paid on August 7, 2015, to common stockholders of record as of July 31, 2015.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is designed to provide a reader of American Capital Agency Corp.'s consolidated financial statements with a narrative from the perspective of management. Our MD&A is presented in five sections:

Executive Overview

Financial Condition

Results of Operations

Liquidity and Capital Resources

Forward-Looking Statements

### EXECUTIVE OVERVIEW

American Capital Agency Corp. ("AGNC," the "Company," "we," "us" and "our") was organized on January 7, 2008 and commenced operations on May 20, 2008 following the completion of our initial public offering. Our common stock is traded on The NASDAQ Global Select Market under the symbol "AGNC." We are externally managed by American Capital AGNC Management, LLC (our "Manager"), an affiliate of American Capital, Ltd. ("American Capital").

We operate so as to qualify to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"). As such, we are required to distribute annually 90% of our taxable net income. As long as we qualify as a REIT, we will generally not be subject to U.S. federal or state corporate taxes on our taxable net income to the extent that we distribute all of our annual taxable net income to our stockholders. It is our intention to distribute 100% of our taxable net income, after application of available tax attributes, within the limits prescribed by the Internal Revenue Code, which may extend into the subsequent taxable year.

We earn income primarily from investing on a leveraged basis in agency mortgage-backed securities ("agency MBS"). These investments consist of residential mortgage pass-through securities and collateralized mortgage obligations ("CMOs") for which the principal and interest payments are guaranteed by a government-sponsored enterprise, such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), or by a U.S. Government agency, such as the Government National Mortgage Association ("Ginnie Mae") (collectively referred to as "GSEs"). We may also invest in agency debenture securities issued by Freddie Mac, Fannie Mae or the Federal Home Loan Bank and in other assets reasonably related to agency securities.

Our principal objective is to generate attractive risk-adjusted returns for distribution to our stockholders through regular monthly dividends from the combination of our net interest income and net realized gains and losses on our investments and hedging activities while preserving our net book value (also referred to as "net asset value", "NAV" and "stockholders' equity"). We fund our investments primarily through borrowings structured as repurchase agreements ("repo").

#### Our Investment Strategy

Our investment strategy is designed to:

- manage an investment portfolio consisting primarily of agency securities and assets reasonably related to agency securities that seeks to generate attractive risk-adjusted returns;
- capitalize on discrepancies in the relative valuations in the agency securities market;
- manage financing, interest rate, prepayment and extension risks;
- preserve our net book value;
- provide regular quarterly distributions to our stockholders;
- continue to qualify as a REIT; and
- remain exempt from the requirements of the Investment Company Act of 1940, as amended (the "Investment Company Act").

The size and composition of our investment portfolio depends on investment strategies implemented by our Manager, the availability of investment capital and overall market conditions, including the availability of attractively priced investments and suitable financing to appropriately leverage our investment portfolio. Market conditions are influenced by, among other things, current levels of and expectations for future levels of interest rates, mortgage

prepayments, market liquidity, housing prices, unemployment rates, general economic conditions, government participation in the mortgage market and evolving regulations or legal settlements that impact servicing practices or other mortgage related activities.

### Our Risk Management Strategy

We use a variety of strategies to hedge a portion of our exposure to market risks, including interest rate, prepayment and extension risks, to the extent that our Manager believes is prudent, taking into account our investment strategy, the cost of the hedging transactions and our intention to qualify as a REIT. As a result, we may not hedge certain interest rate, prepayment or extension risks if our Manager believes that bearing such risks enhances our return relative to our risk/return profile, or the hedging transaction would negatively impact our REIT status.

**Interest Rate Risk.** We hedge a portion of our exposure to potential interest rate mismatches between the interest we earn on our longer term investments and the interest we pay on our shorter term borrowings. Because a majority of our funding is in the form of repurchase agreements, our financing costs fluctuate based on short-term interest rate indices, such as LIBOR. Because our investments are assets that primarily have fixed rates of interest and could mature in up to 40 years, the interest we earn on those assets generally does not move in tandem with the interest that we pay on our repurchase agreements; therefore, we may experience reduced income or losses due to adverse rate movements. In order to attempt to mitigate a portion of such risk, we utilize certain hedging techniques to attempt to lock in a portion of the net interest spread between the interest we earn on our assets and the interest we pay on our financing costs.

Additionally, because prepayments on residential mortgages generally accelerate when interest rates decrease and slow when interest rates increase, mortgage securities typically have "negative convexity." In other words, certain mortgage securities in which we invest may increase in price more slowly than similar duration bonds, or even fall in value, as interest rates decline. Conversely, certain mortgage securities in which we invest may decrease in value more quickly than similar duration bonds as interest rates increase. In order to manage this risk, we monitor, among other things, the "duration gap" between our mortgage assets and our hedge portfolio as well as our convexity exposure. Duration is the estimated percentage change in market value of our mortgage assets or our hedge portfolio that would be caused by a parallel change in short and long-term interest rates. Convexity exposure relates to the way the duration of our mortgage assets or our hedge portfolio changes when the interest rate or prepayment environment changes.

The value of our mortgage assets may also be adversely impacted by fluctuations in the shape of the yield curve or by changes in the market's expectation about the volatility of future interest rates. We analyze our exposure to non-parallel changes in interest rates and to changes in the market's expectation of future interest rate volatility and take actions to attempt to mitigate these risks.

**Prepayment Risk.** Because residential borrowers have the option to prepay their mortgage loans at par at any time, we face the risk that we will experience a return of principal on our investments faster than anticipated. Prepayment risk generally increases when interest rates decline. In this scenario, our financial results may be adversely affected as we may have to invest that principal at potentially lower yields.

**Extension Risk.** Because residential borrowers have the option to make only scheduled payments on their mortgage loans, rather than prepay their mortgage loans, we face the risk that a return of capital on our investment will occur slower than anticipated. Extension risk generally increases when interest rates rise. In this scenario, our financial results may be adversely affected as we may have to finance our investments at potentially higher costs without the ability to reinvest principal into higher yielding securities.

The principal instruments that we use to hedge a portion of our exposure to interest rate, prepayment and extension risks are interest rate swaps and options to enter into interest rate swaps ("interest rate swaptions"). We also utilize forward contracts for the purchase or sale of agency MBS securities on a generic pool basis, or a TBA contract, and on a non-generic, specified pool basis, and U.S. Treasury securities and U.S. Treasury futures contracts, primarily through short sales. We may also purchase or write put or call options on TBA securities and we may invest in mortgage derivatives, such as interest and principal-only securities, and other types of derivative instruments. Our hedging instruments are generally not designed to protect our net book value from "spread risk" (also referred to as "basis risk"), which is the risk of an increase of the market spread between the yield on our agency securities and the benchmark yield on U.S. Treasury securities or interest rate swap rates. The inherent spread risk associated with our agency securities and the resulting fluctuations in fair value of these securities can occur independent of interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated



monetary policy actions by the Federal Reserve ("Fed"), liquidity, or changes in required rates of return on different assets. Consequently, while we use interest rate swaps and other supplemental hedges to attempt to protect our net book value against moves in interest rates, such instruments typically will not protect our net book value against spread risk and, therefore, the value of our agency securities and our net book value could decline.

The risk management actions we take 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. In addition, some of our hedges are intended to provide protection against larger rate moves and as a result may be relatively ineffective for smaller changes in interest rates. There can be no certainty that our Manager's projections of our exposures to interest rates, prepayments, extension or other risks will be accurate or that our hedging activities will be effective and, therefore, actual results could differ materially.

Income from hedging transactions that we enter into to manage risk may not constitute qualifying gross income under one or both of the gross income tests applicable to REITs. Therefore, we may have to limit our use of certain advantageous hedging techniques, which could expose us to greater risks than we would otherwise want to bear, or implement those hedges through a taxable REIT subsidiary ("TRS"). Implementing our hedges through a TRS could increase the cost of our hedging activities because a TRS is subject to tax on income and gains.

#### Trends and Recent Market Impacts

The second quarter of 2015 was challenging for the entire fixed income market, including agency MBS. Global economic uncertainty, particularly in Europe and China, continued to clash with moderately strong U.S. economic indicators and the growing probability that the Federal Reserve will soon begin to raise short term interest rates. Unlike the first quarter of 2015, interest rates increased significantly in the second quarter, with the 10-year U.S. Treasury rate increasing 40 bps to 2.33% as of June 30, 2015. The yield curve also steepened appreciably in the second quarter as the spread between 2- and 10-year U.S. Treasury rates increased 32 bps to 169 bps as of June 30, 2015. Year-to-date, the 10-year U.S. Treasury rate increased 16 bps and the spread between 2- to 10-year U.S. Treasury increased 19 bps through June 30, 2015. Option adjusted spreads ("OAS"), or the spread between agency MBS and other benchmark interest rates adjusted for the cost of the embedded prepayment optionality inherent in all agency MBS, also widened significantly during the second quarter despite the steepening of the yield curve.

Although we entered the second quarter with a very conservative portfolio composition and our lowest "at risk" leverage level since 2008, the combination of higher interest rates, a steeper yield curve and wider mortgage spreads during the quarter led to a decline in our net book value of \$(1.53) per common share to \$24.00 per common share as of June 30, 2015 from \$25.53 per common share as of March 31, 2015. During the quarter we paid dividends totaling \$0.62 per common share. Taken together, the decline in our net book value per common share and the dividends paid resulted in an economic loss of -3.6% for the second quarter, or -14.3% on an annualized basis. Year-to-date, through the second quarter, we had an economic loss of -1.8%, or -3.6% annualized, consisting of \$1.28 in dividends per common share and a decline of \$(1.74) in our net book value per common share.

We manage our sensitivity to interest rate and yield curve fluctuations primarily through hedge selection. Changes in the shape of the yield curve affect our overall business in two primary ways. First, when the yield curve steepens, our net interest margin and overall future earnings outlook generally improve. Second, we anticipate that OAS will correlate to the shape of the yield curve. If the yield curve steepens, we would expect OAS to tighten given the improved earnings characteristics of agency MBS in this environment. Conversely, in a scenario where the yield curve flattens materially, we would expect OAS to widen, as investors demand incremental return to offset the deterioration in net interest margin that occurs in a flatter yield curve environment. In the second quarter, however, the opposite occurred, as OAS spreads widened despite the yield curve steepening. We believe this recent pattern is primarily a function of spreads reaching historically tight levels earlier in the year. With spreads now at more reasonable levels following the widening that occurred in the second quarter, we do not believe this recent correlation is indicative of agency MBS performance if the yield curve continues to steepen.

Additionally, since a flattening of the yield curve tends to impact our overall business negatively through lower net interest margins and wider OAS, we generally position our hedges with a bias toward mitigating the impacts of a flatter yield curve. These strategies are intended to provide a book value benefit to offset the corresponding decline in book value attributable to weak MBS performance in a flat yield curve environment. As a result, if the yield curve steepens, our hedges will tend to underperform and our net asset value will be adversely impacted, which is what we experienced during the second quarter.

As we look forward, we continue to prioritize risk management over short term return opportunities given near term risk factors that include continued uncertainty in China and Europe, renewed weakness in oil and other commodities,

and continued ambiguity surrounding the timing and market impact of Federal Reserve rate hikes. Following the spread widening that occurred in the second quarter, however, we believe MBS valuations are now more reasonable. If interest rate volatility returns to more normal levels and if the aforementioned macro-risk factors subside, we would expect to opportunistically reposition the portfolio toward more normal risk levels, which would likely mean increasing leverage and/or increasing our “duration gap.” Either of these actions could favorably impact our expected return on equity.

For the estimated impact of changes in interests rates and mortgage spreads on our net book value please refer to "Quantitative and Qualitative Disclosures about Market Risk" under Item 3 of this Quarterly Report on Form 10-Q.

Recent Activity in Response to Trends and Recent Market Impacts:

During the three and six months ended June 30, 2015, we undertook moderate portfolio rebalancing actions, which included reducing our total "at risk" leverage and, in turn, our agency MBS position. Our total "at risk" leverage declined to 6.1x as of June 30, 2015, compared to 6.4x as of March 31, 2015 and 6.9x as of December 31, 2014. Our agency MBS holdings, inclusive of our net TBA position, decreased by approximately \$7 billion and \$12 billion during the three and six months ended June 30, 2015, respectively.

As of June 30, 2015, inclusive of our net TBA position,  $\leq$  15-year fixed rate securities represented 34% and 30-year fixed rate securities represented 61% of our investment portfolio, compared to 37% and 58%, respectively, as of both March 31, 2015 and December 31, 2014.

As of June 30, 2015, 84% of our outstanding balance of repurchase agreements, other debt and net TBA position was economically hedged through interest rate swaps, swaptions and U.S. Treasury positions, an increase from 78% as of March 31, 2015 and 76% as of December 31, 2014. Our duration gap increased to 1 year as of June 30, 2015 from 0.2 years as of March 31, 2015 and 0.5 years as of December 31, 2014, largely as a result of higher interest rates and a steeper yield curve.

With our stock trading at significant discounts to our net book value during the second quarter, we repurchased 4.0 million shares of our common stock, or 1% of our outstanding shares as of March 31, 2015. We repurchased the shares at an average price of \$19.86 per share, including expenses, totaling approximately \$79 million. Our decision to repurchase shares of our common stock is based on a variety of factors, including a daily estimate of our price to net book value ratio, an assessment of the overall MBS landscape, our views on interest rates and our overall expectations about the drivers and sustainability of share price weakness among other factors. Since commencing a stock repurchase program in the fourth quarter of 2012, we have repurchased 50.3 million shares of our common stock for total consideration of approximately \$1.1 billion, including expenses. As of June 30, 2015, we had \$0.9 billion available under our current Board of Director authorization for repurchases of our common stock through December 31, 2015.

## Market Information:

The following table summarizes interest rates and prices of generic fixed rate agency mortgage-backed securities as of each date presented below:

| Interest Rate/Security Price <sup>1</sup> | June 30,<br>2014 | Sept.<br>30,<br>2014 | Dec.<br>31,<br>2014 | Mar.<br>31,<br>2015 | June 30,<br>2015 | June 30, 2015<br>vs.<br>Mar. 31, 2015 | June 30, 2015<br>vs<br>Dec. 31, 2014 |
|---|------------------|----------------------|---------------------|---------------------|------------------|---------------------------------------|--------------------------------------|
| <b>LIBOR:</b>                             |                  |                      |                     |                     |                  |                                       |                                      |
| 1-Month                                   | 0.16%            | 0.16%                | 0.17%               | 0.18%               | 0.19%            | +0.01 bps                             | +0.02 bps                            |
| 3-Month                                   | 0.23%            | 0.24%                | 0.26%               | 0.27%               | 0.28%            | +0.01 bps                             | +0.02 bps                            |
| 6-Month                                   | 0.33%            | 0.33%                | 0.36%               | 0.40%               | 0.44%            | +0.04 bps                             | +0.08 bps                            |
| <b>U.S. Treasury Security Rate:</b>       |                  |                      |                     |                     |                  |                                       |                                      |
| 2-Year U.S. Treasury                      | 0.46%            | 0.58%                | 0.67%               | 0.56%               | 0.64%            | +0.08 bps                             | -0.03 bps                            |
| 3-Year U.S. Treasury                      | 0.86%            | 1.06%                | 1.08%               | 0.88%               | 0.99%            | +0.11 bps                             | -0.09 bps                            |
| 5-Year U.S. Treasury                      | 1.62%            | 1.78%                | 1.65%               | 1.37%               | 1.63%            | +0.26 bps                             | -0.02 bps                            |
| 10-Year U.S. Treasury                     | 2.52%            | 2.51%                | 2.17%               | 1.93%               | 2.33%            | +0.40 bps                             | +0.16 bps                            |
| 30-Year U.S. Treasury                     | 3.34%            | 3.21%                | 2.75%               | 2.54%               | 3.10%            | +0.56 bps                             | +0.35 bps                            |
| <b>Interest Rate Swap Rate:</b>           |                  |                      |                     |                     |                  |                                       |                                      |
| 2-Year Swap                               | 0.58%            | 0.83%                | 0.89%               | 0.81%               | 0.89%            | +0.08 bps                             | — bps                                |
| 3-Year Swap                               | 0.99%            | 1.31%                | 1.29%               | 1.11%               | 1.24%            | +0.13 bps                             | -0.05 bps                            |
| 5-Year Swap                               | 1.70%            | 1.95%                | 1.77%               | 1.53%               | 1.77%            | +0.24 bps                             | — bps                                |
| 10-Year Swap                              | 2.61%            | 2.65%                | 2.29%               | 2.03%               | 2.44%            | +0.41 bps                             | +0.15 bps                            |
| 30-Year Swap                              | 3.31%            | 3.20%                | 2.70%               | 2.39%               | 2.92%            | +0.53 bps                             | +0.22 bps                            |
| <b>30-Year Fixed Rate MBS Price:</b>      |                  |                      |                     |                     |                  |                                       |                                      |
| 3.0%                                      | \$98.77          | \$98.59              | \$101.22            | \$102.25            | \$99.58          | -\$2.67                               | -\$1.64                              |
| 3.5%                                      | \$102.92         | \$102.23             | \$104.28            | \$105.05            | \$103.02         | -\$2.03                               | -\$1.26                              |
| 4.0%                                      | \$106.11         | \$105.41             | \$106.75            | \$106.92            | \$105.91         | -\$1.01                               | -\$0.84                              |
| 4.5%                                      | \$108.30         | \$107.91             | \$108.56            | \$109.08            | \$108.09         | -\$0.99                               | -\$0.47                              |
| <b>15-Year Fixed Rate MBS Price:</b>      |                  |                      |                     |                     |                  |                                       |                                      |
| 2.5%                                      | \$101.59         | \$100.55             | \$101.81            | \$102.71            | \$101.17         | -\$1.54                               | -\$0.64                              |
| 3.0%                                      | \$103.88         | \$102.98             | \$103.91            | \$104.83            | \$103.57         | -\$1.26                               | -\$0.34                              |
| 3.5%                                      | \$105.98         | \$105.11             | \$105.61            | \$106.09            | \$105.44         | -\$0.65                               | -\$0.17                              |
| 4.0%                                      | \$106.17         | \$105.69             | \$106.06            | \$105.59            | \$105.06         | -\$0.53                               | -\$1.00                              |

Price information is for generic instruments only and is not reflective of our specific portfolio holdings. Price information is as of 3:00 p.m. (EST) on such date and can vary by source. Prices and interest rates in the table above were obtained from Barclays. LIBOR rates were obtained from Bloomberg.

The following table summarizes recent prepayment trends for our portfolio:

| Annualized Monthly Constant Prepayment Rates <sup>1</sup> | Dec.<br>2014 | Jan.<br>2015 | Feb.<br>2015 | Mar.<br>2015 | Apr.<br>2015 | May<br>2015 | Jun.<br>2015 |
|---|--------------|--------------|--------------|--------------|--------------|-------------|--------------|
| AGNC portfolio  | 8%           | 9%           | 8%           | 9%           | 12%          | 11%         | 12%          |

<sup>1</sup> Weighted average actual one-month annualized CPR released at the beginning of the month based on securities held/outstanding as of the preceding month-end.

## FINANCIAL CONDITION

As of June 30, 2015 and December 31, 2014, our investment portfolio consisted of \$52.1 billion and \$56.7 billion of agency MBS, respectively, and a \$7.1 billion and \$14.8 billion net long TBA position, at fair value, respectively (dollars in millions).

|                                   | June 30, 2015  |            |                |   |     | December 31, 2014 |            |                |      |   |     |   |
|-----------------------------------|----------------|------------|----------------|---|-----|-------------------|------------|----------------|------|---|-----|---|
| Agency MBS and Net TBA Securities | Amortized Cost | Fair Value | Average Coupon | % |     | Amortized Cost    | Fair Value | Average Coupon | %    |   |     |   |
| Fixed rate:                       |                |            |                |   |     |                   |            |                |      |   |     |   |
| ≤ 15-year                         |                |            |                |   |     |                   |            |                |      |   |     |   |
| ≤ 15-year agency MBS              | \$19,679       | \$19,917   | 3.23           | % | 34  | %                 | \$22,694   | \$23,021       | 3.20 | % | 32  | % |
| 15-year net long TBA securities   | 137            | 135        | 10.36          | % | —   | %                 | 3,348      | 3,360          | 2.78 | % | 5   | % |
| Total ≤ 15-year                   | 19,816         | 20,052     | 3.27           | % | 34  | %                 | 26,042     | 26,381         | 3.15 | % | 37  | % |
| 20-year                           | 1,150          | 1,178      | 3.49           | % | 2   | %                 | 1,232      | 1,272          | 3.49 | % | 2   | % |
| 30-year                           |                |            |                |   |     |                   |            |                |      |   |     |   |
| 30-year agency MBS                | 29,190         | 28,975     | 3.74           | % | 49  | %                 | 30,019     | 30,180         | 3.82 | % | 42  | % |
| 30-year net long TBA securities   | 6,967          | 6,923      | 3.21           | % | 12  | %                 | 11,228     | 11,408         | 3.17 | % | 16  | % |
| Total 30-year                     | 36,157         | 35,898     | 3.63           | % | 61  | %                 | 41,247     | 41,588         | 3.63 | % | 58  | % |
| Total fixed rate                  | 57,123         | 57,128     | 3.50           | % | 97  | %                 | 68,521     | 69,241         | 3.45 | % | 97  | % |
| Adjustable rate                   | 584            | 599        | 3.22           | % | 1   | %                 | 659        | 678            | 3.29 | % | 1   | % |
| CMO:                              |                |            |                |   |     |                   |            |                |      |   |     |   |
| CMO                               | 1,056          | 1,078      | 3.39           | % | 2   | %                 | 1,172      | 1,195          | 3.37 | % | 2   | % |
| Interest-only strips              | 156            | 189        | 5.43           | % | —   | %                 | 179        | 203            | 5.46 | % | —   | % |
| Principal-only strips             | 179            | 182        | —              | % | —   | %                 | 193        | 199            | —    | % | —   | % |
| Total CMO                         | 1,391          | 1,449      | 4.00           | % | 2   | %                 | 1,544      | 1,597          | 4.02 | % | 2   | % |
| Total                             | \$59,098       | \$59,176   | 3.52           | % | 100 | %                 | \$70,724   | \$71,516       | 3.47 | % | 100 | % |

Our TBA positions are recorded as derivative instruments in our accompanying consolidated financial statements, with the TBA dollar roll transactions representing a form of off-balance sheet financing. As of June 30, 2015 and December 31, 2014, our TBA position had a net carrying value of \$(46) million and \$192 million, respectively, reported in derivative assets/(liabilities) on our accompanying consolidated balance sheets. The net carrying value represents the difference between the fair value of the underlying agency security in the TBA contract and the cost basis or the forward price to be paid or received for the underlying agency security.

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The following tables summarize certain characteristics of our agency MBS fixed rate portfolio, inclusive of our net TBA position as of June 30, 2015 and December 31, 2014 (dollars in millions):

| Fixed Rate Securities | June 30, 2015<br>Includes Net TBA Position |                |            |  | Excludes Net TBA Position |                                   |                    |              |                                 |
|-----------------------|--|----------------|------------|--|---------------------------|-----------------------------------|--------------------|--------------|---------------------------------|
|                       | Par Value                                  | Amortized Cost | Fair Value | % Lower Loan Balance & HARP <sup>1,2</sup> | Amortized Cost Basis      | Weighted Average WAC <sup>3</sup> | Yield <sup>4</sup> | Age (Months) | Projected Life CPR <sup>4</sup> |
| Fixed rate            |  |                |            |  |                           |                                   |                    |              |                                 |
| ≤ 15-year             |  |                |            |  |                           |                                   |                    |              |                                 |
| ≤ 2.5%                | \$4,483                                    | \$4,575        | \$4,568    | 50%  | 101.9%                    | 2.97%                             | 2.03%              | 33           | 8%                              |
| 3.0%                  | 4,710                                      | 4,863          | 4,896      | 72%  | 103.2%                    | 3.50%                             | 2.18%              | 37           | 9%                              |
| 3.5%                  | 5,639                                      | 5,859          | 5,964      | 77%  | 103.7%                    | 3.95%                             | 2.55%              | 46           | 10%                             |
| 4.0%                  | 3,891                                      | 4,067          | 4,163      | 89%  | 104.5%                    | 4.40%                             | 2.72%              | 55           | 11%                             |
| 4.5%                  | 423  | 444            | 455        | 98%  | 105.0%                    | 4.87%                             | 3.06%              | 58           | 12%                             |
| ≥ 5.0%                | 6  | 6              | 6          | 31%  | 103.9%                    | 6.49%                             | 4.50%              | 90           | 14%                             |
| Total ≤ 15-year       | 19,152                                     | 19,814         | 20,052     | 72%  | 103.3%                    | 3.69%                             | 2.37%              | 42           | 9%                              |
| 20-year               |  |                |            |  |                           |                                   |                    |              |                                 |
| ≤ 3.0%                | 306  | 304            | 312        | 28%  | 99.3%                     | 3.55%                             | 3.11%              | 25           | 7%                              |
| 3.5%                  | 652  | 667            | 682        | 64%  | 102.2%                    | 4.05%                             | 3.05%              | 28           | 9%                              |
| 4.0%                  | 73   | 76             | 78         | 48%  | 104.6%                    | 4.53%                             | 3.00%              | 46           | 10%                             |
| 4.5%                  | 93   | 99             | 101        | 99%  | 106.8%                    | 4.89%                             | 3.05%              | 55           | 10%                             |
| ≥ 5.0%                | 4  | 4              | 5          | —%   | 106.1%                    | 5.92%                             | 3.36%              | 85           | 18%                             |
| Total 20-year:        | 1,128                                      | 1,150          | 1,178      | 56%  | 101.9%                    | 4.03%                             | 3.06%              | 31           | 9%                              |
| 30-year:              |  |                |            |  |                           |                                   |                    |              |                                 |
| ≤ 3.0%                | 6,868                                      | 6,912          | 6,851      | 2%   | 100.6%                    | 3.59%                             | 2.92%              | 25           | 6%                              |
| 3.5%                  | 14,301                                     | 14,989         | 14,783     | 56%  | 105.3%                    | 4.04%                             | 2.79%              | 29           | 7%                              |
| 4.0%                  | 11,323                                     | 12,087         | 12,043     | 62%  | 106.7%                    | 4.53%                             | 3.02%              | 27           | 8%                              |
| 4.5%                  | 1,682                                      | 1,797          | 1,837      | 89%  | 106.8%                    | 4.96%                             | 3.43%              | 49           | 8%                              |
| 5.0%                  | 166  | 176            | 183        | 65%  | 106.5%                    | 5.45%                             | 3.77%              | 86           | 11%                             |
| ≥ 5.5%                | 179  | 196            | 201        | 37%  | 109.4%                    | 6.22%                             | 3.44%              | 102          | 16%                             |
| Total 30-year         | 34,519                                     | 36,157         | 35,898     | 50%  | 105.5%                    | 4.28%                             | 2.95%              | 30           | 7%                              |
| Total fixed rate      | \$54,799                                   | \$57,121       | \$57,128   | 58%  | 104.5%                    | 4.04%                             | 2.72%              | 35           | 8%                              |

Lower loan balance securities represent pools backed by an original loan balance of ≤ \$150,000. Our lower loan balance securities had a weighted average original loan balance of \$98,000 and \$97,000 for 15-year and 30-year securities, respectively, as of June 30, 2015.

HARP securities are defined as pools backed by 100% refinance loans with LTV ≥ 80%. Our HARP securities had a weighted average LTV of 110% and 120% for 15-year and 30-year securities, respectively, as of June 30, 2015.

<sup>2</sup> Includes \$1.0 billion and \$2.9 billion of 15-year and 30-year securities, respectively, with >105 LTV pools which are not deliverable into TBA securities.

<sup>3</sup> WAC represents the weighted average coupon of the underlying collateral.

<sup>4</sup> Portfolio yield incorporates a projected life CPR assumption based on forward rate assumptions as of June 30, 2015.

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| Fixed Rate Securities | December 31, 2014         |                |            |  | Excludes Net TBA Position |                  |                    |              |  | Projected Life CPR <sup>4</sup> |
|-----------------------|---------------------------|----------------|------------|--|---------------------------|------------------|--------------------|--------------|--|---------------------------------|
|                       | Includes Net TBA Position |                |            | % Lower Loan Balance & HARP <sup>1,2</sup> | Weighted Average          |                  |                    |              |  |                                 |
|                       | Par Value                 | Amortized Cost | Fair Value |  | Amortized Cost Basis      | WAC <sup>3</sup> | Yield <sup>4</sup> | Age (Months) |  |                                 |
| Fixed rate            |                           |                |            |  |                           |                  |                    |              |  |                                 |
| ≤ 15-year             |                           |                |            |  |                           |                  |                    |              |  |                                 |
| ≤ 2.5%                | \$7,828                   | \$7,972        | \$7,993    | 30%  | 102.0%                    | 2.96%            | 2.03%              | 26           |  | 8%                              |
| 3.0%                  | 7,635                     | 7,897          | 7,950      | 48%  | 103.1%                    | 3.50%            | 2.25%              | 31           |  | 9%                              |
| 3.5%                  | 4,726                     | 4,889          | 5,017      | 99%  | 103.6%                    | 3.95%            | 2.56%              | 41           |  | 10%                             |
| 4.0%                  | 4,569                     | 4,776          | 4,906      | 89%  | 104.5%                    | 4.40%            | 2.72%              | 49           |  | 12%                             |
| 4.5%                  | 478                       | 501            | 508        | 97%  | 105.0%                    | 4.87%            | 3.06%              | 52           |  | 12%                             |
| ≥ 5.0%                | 6                         | 7              | 7          | 26%  | 104.2%                    | 6.46%            | 4.44%              | 84           |  | 14%                             |
| Total ≤ 15-year       | 25,242                    | 26,042         | 26,381     | 61%  | 103.2%                    | 3.65%            | 2.37%              | 36           |  | 10%                             |
| 20-year               |                           |                |            |  |                           |                  |                    |              |  |                                 |
| ≤ 3.0%                | 324                       | 322            | 334        | 28%  | 99.3%                     | 3.55%            | 3.11%              | 19           |  | 7%                              |
| 3.5%                  | 698                       | 713            | 736        | 63%  | 102.2%                    | 4.05%            | 3.05%              | 22           |  | 10%                             |
| 4.0%                  | 80                        | 84             | 86         | 47%  | 104.5%                    | 4.53%            | 2.98%              | 40           |  | 11%                             |
| 4.5%                  | 101                       | 108            | 111        | 99%  | 106.8%                    | 4.89%            | 3.05%              | 49           |  | 11%                             |
| ≥ 5.0%                | 5                         | 5              | 5          | —%   | 106.0%                    | 5.91%            | 3.34%              | 79           |  | 20%                             |
| Total 20-year:        | 1,208                     | 1,232          | 1,272      | 55%  | 102.0%                    | 4.03%            | 3.06%              | 25           |  | 9%                              |
| 30-year:              |                           |                |            |  |                           |                  |                    |              |  |                                 |
| ≤ 3.0%                | 6,887                     | 6,875          | 6,969      | 2%   | 98.9%                     | 3.58%            | 3.14%              | 19           |  | 6%                              |
| 3.5%                  | 17,970                    | 18,748         | 18,765     | 49%  | 105.2%                    | 3.98%            | 2.78%              | 27           |  | 7%                              |
| 4.0%                  | 12,644                    | 13,398         | 13,551     | 61%  | 106.4%                    | 4.43%            | 3.00%              | 20           |  | 9%                              |
| 4.5%                  | 1,699                     | 1,807          | 1,868      | 96%  | 106.5%                    | 4.96%            | 3.41%              | 43           |  | 10%                             |
| 5.0%                  | 183                       | 194            | 203        | 65%  | 106.2%                    | 5.45%            | 3.74%              | 80           |  | 12%                             |
| ≥ 5.5%                | 207                       | 225            | 232        | 36%  | 108.9%                    | 6.23%            | 3.40%              | 96           |  | 18%                             |
| Total 30-year         | 39,590                    | 41,247         | 41,588     | 47%  | 105.6%                    | 4.28%            | 2.96%              | 25           |  | 8%                              |
| Total fixed rate      | \$66,040                  | \$68,521       | \$69,241   | 53%  | 104.5%                    | 4.01%            | 2.72%              | 29           |  | 9%                              |

Lower loan balance securities represent pools backed by an original loan balance of ≤ \$150,000. Our lower loan balance securities had a weighted average original loan balance of \$97,000 and \$96,000 for 15-year and 30-year securities, respectively, as of December 31, 2014.

HARP securities are defined as pools backed by 100% refinance loans with LTVs ≥ 80%. Our HARP securities had a weighted average LTV of 109% and 118% for 15-year and 30-year securities, respectively, as of December 31, 2014. Includes \$934 million and \$3.1 billion of 15-year and 30-year securities, respectively, with >105 LTV pools which are not deliverable into TBA securities.

WAC represents the weighted average coupon of the underlying collateral.

Portfolio yield incorporates a projected life CPR assumption based on forward rate assumptions as of December 31, 2014.

As of June 30, 2015 and December 31, 2014, the combined weighted average yield of our agency MBS portfolio, inclusive of interest and principal-only strips, was 2.75% and 2.74%, respectively.

Our pass-through agency MBS collateralized by adjustable rate mortgage loans ("ARMs") have coupons linked to various indices. As of June 30, 2015 and December 31, 2014, our ARM securities had a weighted average next reset date of 49 months and 51 months, respectively.



## RESULTS OF OPERATIONS

### Non-GAAP Financial Measures

In addition to the results presented in accordance with GAAP, our results of operations discussed below include certain non-GAAP financial information, including "adjusted net interest expense" (defined as interest expense plus the periodic interest rate costs of our interest rate swaps reported in gain (loss) on derivatives and other securities, net in our consolidated statements of comprehensive income), "net spread and dollar roll income" (defined as interest income, TBA dollar roll income and dividends from REIT equity securities, net of adjusted net interest expense and operating expenses) and "estimated taxable income" and certain financial metrics derived from non-GAAP information, such as "cost of funds" and "net interest rate spread." By providing users of our financial information with such measures in addition to the related GAAP measures, we believe it gives users greater

transparency into the information used by our management in its financial and operational decision-making and that it is meaningful information to consider related to: (i) the economic costs of financing our investment portfolio inclusive of interest rate swaps used to economically hedge against fluctuations in our borrowing costs, (ii) in the case of net spread and dollar roll income, our current financial performance without the effects of certain transactions that are not necessarily indicative of our current investment portfolio and operations, and (iii) in the case of estimated taxable income, information that is directly related to the amount of dividends we are required to distribute in order to maintain our REIT qualification status. However, because such measures are incomplete measures of our financial performance and involve differences from results computed in accordance with GAAP, they should be considered as supplementary to, and not as a substitute for, our results computed in accordance with GAAP. In addition, because not all companies use identical calculations, our presentation of such non-GAAP measures may not be comparable to other similarly-titled measures of other companies. Furthermore, estimated taxable income can include certain information that is subject to potential adjustments up to the time of filing our income tax returns, which occurs after the end of our fiscal year.

### Selected Financial Data

The following selected financial data is derived from our interim consolidated financial statements and the notes thereto. The tables below present our condensed consolidated balance sheets as of June 30, 2015 and December 31, 2014 and our condensed consolidated statements of comprehensive income and key statistics for the three and six months ended June 30, 2015 and 2014 (in millions, except per share amounts):

(\$ in millions, except per share amounts)

| Balance Sheet Data   | June 30,<br>2015<br>(unaudited) | December 31,<br>2014 |
|--|---------------------------------|----------------------|
| Investment portfolio, at fair value                            | \$52,118                        | \$56,748             |
| Total assets   | \$62,885                        | \$67,766             |
| Repurchase agreements and other debt                           | \$50,852                        | \$51,057             |
| Total liabilities  | \$54,167                        | \$58,338             |
| Total stockholders' equity                                     | \$8,718                         | \$9,428              |
| Net asset value per common share as of period end <sup>1</sup> | \$24.00                         | \$25.74              |

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|   | Three Months Ended<br>June 30, |          | Six Months Ended June<br>30, |           |
|---|--------------------------------|----------|------------------------------|-----------|
| Statement of Comprehensive Income Data (unaudited)  | 2015                           | 2014     | 2015                         | 2014      |
| Interest income   | \$414                          | \$385    | \$797                        | \$784     |
| Interest expense <sup>2</sup>   | 81                             | 95       | 167                          | 203       |
| Net interest income   | 333                            | 290      | 630                          | 581       |
| Other income (loss), net <sup>2</sup>   | 215                            | (222 )   | (298 )                       | (618 )    |
| Expenses  | 36                             | 36       | 72                           | 71        |
| Net income (loss)   | 512                            | 32       | 260                          | (108 )    |
| Dividend on preferred stock   | 7                              | 5        | 14                           | 9         |
| Net income (loss) available (attributable) to common stockholders                         | \$505                          | \$27     | \$246                        | \$(117 )  |
| Net income (loss)   | \$512                          | \$32     | \$260                        | \$(108 )  |
| Other comprehensive (loss) income <sup>2</sup>  | (846 )                         | 830      | (426 )                       | 1,395     |
| Comprehensive (loss) income   | (334 )                         | 862      | (166 )                       | 1,287     |
| Dividend on preferred stock   | 7                              | 5        | 14                           | 9         |
| Comprehensive (loss) income available to common stockholders                              | \$(341 )                       | \$857    | \$(180 )                     | \$1,278   |
| Weighted average number of common shares outstanding - basic and diluted                  | 352.1                          | 352.8    | 352.5                        | 353.8     |
| Net loss per common share - basic and diluted   | \$1.43                         | \$0.08   | \$0.70                       | \$(0.33 ) |
| Comprehensive (loss) income per common share - basic and diluted                          | \$(0.97 )                      | \$2.43   | \$(0.51 )                    | \$3.61    |
| Dividends declared per common share   | \$0.62                         | \$0.65   | \$1.28                       | \$1.30    |
|   | Three Months Ended<br>June 30, |          | Six Months Ended June<br>30, |           |
| Other Data (unaudited)  | 2015                           | 2014     | 2015                         | 2014      |
| Average agency securities - at par  | \$53,660                       | \$54,365 | \$55,267                     | \$57,218  |
| Average agency securities - at cost   | \$56,106                       | \$56,923 | \$57,779                     | \$59,905  |
| Average net TBA portfolio - at cost   | \$5,973                        | \$13,963 | \$6,462                      | \$9,275   |
| Average total assets - at fair value  | \$68,552                       | \$68,132 | \$70,225                     | \$70,750  |
| Average agency MBS borrowings outstanding <sup>3</sup>                                    | \$50,410                       | \$50,448 | \$52,177                     | \$53,976  |
| Average stockholders' equity <sup>4</sup>   | \$9,108                        | \$9,315  | \$9,240                      | \$9,193   |
| Average coupon - agency securities <sup>5</sup>   | 3.60 %                         | 3.63 %   | 3.62 %                       | 3.62 %    |
| Average asset yield - agency securities <sup>6</sup>                                      | 2.95 %                         | 2.71 %   | 2.76 %                       | 2.62 %    |
| Average cost of funds <sup>7</sup>  | (1.43 )%                       | (1.45 )% | (1.35 )%                     | (1.40 )%  |
| Average net interest rate spread  | 1.52 %                         | 1.26 %   | 1.41 %                       | 1.22 %    |
| Average net interest rate spread, including estimated TBA dollar roll income <sup>8</sup> | 1.74 %                         | 1.84 %   | 1.65 %                       | 1.64 %    |
| Average coupon - agency securities (as of period end)                                     | 3.62 %                         | 3.63 %   | 3.62 %                       | 3.63 %    |
| Average asset yield - agency securities (as of period end)                                | 2.75 %                         | 2.70 %   | 2.75 %                       | 2.70 %    |
| Average cost of funds (as of period end) <sup>9</sup>                                     | (1.56 )%                       | (1.53 )% | (1.56 )%                     | (1.53 )%  |
| Average net interest rate spread (as of period end)                                       | 1.19 %                         | 1.17 %   | 1.19 %                       | 1.17 %    |
| Net comprehensive income return on average common equity - annualized <sup>10</sup>       | (15.6 )%                       | 38.0 %   | (4.1 )%                      | 28.7 %    |
| Economic return on common equity - annualized <sup>11</sup>                               | (14.3 )%                       | 39.6 %   | (3.6 )%                      | 30.6 %    |
| Average leverage <sup>12</sup>  | 5.6:1                          | 5.6:1    | 5.7:1                        | 6.1:1     |

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|  |       |   |       |   |       |   |       |   |
|--|-------|---|-------|---|-------|---|-------|---|
| Average "at risk" leverage, inclusive of the net TBA position <sup>13</sup>        | 6.2:1 |   | 7.1:1 |   | 6.4:1 |   | 7.1:1 |   |
| Leverage (as of period end) <sup>14</sup>  | 5.3:1 |   | 5.0:1 |   | 5.3:1 |   | 5.0:1 |   |
| "At risk" leverage, inclusive of net TBA position (as of period end) <sup>15</sup> | 6.1:1 |   | 6.9:1 |   | 6.1:1 |   | 6.9:1 |   |
| Expenses % of average total assets - annualized                                    | 0.21  | % | 0.21  | % | 0.21  | % | 0.20  | % |
| Expenses % of average assets, including average net TBA portfolio - annualized     | 0.19  | % | 0.18  | % | 0.19  | % | 0.18  | % |
| Expenses % of average stockholders' equity - annualized                            | 1.59  | % | 1.55  | % | 1.57  | % | 1.56  | % |

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\* Except as noted below, average numbers for each period are weighted based on days on our books and records. All percentages are annualized.

- Net asset value per common share is calculated as our total stockholders' equity, less our Series A and Series B Preferred Stock aggregate liquidation preference, divided by our number of common shares outstanding as of period end.
- We voluntarily discontinued hedge accounting for our interest rate swaps as of September 30, 2011. Please refer to our Interest Expense and Cost of Funds discussion further below and Notes 3 and 6 of our Consolidated Financial Statements in this Quarterly Report on Form 10-Q for additional information regarding our discontinuance of hedge accounting.
- Agency MBS borrowings include agency MBS repo, FHLB advances and debt of consolidated VIEs. Excludes U.S. Treasury repo agreements.
- Average stockholders' equity calculated as our average month-end stockholders' equity during the period.
- Average coupon for the period was calculated by dividing our total coupon (or cash) interest income on agency securities by our average agency securities held at par.
- Average asset yield for the period was calculated by dividing our total cash interest income on agency securities, adjusted for amortization of premiums and discounts, by our average amortized cost of agency securities held.
- Average cost of funds includes agency MBS borrowings and interest rate swaps currently in effect, but excludes interest rate swap termination fees, forward starting swaps and costs associated with other supplemental hedges such as interest rate swaptions and short U.S. Treasury or TBA positions. Average cost of funds for the period was calculated by dividing our total cost of funds by our average agency MBS borrowings outstanding for the period. TBA dollar roll income / (loss) is net of short TBAs used for hedging purposes. Dollar roll income excludes the impact of other supplemental hedges, and is recognized in gain (loss) on derivative instruments and other securities, net.
- Average cost of funds as of period end includes agency MBS borrowings outstanding, plus the impact of interest rate swaps in effect as of each period end and forward starting swaps becoming effective, net of swaps expiring, within three months of each period end, but excludes costs associated with other supplemental hedges such as swaptions, U.S. Treasuries and TBA positions.
- Net comprehensive income (loss) return on average common equity for the period was calculated by dividing our comprehensive income/(loss) available /(attributable) to common stockholders by our average stockholders' equity, net of the Series A and Series B Preferred Stock aggregate liquidation preference.
- Economic return (loss) on common equity represents the sum of the change in our net asset value per common share and our dividends declared on common stock during the period over our beginning net asset value per common share.
- Average leverage during the period was calculated by dividing our daily weighted average agency MBS borrowings outstanding for the period by the sum of our average stockholders' equity less our average investment in REIT equity securities for the period. Leverage excludes U.S. Treasury repurchase agreements.
- Average "at risk" leverage, inclusive of net TBA portfolio, during the period includes the components of "average leverage" plus our daily weighted average net TBA dollar position (at cost) during the period.
- Leverage at period end is calculated by dividing the sum of our agency MBS borrowings outstanding and our receivable / payable for unsettled agency securities by the sum of our total stockholders' equity less the fair value of investments in REIT equity securities at period end. Leverage excludes U.S. Treasury repurchase agreements.
- "At risk" leverage at period end, inclusive of net TBA position, includes the components of "leverage (as of period end)" plus our net TBA dollar roll position outstanding as of period end, at cost.

#### Interest Income and Asset Yield

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The following table summarizes our interest income for the three and six months ended June 30, 2015 and 2014 (dollars in millions):

|  | Three Months Ended June 30, |         |   |        |         |   | Six Months Ended June 30, |         |   |         |         |   |
|--|-----------------------------|---------|---|--------|---------|---|---------------------------|---------|---|---------|---------|---|
|  | 2015                        |         |   | 2014   |         |   | 2015                      |         |   | 2014    |         |   |
|  | Amount                      | Yield   |   | Amount | Yield   |   | Amount                    | Yield   |   | Amount  | Yield   |   |
| Cash/coupon interest income  | \$483                       | 3.60    | % | \$494  | 3.63    | % | \$999                     | 3.62    | % | \$1,035 | 3.62    | % |
| Premium amortization   | (69 )                       | (0.65 ) | % | (109 ) | (0.92 ) | % | (202 )                    | (0.86 ) | % | (251 )  | (1.00 ) | % |
| Interest income  | \$414                       | 2.95    | % | \$385  | 2.71    | % | \$797                     | 2.76    | % | \$784   | 2.62    | % |
| Actual portfolio CPR   | 12                          | %       |   | 9      | %       |   | 10                        | %       |   | 8       | %       |   |
| Projected life CPR as of period end                                    | 8                           | %       |   | 8      | %       |   | 8                         | %       |   | 8       | %       |   |
| Average 30-year fixed rate mortgage rate as of period end <sup>1</sup> | 4.08                        | %       |   | 4.14   | %       |   | 4.08                      | %       |   | 4.14    | %       |   |
| 10-year U.S. Treasury rate as of period end                            | 2.33                        | %       |   | 2.53   | %       |   | 2.33                      | %       |   | 2.53    | %       |   |

1. Source: Freddie Mac Primary Fixed Mortgage Rate Mortgage Market Survey

The principal elements impacting our interest income are the size of our average agency MBS portfolio and the yield on our investments. The following is a summary of the estimated impact of each of these elements on the increase in interest income for the three and six months ended June 30, 2015 and 2014 (in millions):

Impact of Changes in the Principal Elements Impacting Interest Income  
Periods Ended June 30, 2015 vs. June 30, 2014

|                    | Net<br>Increase | Due to Change in Average<br>Portfolio Size | Asset<br>Yield |
|--------------------|-----------------|--|----------------|
| Three months ended | \$29            | \$(6                                       | ) \$35         |
| Six months ended   | \$13            | \$(28                                      | ) \$41         |

Our average agency MBS portfolio decreased in par value by 1% and 3% for the three and six months ended June 30, 2015, respectively, reflective of lower "at risk" leverage, partially offset by a shift from TBA dollar roll funded assets to agency MBS repo funded assets. Our reported interest income does not include our TBA dollar roll income, which we report in gain/loss on derivative instruments and other securities, net in our accompanying consolidated financial statements in this Form 10-Q.

The increase in our average asset yield was primarily due to fluctuations in "catch-up" premium amortization adjustments recognized due to changes in our projected life CPR forecasts. Excluding "catch-up" premium amortization adjustments, our average asset yield was largely unchanged at 2.71% and 2.69% for the three and six months ended June 30, 2015, respectively, versus 2.71% and 2.70% for the three and six months ended June 30, 2014, respectively.

#### Leverage

Our leverage was 5.3x our stockholders' equity as of June 30, 2015, compared to 5.3x and 5.0x as of December 31, 2014 and June 30, 2014, respectively, measured as the sum of our agency MBS repo agreements, FHLB advances and debt of consolidated VIEs (collectively referred to as "agency MBS borrowings") and our net receivable / payable for unsettled agency securities divided by the sum of our total stockholders' equity less the fair value of our investments in REIT equity securities as of period end. Since the individual agency mortgage REITs in which we invest employ similar leverage as within our agency portfolio, we acquire these securities on an unlevered basis and, therefore, exclude from our leverage measurements the portion of our stockholders' equity allocated to investments in other mortgage REITs. In addition, our measurement of leverage excludes repurchase agreements used to fund short-term investments in U.S. Treasury securities due to the highly liquid and temporary nature of these investments. Inclusive of our net TBA position, our total "at risk" leverage was 6.1x our stockholders' equity as of June 30, 2015, compared to 6.9x as of both December 31, 2014 and June 30, 2014. Since we recognize our TBA commitments as derivatives under GAAP, they are not included in our repo and other debt leverage calculations as measured from our consolidated balance sheets; however, a long TBA position carries similar risks as if we had purchased the underlying MBS assets and funded such purchases with on-balance sheet repo agreements. Similarly, a short TBA position has substantially the same effect as selling the underlying MBS assets and reducing our on-balance sheet repurchase commitments. (Refer to Liquidity and Capital Resources for further discussion of TBA dollar roll positions).

Therefore, we commonly refer to our leverage adjusted for TBA positions as our "at risk" leverage.

The decline in our "at risk" leverage was due to our bias towards prioritizing risk management against the backdrop of global economic uncertainty, particularly in Europe and China, and the growing probability that the Federal Reserve will soon begin to raise short term interest rates. We believe operating with lower leverage in the current environment increases our ability to take advantage of attractive opportunities as they arise, thereby increasing our longer-term earnings potential.

The table below presents our average and quarter-end agency MBS borrowings, net TBA position and leverage ratios for each of the three month periods listed below (dollars in millions):

| Quarter Ended | Agency MBS Borrowings <sup>1</sup> |                            |                  | Net TBA Position<br>Long / (Short) <sup>2</sup> |                  | Average<br>Leverage     | Average<br>Total<br>"At Risk"<br>Leverage | Leverage<br>as of<br>Period<br>End <sup>1,5</sup> | "At Risk"<br>Leverage<br>as of<br>Period<br>End <sup>1,6</sup> |
|---------------|------------------------------------|----------------------------|------------------|---|------------------|-------------------------|---|---|--|
|               | Average<br>Daily<br>Amount         | Maximum<br>Daily<br>Amount | Ending<br>Amount | Average<br>Daily<br>Amount                      | Ending<br>Amount | during<br>the<br>Period | during                                    |   |  |

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|                   |          |          |          |          |          | <sup>1,3</sup> | the<br>Period <sup>1,4</sup> |       |       |
|-------------------|----------|----------|----------|----------|----------|----------------|------------------------------|-------|-------|
| June 30, 2015     | \$50,410 | \$55,097 | \$45,860 | \$5,973  | \$7,104  | 5.6:1          | 6.2:1                        | 5.3:1 | 6.1:1 |
| March 31, 2015    | \$53,963 | \$58,217 | \$55,056 | \$6,957  | \$4,815  | 5.8:1          | 6.5:1                        | 5.8:1 | 6.4:1 |
| December 31, 2014 | \$45,554 | \$49,170 | \$49,150 | \$18,492 | \$14,576 | 4.9:1          | 6.9:1                        | 5.3:1 | 6.9:1 |
| June 30, 2014     | \$50,448 | \$52,945 | \$48,362 | \$13,963 | \$18,184 | 5.6:1          | 7.1:1                        | 5.0:1 | 6.9:1 |
| March 31, 2014    | \$57,544 | \$63,117 | \$50,454 | \$4,534  | \$14,127 | 6.7:1          | 7.2:1                        | 5.9:1 | 7.6:1 |

<sup>1</sup> Includes agency MBS repo, FHLB advances and debt of consolidated VIEs. Excludes U.S. Treasury repo agreements.



2. Daily average and ending net TBA position outstanding measured at cost.

Average leverage during the period was calculated by dividing the sum of our daily weighted average agency MBS

3. borrowings outstanding by the sum of our average month-end stockholders' equity less our average investment in REIT equity securities for the period.

4. Average "at risk" leverage during the period includes the components of "average leverage during the period," plus our daily weighted average net TBA position (at cost) during the period.

Leverage as of period end was calculated by dividing the sum of the amount of agency MBS borrowings

5. outstanding and net payables and receivables for unsettled agency MBS securities by the sum of our total stockholders' equity less the fair value of our investment in REIT equity securities at period end.

6. "At risk" leverage as of period end includes the components of "leverage as of period end," plus the cost basis (or contract price) of our net TBA position.

## Interest Expense and Cost of Funds

Our interest expense is comprised of interest expense on our agency MBS borrowings and the reclassification of accumulated OCI into interest expense related to previously de-designated interest rate swaps. Our agency MBS borrowings primarily consist of agency MBS repurchase agreements. Upon our election to discontinue hedge accounting under GAAP as of September 30, 2011, the net deferred loss related to our de-designated interest rate swaps remained in accumulated OCI and is being reclassified from accumulated OCI into interest expense on a straight-line basis over the remaining term of each interest rate swap.

Our "adjusted net interest expense," also referred to as our "cost of funds" when stated as a percentage of our agency MBS borrowings outstanding, includes periodic interest costs on our interest rate swaps reported in gain (loss) on derivatives and other securities, net in our consolidated statements of comprehensive income. Our cost of funds does not include swap termination fees, forward starting swaps and costs associated with our other supplemental hedges, such as swaptions and U.S. Treasury positions. Our cost of funds also does not include the implied financing cost/benefit of our net TBA dollar roll position, but does however include interest rate swap hedge costs related to our TBA dollar roll funded assets. Consequently, our cost of funds measured as a percentage of our outstanding agency MBS borrowings is higher than if we allocated a portion of our swap hedge costs to our TBA dollar roll funded assets. The table below presents a reconciliation of our interest expense (the most comparable GAAP financial measure) to our adjusted net interest expense and cost of funds (non-GAAP financial measures) for the three and six months ended June 30, 2015 and 2014 (dollars in millions):

|  | Three Months Ended June 30, |                |   |        |                | Six Months Ended June 30, |        |                |   |        |                |   |
|--|-----------------------------|----------------|---|--------|----------------|---------------------------|--------|----------------|---|--------|----------------|---|
|  | 2015                        |                |   | 2014   |                |                           | 2015   |                |   | 2014   |                |   |
| Adjusted Net Interest Expense and Cost of Funds  | Amount                      | % <sup>1</sup> |   | Amount | % <sup>1</sup> |                           | Amount | % <sup>1</sup> |   | Amount | % <sup>1</sup> |   |
| Interest expense:  |                             |                |   |        |                |                           |        |                |   |        |                |   |
| Agency MBS borrowing interest expense  | \$55                        | 0.44           | % | \$55   | 0.44           | %                         | \$112  | 0.43           | % | \$120  | 0.45           | % |
| Periodic interest costs of interest rate swaps previously designated as hedges under GAAP, net | 26                          | 0.21           | % | 40     | 0.32           | %                         | 55     | 0.21           | % | 83     | 0.31           | % |
| Total interest expense   | 81                          | 0.65           | % | 95     | 0.76           | %                         | 167    | 0.64           | % | 203    | 0.76           | % |
| Other periodic interest costs of interest rate swaps, net                                      | 99                          | 0.78           | % | 87     | 0.69           | %                         | 183    | 0.71           | % | 170    | 0.64           | % |
| Total adjusted net interest expense and cost of funds  | \$180                       | 1.43           | % | \$182  | 1.45           | %                         | \$350  | 1.35           | % | \$373  | 1.40           | % |

1. Percent of our average agency MBS borrowing outstanding for the period annualized.

The principal elements impacting our adjusted net interest expense are our average agency MBS borrowings outstanding and interest rate swaps currently in effect ("current pay interest rate swaps") during the period as well as our cost of funds. The following is a summary of the estimated impact of these elements on changes in our adjusted net interest expense for the three and six months ended June 30, 2015 and 2014 (in millions):

# Impact of Changes in the Principal Elements of Adjusted Net Interest Expense

Periods Ended June 30, 2015 vs. June 30, 2014

|  | Decrease | Due to Change in Average<br>Borrowing /      Borrowing /<br>Swap Balance      Swap Rate |        |   |
|--|----------|---|--------|---|
| Three months ended:                            |          |   |        |   |
| Agency MBS borrowings interest expense         | \$—      | \$—   | \$—    |   |
| Periodic interest rate swap costs <sup>1</sup> | (2       | ) (4  | ) 2    |   |
| Total change in adjusted net interest expense  | \$(2     | ) \$(4  | ) \$2  |   |
| Six months ended:                              |          |   |        |   |
| Agency MBS borrowings interest expense         | \$(8     | ) \$(4  | ) \$(4 | ) |
| Periodic interest rate swap costs <sup>1</sup> | (15      | ) (18   | ) 3    |   |
| Total change in adjusted net interest expense  | \$(23    | ) \$(22   | ) \$(1 | ) |

1. Includes amounts recognized in interest expense and in gain (loss) on derivatives and other securities, net in our consolidated statements of comprehensive income. The change due to interest rate reflects the net impact of the change in the weighted average fixed pay and variable receive rates.

The modest decline in our adjusted net interest expense was primarily a function of maintaining a smaller portfolio of current pay interest rate swaps during the three and six months ended June 30, 2015. The table below presents a summary of our average agency MBS outstanding and our average current pay interest rates swaps in effect for the three and six months ended June 30, 2015 and 2014 (dollars in millions):

|   | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|---|--------------------------------|----------|------------------------------|----------|
| Average Ratio of Current Pay Interest Rate Swaps Outstanding to<br>Agency MBS Borrowings <sup>1</sup> | 2015                           | 2014     | 2015                         | 2014     |
| Average agency MBS borrowings   | \$50,410                       | \$50,448 | \$52,177                     | \$53,976 |
| Average notional amount of current pay interest rate swaps  | \$35,592                       | \$36,636 | \$34,265                     | \$36,917 |
| Average ratio of current pay interest rate swaps to agency MBS<br>borrowings                          | 71                             | % 73     | % 66                         | % 68     |
| Weighted average pay rate on current pay interest rate swaps  | 1.67                           | % 1.60   | % 1.65                       | % 1.59   |
| Weighted average receive rate on current pay interest rate swaps                                      | 0.26                           | % 0.21   | % 0.25                       | % 0.21   |
| Weighted average net pay rate on current pay interest rate swaps                                      | 1.41                           | % 1.39   | % 1.40                       | % 1.38   |

1. Excludes forward starting swaps not in effect during the periods presented.

Our average interest rate swaps outstanding in the table above exclude our forward starting swaps not in effect during the periods presented. Forward starting interest rate swaps do not impact our adjusted net interest expense and cost of funds until they commence accruing net interest settlements on their forward start dates. We enter into forward starting interest rate swaps based on a variety of factors, including our view of the forward yield curve and the timing of potential changes in short-term interest rates, time to deploy new capital, amount and timing of expirations of our existing interest rate swap portfolio, current and anticipated swap spreads and our desire to mitigate our exposure to specific sectors of the yield curve.

Our average ratio of interest rate swaps outstanding, inclusive of forward starting swaps, to our average agency MBS borrowings and net TBA position (at cost) was 82% and 78% for the three and six months ended June 30, 2015, respectively, and 74% and 71% for the three and six months ended June 30, 2014, respectively.

Three Months Ended  
June 30,

Six Months Ended  
June 30,

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|  |          |          |          |          |   |
|--|----------|----------|----------|----------|---|
| Average Ratio of all Interest Rate Swaps Outstanding to Agency MBS Borrowings and Net TBA Position | 2015     | 2014     | 2015     | 2014     |   |
| Average agency MBS borrowings  | \$50,410 | \$50,448 | \$52,177 | \$53,976 |   |
| Average net TBA portfolio - at cost  | 5,973    | 13,963   | 6,462    | 9,275    |   |
| Total average agency MBS borrowings and net TBA position   | \$56,383 | \$64,411 | \$58,639 | \$63,251 |   |
| Average notional amount of interest rate swaps (inclusive of forward starting swaps)               | \$46,025 | \$47,662 | \$45,953 | \$45,202 |   |
| Average ratio of interest rate swaps to agency MBS borrowings and net TBA position                 | 82       | % 74     | % 78     | % 71     | % |

# Net Spread and Dollar Roll Income

The table below presents a reconciliation of our net interest income (the most comparable GAAP financial measure) to our net spread and dollar roll income and to our net spread and dollar roll income, excluding estimated "catch-up" premium amortization cost, (non-GAAP financial measures) for the three and six months ended June 30, 2015 and 2014 (dollars in millions):

|  | Three Months<br>Ended June 30, |        | Six Months Ended<br>June 30, |        |
|--|--------------------------------|--------|------------------------------|--------|
|  | 2015                           | 2014   | 2015                         | 2014   |
| Net interest income  | \$333                          | \$290  | \$630                        | \$581  |
| Other periodic interest costs of interest rate swaps, net <sup>1</sup>   | (99)                           | (87)   | (183)                        | (170)  |
| Dividend from REIT equity securities   | 2                              | 6      | 4                            | 16     |
| TBA dollar roll income <sup>1</sup>  | 54                             | 138    | 111                          | 186    |
| Adjusted net interest income   | 290                            | 347    | 562                          | 613    |
| Operating expenses   | 36                             | 36     | 72                           | 70     |
| Net spread and dollar roll income  | 254                            | 311    | 490                          | 543    |
| Dividend on preferred stock  | 7                              | 5      | 14                           | 9      |
| Net spread and dollar roll income available to common stockholders   | 247                            | 306    | 476                          | 534    |
| Estimated "catch-up" premium amortization (benefit) cost due to change in CPR forecast                             | (37)                           | —      | (18)                         | 25     |
| Net spread and dollar roll income, excluding "catch-up" premium amortization, available to common stockholders     | \$210                          | \$306  | \$458                        | \$559  |
| Weighted average number of common shares outstanding - basic and diluted   | 352.1                          | 352.8  | 352.5                        | 353.8  |
| Net spread and dollar roll income per common share - basic and diluted   | \$0.70                         | \$0.87 | \$1.35                       | \$1.51 |
| Net spread and dollar roll income, excluding "catch-up" premium amortization, per common share - basic and diluted | \$0.60                         | \$0.87 | \$1.30                       | \$1.58 |

<sup>1</sup> Reported in gain (loss) on derivatives and other securities, net in our consolidated statements of comprehensive income

Net spread and dollar roll income, excluding "catch-up" premium amortization adjustments, for the three and six months ended June 30, 2015 decreased to \$0.60 and \$1.30 per common share, respectively, versus \$0.87 and \$1.58 per common share for the three and six months ended June 30, 2014, respectively. The decline was primarily due to lower average "at risk" leverage and lower TBA dollar roll income. The decline in dollar roll income was a function of a smaller average net TBA dollar roll position, as well as an increase in TBA implied financing rates. Our average net interest rate spread and dollar roll income (i.e., the difference between the average yield on our assets and our average cost of funds), excluding catch-up premium amortization cost, was approximately 1.50% and 1.59% for the three and six months ended June 30, 2015, respectively, compared to 1.84% and 1.71% for the three and six months ended June 30, 2014, respectively. Including catch-up premium amortization adjustments, our net interest rate spread and dollar roll income was 1.74% and 1.65% for the three and six months ended June 30, 2015, respectively, compared to 1.84% and 1.64% for the three and six months ended June 30, 2014, respectively.

# Gain (Loss) on Sale of Agency Securities, Net

The following table is a summary of our net gain (loss) on sale of agency MBS for the three and six months ended June 30, 2015 and 2014 (in millions):

| Three Months Ended<br>June 30, |      | Six Months Ended<br>June 30, |      |
|--------------------------------|------|------------------------------|------|
| 2015                           | 2014 | 2015                         | 2014 |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Agency MBS sold, at cost                   | \$(10,241) | \$(7,166 ) | \$(17,974) | \$(16,877) |
| Proceeds from agency MBS sold <sup>1</sup> | 10,219     | 7,188      | 17,988     | 16,880     |
| Net (loss) gain on sale of agency MBS      | \$(22 )    | \$22       | \$14       | \$3        |
| Gross gain on sale of agency MBS           | \$22       | \$49       | \$79       | \$91       |
| Gross loss on sale of agency MBS           | (44 )      | (27 )      | (65 )      | (88 )      |
| Net (loss) gain on sale of agency MBS      | \$(22 )    | \$22       | \$14       | \$3        |

<sup>1</sup> Proceeds include cash received during the period, plus receivable for agency MBS sold during the period as of period end.

Asset sales primarily resulted from reducing leverage and portfolio repositioning.

# Gain (Loss) on Derivative Instruments and Other Securities, Net

The following table is a summary of our gain (loss) on derivative instruments and other securities, net for the three and six months ended June 30, 2015 and 2014 (in millions):

|  | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |
|--|--------------------------------|---------|------------------------------|---------|
|  | 2015                           | 2014    | 2015                         | 2014    |
| Periodic interest costs of interest rate swaps, net <sup>1</sup>                         | \$(99)                         | \$(87)  | \$(183)                      | \$(170) |
| Realized (loss) gain on derivative instruments and other securities, net:                |                                |         |                              |         |
| TBA securities - dollar roll income, net   | 54                             | 138     | 111                          | 186     |
| TBA securities - mark-to-market net (loss) gain  | (39)                           | 181     | 250                          | 214     |
| Payer swaptions  | 3                              | (27)    | (12)                         | (108)   |
| Receiver swaptions   | 2                              | —       | 15                           | —       |
| U.S. Treasury securities - long position   | (83)                           | 2       | (47)                         | 19      |
| U.S. Treasury securities - short position  | (18)                           | (79)    | (65)                         | (90)    |
| U.S. Treasury futures - short position   | (3)                            | (17)    | (14)                         | (22)    |
| Interest rate swap termination fees  | —                              | 5       | (162)                        | 38      |
| REIT equity securities   | 2                              | 29      | 4                            | 48      |
| Other  | 1                              | (5)     | 1                            | (7)     |
| Total realized (loss) gain on derivative instruments and other securities, net           | (81)                           | 227     | 81                           | 278     |
| Unrealized gain (loss) on derivative instruments and other securities, net: <sup>2</sup> |                                |         |                              |         |
| TBA securities - mark-to-market net (loss) gain  | (125)                          | 224     | (237)                        | 204     |
| Interest rate swaps  | 533                            | (505)   | 33                           | (835)   |
| Payer swaptions  | 10                             | (14)    | 8                            | (38)    |
| Receiver swaptions   | (15)                           | —       | (11)                         | —       |
| Interest and principal-only strips   | (7)                            | 15      | 4                            | 27      |
| U.S. Treasury securities - long position   | (33)                           | 6       | (17)                         | 61      |
| U.S. Treasury securities - short position  | 36                             | (94)    | 1                            | (128)   |
| U.S. Treasury futures - short position   | 18                             | (2)     | 9                            | (33)    |
| Debt of consolidated VIEs  | 9                              | (9)     | 9                            | (12)    |
| REIT equity securities   | (8)                            | (5)     | (8)                          | 25      |
| Other  | (1)                            | —       | (1)                          | —       |
| Total unrealized gain (loss) on derivative instruments and other securities, net         | 417                            | (384)   | (210)                        | (729)   |
| Total gain (loss) on derivative instruments and other securities, net                    | \$237                          | \$(244) | \$(312)                      | \$(621) |

<sup>1</sup> Please refer to Interest Expense and Cost of Funds discussion above for additional information regarding other periodic interest costs of interest rate swaps, net.

<sup>2</sup> Unrealized gain (loss) from derivative instruments and other securities, net includes reversals of prior period amounts for settled, terminated or expired derivative instruments and other securities.

For further details regarding our use of derivative instruments and related activity refer to Notes 3 and 6 of our Consolidated Financial Statements in this Form 10-Q.

## Management Fees and General and Administrative Expenses

We pay our Manager a management fee payable monthly in arrears in an amount equal to one-twelfth of 1.25% of our month-end stockholders' equity, adjusted to exclude the effect of any unrealized gains or losses included in either retained earnings or accumulated OCI, each as computed in accordance with GAAP. There is no incentive compensation payable to our Manager pursuant to the management agreement. We incurred management fees of \$29 million and \$30 million for the three months ended June 30, 2015 and 2014, respectively, and \$59 million for both of the six months ended June 30, 2015 and 2014.

General and administrative expenses were \$7 million and \$6 million for the three months ended June 30, 2015 and 2014, respectively, and \$13 million and \$12 million for the six months ended June 30, 2015 and 2014, respectively. Our general and



administrative expenses primarily consisted of prime broker fees, information technology costs, accounting fees, legal fees, Board of Director fees, insurance expense and general overhead expense.

Our total annualized operating expense as a percentage of our average stockholders' equity was 1.59% and 1.55% for the three months ended June 30, 2015 and 2014, respectively, and 1.57% and 1.56% for the six months ended June 30, 2015 and 2014, respectively.

#### Dividends and Income Taxes

For the three months ended June 30, 2015 and 2014, we had estimated taxable income available to common stockholders of \$115 million and \$100 million (or \$0.33 and \$0.28 per common share), respectively, and for the six months ended June 30, 2015 and 2014, we had estimated taxable income available to common stockholders of \$281 million and \$267 million (or \$0.80 and \$0.75 per common share), respectively.

As a REIT, we are required to distribute annually 90% of our ordinary taxable income to maintain our status as a REIT and all of our taxable income to avoid federal and state corporate income taxes. We can treat dividends declared by September 15 and paid by December 31 as having been a distribution of our taxable income for our prior tax year ("spill-back provision"). Income as determined under GAAP differs from income as determined under tax rules because of both temporary and permanent differences in income and expense recognition. The primary differences are (i) unrealized gains and losses associated with interest rate swaps and other derivatives and securities marked-to-market in current income for GAAP purposes, but excluded from taxable income until realized or settled, (ii) timing differences, both temporary and potentially permanent, in the recognition of certain realized gains and losses and (iii) temporary differences related to the amortization of net premiums paid on investments. Furthermore, our estimated taxable income is subject to potential adjustments up to the time of filing our appropriate tax returns, which occurs after the end of our fiscal year.

The following is a reconciliation of our GAAP net income to our estimated taxable income for the three and six months ended June 30, 2015 and 2014 (dollars in millions):

|   | Three Months<br>Ended June 30, |         | Six Months Ended<br>June 30, |         |
|---|--------------------------------|---------|------------------------------|---------|
|   | 2015                           | 2014    | 2015                         | 2014    |
| Net income (loss)   | \$512                          | \$32    | \$260                        | \$(108) |
| Estimated book to tax differences:  |                                |         |                              |         |
| Premium amortization, net   | (55)                           | (5)     | (29)                         | 26      |
| Realized (gain) loss, net   | (39)                           | 5       | (152)                        | 41      |
| Net capital loss/(utilization of net capital loss carryforward)           | 121                            | (310)   | 6                            | (412)   |
| Unrealized (gain) loss, net   | (417)                          | 384     | 210                          | 729     |
| Other   | —                              | (1)     | —                            | —       |
| Total book to tax differences   | (390)                          | 73      | 35                           | 384     |
| Estimated REIT taxable income   | 122                            | 105     | 295                          | 276     |
| Dividend on preferred stock   | 7                              | 5       | 14                           | 9       |
| Estimated REIT taxable income available to common stockholders            | \$115                          | \$100   | \$281                        | \$267   |
| Weighted average number of common shares outstanding - basic and diluted  | 352.1                          | 352.8   | 352.5                        | 353.8   |
| Estimated REIT taxable income per common share - basic and diluted        | \$0.33                         | \$0.28  | \$0.80                       | \$0.75  |
| Beginning cumulative non-deductible net capital loss                      | \$648                          | \$1,683 | \$763                        | \$1,785 |
| Net capital loss/(utilization of net capital loss carryforward)           | 121                            | (310)   | 6                            | (412)   |
| Ending cumulative non-deductible net capital loss                         | \$769                          | \$1,373 | \$769                        | \$1,373 |
| Ending cumulative non-deductible net capital loss per ending common share | \$2.20                         | \$3.89  | \$2.20                       | \$3.89  |

Our estimated taxable income for the three and six months ended June 30, 2015 excludes \$121 million and \$6 million, respectively, of estimated net capital losses. Our estimated taxable income for the three and six months ended June 30,

2014 excludes \$310 million and \$412 million, respectively, of estimated net capital gains applied against our net capital loss carryforward. As of June 30, 2015, we had \$769 million (or \$2.20 per common share) of remaining net capital loss carryforwards, which can be carried forward and applied against future net capital gains through fiscal year 2018.

The following table summarizes dividends declared on our Series A Preferred Stock, depositary shares underlying our Series B Preferred Stock and common stock during the six months ended June 30, 2015 and 2014:

| Quarter Ended  | Dividends Declared per Share |   |              |
|----------------|------------------------------|---|--------------|
|                | Series A Preferred Stock     | Series B Preferred Stock (Per Depositary Share) | Common Stock |
| June 30, 2015  | \$0.50000                    | \$0.484375                                      | \$0.62       |
| March 31, 2015 | 0.50000                      | 0.484375  | 0.66         |
| Total          | \$1.00000                    | \$0.968750                                      | \$1.28       |
| June 30, 2014  | \$0.50000                    | \$0.360590                                      | \$0.65       |
| March 31, 2014 | 0.50000                      | —   | 0.65         |
| Total          | \$1.00000                    | \$0.360590                                      | \$1.30       |

The final tax characterization of our fiscal year 2015 dividends will be determined and reported to stockholders on their annual Form 1099-DIV statement after the end of the year.

#### Other Comprehensive (Loss) Income

The following table summarizes the components of our other comprehensive (loss) income for the three and six months ended June 30, 2015 and 2014 (in millions):

|   | Three Months Ended June 30, |       | Six Months Ended June 30, |         |
|---|-----------------------------|-------|---------------------------|---------|
|   | 2015                        | 2014  | 2015                      | 2014    |
| Unrealized (loss) gain on available-for-sale securities, net:   |                             |       |                           |         |
| Unrealized (loss) gain, net   | \$(894 )                    | \$812 | \$(467 )                  | \$1,315 |
| Reversal of prior period unrealized loss (gain), net, upon realization  | 22                          | (22 ) | (14 )                     | (3 )    |
| Unrealized (loss) gain on available-for-sale securities, net:   | (872 )                      | 790   | (481 )                    | 1,312   |
| Unrealized gain on interest rate swaps designated as cash flow hedges:  |                             |       |                           |         |
| Reversal of prior period unrealized loss on interest rate swaps, net, upon reclassification to interest expense | 26                          | 40    | 55                        | 83      |
| Total other comprehensive (loss) income   | \$(846 )                    | \$830 | \$(426 )                  | \$1,395 |

## LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of funds are borrowings under master repurchase agreements, equity offerings, asset sales and monthly principal and interest payments on our investment portfolio. Because the level of our borrowings can be adjusted on a daily basis, the level of cash and cash equivalents carried on our balance sheet is significantly less important than the potential liquidity available under our borrowing arrangements. We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings, maintenance of any margin requirements and the payment of cash dividends as required for our continued qualification as a REIT. To qualify as a REIT, we must distribute annually at least 90% of our taxable income. To the extent that we annually distribute all of our taxable income in a timely manner, we will generally not be subject to federal and state income taxes. We currently expect to distribute all of our taxable income in a timely manner so that we are not subject to federal and state income taxes. This distribution requirement limits our ability to retain earnings and thereby replenish or increase capital from operations.

### Debt Capital

#### Repurchase Agreements

As part of our investment strategy, we borrow against our investment portfolio pursuant to master repurchase agreements. We expect that our borrowings under such master repurchase agreements will generally have maturities ranging up to one year, but may have maturities up to five years or longer. Our leverage may vary periodically depending on market conditions and our Manager's assessment of risks and returns. We generally would expect our leverage to be within six to eleven times the amount of our stockholders' equity. However, under certain market conditions, we may operate at leverage levels outside of this range for extended periods of time.

As of June 30, 2015, we had \$45.2 billion of repurchase agreements outstanding used to fund acquisitions of agency securities and we had an additional \$5.0 billion of repurchase agreements outstanding used to fund temporary holdings of U.S. Treasury securities, which we exclude from our leverage measurements due to the highly liquid and temporary nature of these investments. Inclusive of our net TBA position, our "at risk" leverage ratio was 6.1x as of June 30, 2015, compared to 6.9x as of December 31, 2014, measured as the sum of our agency MBS borrowings (primarily consisting of our agency MBS repurchase agreements), our net TBA position (at cost) and our net receivable / payable for unsettled agency securities divided by the sum of our total stockholders' equity less the fair value of our investment in REIT equity securities as of period end. Excluding our net TBA position, our leverage ratio was 5.3x our stockholders' equity as of June 30, 2015, unchanged from December 31, 2014.

As of June 30, 2015, our agency MBS repurchase agreements had a weighted average cost of funds of 0.45% and a weighted average remaining days-to-maturity of 177 days, compared 0.41% and 143 days, respectively, as of December 31, 2014.

To limit our exposure to counterparty credit risk, we diversify our funding across multiple counterparties and by counterparty region. As of June 30, 2015, we had master repurchase agreements with 36 financial institutions located throughout North America, Europe and Asia. As of June 30, 2015, less than 5% of our stockholders' equity was at risk with any one repo counterparty, with the top five repo counterparties representing approximately 12% of our stockholders' equity. The table below includes a summary of our repurchase agreement funding by number of repo counterparties and counterparty region as of June 30, 2015. For further details regarding our borrowings under repurchase agreements and other debt as of June 30, 2015, please refer to Note 5 to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

| Counter-Party Region | June 30, 2015             |   |
|----------------------|---------------------------|---|
|                      | Number of Counter-Parties | Percent of Repurchase Agreement Funding |
| North America        | 18                        | 67%                                     |
| Asia                 | 5                         | 12%                                     |
| Europe               | 13                        | 21%                                     |
|                      | 36                        | 100%                                    |

Amounts available to be borrowed under our repurchase agreements are dependent upon lender collateral requirements and the lender's determination of the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, credit quality and liquidity conditions within the investment banking, mortgage finance and real estate industries. In addition, our counterparties apply a "haircut" to our pledged collateral, which means our collateral is valued at slightly less than market value. This haircut reflects the underlying risk of the specific collateral and protects our counterparty against a change in its value, but

conversely subjects us to counterparty risk and limits the amount we can borrow against our investment securities. Our master repurchase agreements do not specify the haircut; rather haircuts are determined on an individual repurchase transaction basis. Throughout the six months ended June 30, 2015, haircuts on our pledged collateral remained stable and as of June 30, 2015, our weighted average haircut was approximately 5% of the value of our collateral.

Under our repurchase agreements, we may be required to pledge additional assets to the repurchase agreement counterparties in the event the estimated fair value of the existing pledged collateral under such agreements declines and such counterparties demand additional collateral (a "margin call"), which may take the form of additional securities or cash. Specifically, margin calls would result from a decline in the value of our agency securities securing our repurchase agreements and prepayments on the mortgages securing such agency securities. Similarly, if the estimated fair value of our investment securities increases due to changes in interest rates or other factors, counterparties may release collateral back to us. Our repurchase agreements generally provide that the valuations for the agency MBS securing our repurchase agreements are to be obtained from a generally recognized source agreed to by the parties. However, in certain circumstances under certain of our repurchase agreements our lenders have the sole discretion to determine the value of the agency MBS securing our repurchase agreements. In such instances, our lenders are required to act in good faith in making determinations of value. Our repurchase agreements generally provide that in the event of a margin call, we must provide additional securities or cash on the same business day that a margin call is made if the lender provides us notice prior to the margin notice deadline on such day.

As of June 30, 2015, we had met all of our margin requirements and we had unrestricted cash and cash equivalents of \$1.5 billion and unpledged securities of approximately \$3.2 billion, including securities pledged to us, available to meet margin calls on our repurchase agreements and derivative instruments and for other corporate purposes.

Although we believe we will have adequate sources of liquidity available to us through repurchase agreement financing to execute our business strategy, there can be no assurances that repurchase agreement financing will be available to us upon the maturity of our current repurchase agreements to allow us to renew or replace our repurchase agreement financing on favorable terms or at all. If our repurchase agreement lenders default on their obligations to resell the underlying collateral back to us at the end of the term, we could incur a loss equal to the difference between the value of the collateral and the cash we originally received.

To help manage the adverse impact of interest rate changes on the value of our investment portfolio as well as our cash flows, we utilize an interest rate risk management strategy under which we use derivative financial instruments. In particular, we attempt to mitigate the risk of the cost of our variable rate liabilities increasing at a faster rate than the earnings of our long-term fixed rate assets during a period of rising interest rates. The principal derivative instruments that we use are interest rate swaps, supplemented with the use of interest rate swaptions, TBA securities, U.S. Treasury securities, U.S. Treasury futures contracts and other instruments. Please refer to Notes 3 and 6 to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q for further details regarding our use of derivative instruments.

Our derivative agreements typically require that we pledge/receive collateral on such agreements to/from our counterparties in a similar manner as we are required to under our repurchase agreements. Our counterparties, or the clearing agency in the case of centrally cleared interest rate swaps, typically have the sole discretion to determine the value of the derivative instruments and the value of the collateral securing such instruments. In the event of a margin call, we must generally provide additional collateral on the same business day.

Similar to repurchase agreements, our use of derivatives exposes us to counterparty credit risk relating to potential losses that could be recognized in the event that the counterparties to these instruments fail to perform their obligations under the contracts. We minimize this risk by limiting our counterparties to major financial institutions with acceptable credit ratings and by monitoring positions with individual counterparties.

Excluding centrally cleared interest rate swaps, as of June 30, 2015, our amount at risk with any counterparty related to our interest rate swap and swaption agreements was less than 1% of our stockholders' equity.

In the case of centrally cleared interest rate swap contracts, we could be exposed to credit risk if the central clearing agency or a clearing member defaults on its respective obligation to perform under the contract. However, we believe that the risk is minimal due to the exchange's initial and daily mark to market margin requirements and a

clearinghouse guarantee fund and other resources that are available in the event of a clearing member default.

**TBA Dollar Roll Transactions**

TBA dollar roll transactions represent a form of off-balance sheet financing accounted for as derivative instruments and we may use them as a means of leveraging (or deleveraging) our investment portfolio through the use of long (or short) TBA contracts. (See Notes 3 and 6 to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q). Inclusive of our net TBA position, as of June 30, 2015, our total "at risk" leverage was 6.1 times our stockholders' equity.

Under certain market conditions, it may be uneconomical for us to roll our TBA contracts into future months and we may need to take or make physical delivery of the underlying securities. If we were required to take physical delivery to settle a long TBA contract, we would have to fund our total purchase commitment with cash or other financing sources and our liquidity position could be negatively impacted. As of June 30, 2015, we had a net long TBA position with a market value and a total contract price of \$7.1 billion and a total net carrying value of \$(46) million recognized in derivative assets/(liabilities), at fair value on our consolidated balance sheets in this Quarterly Report on Form 10-Q.

Our TBA dollar roll contracts are also subject to margin requirements governed by the Mortgage-Backed Securities Division ("MBSD") of the Fixed Income Clearing Corporation and by our prime brokerage agreements, which may establish margin levels in excess of the MBSD. Such provisions require that we establish an initial margin based on the notional value of the TBA contract, which is subject to increase if the estimated fair value of our TBA contract or the estimated fair value of our pledged collateral declines. The MBSD has the sole discretion to determine the value of our TBA contracts and of the pledged collateral securing such contracts. In the event of a margin call, we must generally provide additional collateral on the same business day.

Settlement of our TBA obligations by taking delivery of the underlying securities as well as satisfying margin requirements could negatively impact our liquidity position. However, since we do not use TBA dollar roll transactions as our primary source of financing, we believe that we will have adequate sources of liquidity to meet such obligations.

#### Federal Home Loan Bank Membership

In April 2015, our wholly-owned captive insurance subsidiary, Old Georgetown Insurance Co., LLC ("AGNC Captive"), was approved as a member of the Federal Home Loan Bank ("FHLB") of Des Moines. The 12 regional FHLBs provide a variety of products and services to their members, including long-term and short-term secured loans, called "advances." FHLB members may use a variety of real estate related assets, including agency MBS, as collateral for such advances. Membership in the FHLB obligates AGNC Captive to purchase membership stock and activity-based stock in the FHLB, the latter dependent upon the aggregate amount of advances obtained from the FHLB.

The ability to borrow from the FHLB is subject to our subsidiary's continued creditworthiness, pledging of sufficient eligible collateral to secure advances, and compliance with certain agreements with the FHLB. Each advance requires approval by the FHLB and is secured by collateral in accordance with the FHLB's credit and collateral guidelines, as may be revised from time to time by the FHLB.

FHLB advances collateralized by agency MBS typically require higher effective "haircuts" than those required under our current repurchase agreements due to the combination of slightly higher haircuts implemented by the FHLB of Des Moines and the requirement to acquire activity-based stock in the FHLB concurrent with such borrowings. The FHLBs also determine the fair value of the securities pledged as collateral and retain the right to adjust collateral haircuts during the term of secured borrowings. Furthermore, there is uncertainty regarding the continued membership eligibility of captive insurance subsidiaries to the FHLBs. Consequently, we do not currently anticipate FHLB advances to serve as a primary source of funding for our investment portfolio.

In September 2014, the Federal Housing Financing Authority ("FHFA") issued a Notice of Proposed Rulemaking and Request for Comments Involving Proposed Changes to Regulations Concerning Federal Home Loan Bank Membership Criteria (the "Proposed Rule"). If enacted, the Proposed Rule, among other things, would immediately terminate the membership of captive insurance companies that became members of the FHLB system after publication of the Proposed Rule, which would include AGNC Captive. If AGNC Captive's membership in the FHLB were



terminated, the FHLB would have up to five years to redeem the FHLB stock that AGNC Captive purchased and owns as the result of its membership and level of FHLB activity. In addition, if such membership were terminated, AGNC Captive could be required to immediately unwind any outstanding debt advances from the FHLB. It is unclear at this point whether the Proposed Rule will be enacted in its current form. The ultimate content of any rule enacted by FHFA with respect to captive insurance company membership in FHLBs, FHLB advance requirements or standards, or similar matters could have a material impact on AGNC Captive's ability to procure funding through the FHLB, which could cause us to experience losses and could have a material adverse effect on our business to the extent of our reliance on FHLB advances.

#### Asset Sales and TBA Eligible Securities

We maintain a portfolio of highly liquid agency MBS securities. We may sell our agency MBS securities through the TBA market by delivering securities into TBA contracts for the sale of agency securities, subject to "good delivery" provisions promulgated by the Securities Industry and Financial Markets Association ("SIFMA"). We may alternatively sell agency MBS securities that have more unique attributes on a specified basis when such securities trade at a premium over generic TBA securities or if the securities are not otherwise eligible for TBA delivery. Since the TBA market is the second most liquid market (second to the U.S. Treasury market), maintaining a significant level of agency MBS securities eligible for TBA delivery enhances our liquidity profile and provides price support for our TBA eligible securities at or above generic TBA prices. As of June 30, 2015, approximately 92% of our fixed rate agency MBS portfolio was eligible for TBA delivery.

#### Equity Capital

To the extent we raise additional equity capital through follow-on equity offerings, through our at-the-market offering program or under our dividend reinvestment and direct stock purchase plan, we may use cash proceeds from such transactions to purchase additional investment securities, to make scheduled payments of principal and interest on our repurchase agreements and for other general corporate purposes. There can be no assurance, however, that we will be able to raise additional equity capital at any particular time or on any particular terms.

#### Common Stock Repurchase Program

Our Board of Directors adopted a program that authorizes repurchases of our common stock through December 31, 2015, up to a specified amount. Shares of our common stock may be purchased in the open market, including through block purchases, or through privately negotiated transactions, or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended. The timing, manner, price and amount of any repurchases will be determined at our discretion and the program may be suspended, terminated or modified at any time for any reason. Among other factors, we intend to only consider repurchasing shares of our common stock when the purchase price is less than our estimate of our current net asset value per common share. Generally, when we repurchase our common stock at a discount to our net asset value, the net asset value of our remaining shares of common stock outstanding increases. In addition, we do not intend to repurchase any shares from directors, officers or other affiliates. The program does not obligate us to acquire any specific number of shares, and all repurchases will be made in accordance with Rule 10b-18, which sets certain restrictions on the method, timing, price and volume of stock repurchases. During the three and six months ended June 30, 2015, we repurchased approximately 4.0 million shares of our common stock at an average repurchase price of \$19.86 per share, including expenses, totaling \$79 million. As of June 30, 2015, the total remaining amount authorized for repurchases of our common stock was \$913 million.

#### Off-Balance Sheet Arrangements

As of June 30, 2015, 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 June 30, 2015, we had not guaranteed any obligations of unconsolidated entities or entered into any commitment or intent to provide funding to any such entities.

#### FORWARD-LOOKING STATEMENTS

This document contains "forward-looking statements" (within the meaning of the Private Securities Litigation Reform Act of 1995) that inherently involve risks and uncertainties. Our actual results and liquidity can differ materially from those anticipated in these forward-looking statements because of changes in the level and composition of our investments and other factors. These factors may include, but are not limited to, changes in general economic conditions, the availability of suitable investments from both an investment return and regulatory perspective, the availability of new investment capital, fluctuations in interest rates and levels of mortgage prepayments, deterioration in credit quality and ratings, the effectiveness of risk management strategies, the impact of leverage, liquidity of

secondary markets and credit markets, increases in costs and other general competitive factors.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the exposure to loss resulting from changes in market factors such as interest rates, foreign currency exchange rates, commodity prices and equity prices. The primary market risks that we are exposed to are interest rate risk, prepayment risk, spread risk, liquidity risk, extension risk and counterparty credit risk.

## Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control.

Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities, by affecting the spread between our interest-earning assets and interest-bearing liabilities.

Changes in the level of interest rates can also affect the rate of prepayments of our securities and the value of the agency securities that constitute our investment portfolio, which affects our net income and ability to realize gains from the sale of these assets and impacts our ability and the amount that we can borrow against these securities.

We may utilize a variety of financial instruments in order to limit the effects of changes in interest rates on our operations. The principal instruments that we use are interest rate swaps and swaptions. We also utilize TBA contracts as well as U.S. Treasury securities and U.S. Treasury futures contracts, primarily through short sales. We may also purchase or write put or call options on TBA securities and we may invest in mortgage derivatives, such as interest and principal-only securities, and other types of derivative instruments. Derivative instruments may expose us to certain risks, including the risk that losses on a hedge position will reduce the funds available for payments to holders of our common stock and that the losses may exceed the amount we invested in the instruments.

Our profitability and the value of our investment portfolio (including derivatives used for hedging purposes) may be adversely affected during any period as a result of changing interest rates including changes in the forward yield curve.

Primary measures of an instrument's price sensitivity to interest rate fluctuations are its duration and convexity. The duration of our investment portfolio changes with interest rates and tends to increase when rates rise and decrease when rates fall. This "negative convexity" generally increases the interest rate exposure of our investment portfolio in excess of what is measured by duration alone.

We estimate the duration and convexity of our portfolio using both a third-party risk management system and market data. We review the duration estimates from the third-party model and may make adjustments based on our Manager's judgment. These adjustments are intended to, in our Manager's opinion, better reflect the unique characteristics and market trading conventions associated with certain types of securities.

The table below quantifies the estimated changes in net interest income (including periodic interest costs on our interest rate swaps) and the estimated changes in the fair value of our investment portfolio (including derivatives and other securities used for hedging purposes) and in our net asset value as of June 30, 2015 and December 31, 2014 should interest rates go up or down by 50 and 100 basis points, assuming instantaneous parallel shifts in the yield curve and including the impact of both duration and convexity.

All changes in income and value in the table below are measured as percentage changes from the base interest rate scenario. The base interest rate scenario assumes interest rates and prepayment projections as of June 30, 2015 and December 31, 2014. We apply a floor of 0% for the down rate scenarios on our interest bearing liabilities and the variable leg of our interest rate swaps, such that any hypothetical interest rate decrease would have a limited positive impact on our funding costs beyond a certain level.

Actual results could differ materially from estimates, especially in the current market environment. To the extent that these estimates or other assumptions do not hold true, which is likely in a period of high price volatility, actual results will likely differ materially from projections and could be larger or smaller than the estimates in the table below.

Moreover, if different models were employed in the analysis, materially different projections could result. Lastly, while the table below reflects the estimated impact of interest rate changes on a static portfolio, we actively manage our portfolio and we continuously make adjustments to the size and composition of our asset and hedge portfolio.

# Interest Rate Sensitivity <sup>1</sup>

| Change in Interest Rate | Percentage Change in Projected   |                                       |                                |
|-------------------------|----------------------------------|---------------------------------------|--------------------------------|
|                         | Net Interest Income <sup>2</sup> | Portfolio Market Value <sup>3,4</sup> | Net Asset Value <sup>3,5</sup> |
| As of June 30, 2015     |                                  |                                       |                                |
| -100 Basis Points       | -17.8%                           | +0.1%                                 | +0.8%                          |
| -50 Basis Points        | -6.1%                            | +0.3%                                 | +2.3%                          |
| +50 Basis Points        | +2.5%                            | -0.7%                                 | -4.6%                          |
| +100 Basis Points       | +4.8%                            | -1.5%                                 | -10.5%                         |
| As of December 31, 2014 |                                  |                                       |                                |
| -100 Basis Points       | -14.5%                           | -0.6%                                 | -4.7%                          |
| -50 Basis Points        | -3.3%                            | +0.1%                                 | +0.5%                          |
| +50 Basis Points        | +0.9%                            | -0.5%                                 | -3.8%                          |
| +100 Basis Points       | -0.4%                            | -1.2%                                 | -9.6%                          |

Interest rate sensitivity is derived from models that are dependent on inputs and assumptions provided by third parties as well as by our Manager, assumes there are no changes in mortgage spreads and assumes a static portfolio. Actual results could differ materially from these estimates.

Represents the estimated dollar change in net interest income expressed as a percent of net interest income based on asset yields and cost of funds as of such date. It includes the effect of periodic interest costs on our current pay interest rate swaps, but excludes costs associated with our other supplemental hedges, such as swaptions and U.S. Treasury securities. Also excludes costs associated with our TBA position and TBA dollar roll income/loss. Base case scenario assumes interest rates and forecasted CPR of 8% and 9% as of June 30, 2015 and December 31, 2014, respectively. As of June 30, 2015, rate shock scenarios assume a forecasted CPR of 11%, 9%, 8% and 7% for the -100, -50, +50 and +100 basis points scenarios, respectively. As of December 31, 2014, rate shock scenarios assume a forecasted CPR of 14%, 11%, 8% and 7% for such scenarios, respectively. Estimated dollar change in net interest income does not include the impact of retroactive "catch-up" premium amortization adjustments due to changes in our forecasted CPR and does not include dividend income from investments in other REITs. Down rate scenarios assume a floor of 0% for anticipated interest rates.

3. Includes the effect of derivatives and other securities used for hedging purposes.

4. Estimated dollar change in investment portfolio value expressed as a percent of the total fair value of our investment portfolio as of such date.

5. Estimated dollar change in portfolio value expressed as a percent of stockholders' equity, net of the Series A and Series B Preferred Stock liquidation preference, as of such date.

## Prepayment Risk

Because residential borrowers have the option to prepay their mortgage loans at par at any time, we face the risk that we will experience a return of principal on our investments faster than anticipated. Various factors affect the rate at which mortgage prepayments occur, including changes in the level of and directional trends in housing prices, interest rates, general economic conditions, loan age and size, loan-to-value ratio, the location of the property and social and demographic conditions. Additionally, changes to GSE underwriting practices or other governmental programs could also significantly impact prepayment rates or expectations. Also, the pace at which the loans underlying our securities become seriously delinquent or are modified and the timing of GSE repurchases of such loans from our securities can materially impact the rate of prepayments. Generally, prepayments on agency MBS increase during periods of falling mortgage interest rates and decrease during periods of rising mortgage interest rates. However, this may not always be the case.

We may reinvest principal repayments at a yield that is lower or higher than the yield on the repaid investment, thus affecting our net interest income by altering the average yield on our assets. We also amortize or accrete premiums and discounts associated with the purchase of agency MBS into interest income over the projected lives of the

securities, including contractual payments and estimated prepayments using the effective interest method. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate published prepayment data for similar agency securities, market consensus and current market conditions. If the actual prepayment experienced differs from our estimate of prepayments, we will be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income.

#### Spread Risk

When the market spread widens between the yield on our agency securities and benchmark interest rates, our net book value could decline if the value of our agency securities fall by more than the offsetting fair value increases on our hedging instruments tied to the underlying benchmark interest rates. We refer to this as "spread risk" or "basis risk." The spread risk associated with our mortgage assets and the resulting fluctuations in fair value of these securities can occur independent of changes in benchmark interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated

monetary policy actions by the Fed, market liquidity, or changes in required rates of return on different assets. Consequently, while we use interest rate swaps and other supplemental hedges to attempt to protect against moves in interest rates, such instruments typically will not protect our net book value against spread risk.

The table below quantifies the estimated changes in the fair value of our investment portfolio (including derivatives and other securities used for hedging purposes) and in our net asset value as of June 30, 2015 and December 31, 2014 should spreads widen or tighten by 10 and 25 basis points. The estimated impact of changes in spreads is in addition to our interest rate shock sensitivity included in the interest rate shock table above. The table below assumes a spread duration of 5.2 years and 5.3 years based on interest rates and MBS prices as of June 30, 2015 and December 31, 2014, respectively. However, our portfolio's sensitivity of mortgage spread changes will vary with changes in interest rates and in the size and composition of our investment portfolio. Therefore, actual results could differ materially from our estimates.

#### Spread Sensitivity of Agency MBS Portfolio <sup>1</sup>

| Change in MBS Spread    | Percentage Change in Projected        |                                |
|-------------------------|---------------------------------------|--------------------------------|
|                         | Portfolio Market Value <sup>2,3</sup> | Net Asset Value <sup>2,4</sup> |
| As of June 30, 2015     |                                       |                                |
| -25 Basis Points        | +1.4%                                 | +9.7%                          |
| -10 Basis Points        | +0.6%                                 | +3.9%                          |
| +10 Basis Points        | -0.6%                                 | -3.9%                          |
| +25 Basis Points        | -1.4%                                 | -9.7%                          |
| As of December 31, 2014 |                                       |                                |
| -25 Basis Points        | +1.3%                                 | +9.8%                          |
| -10 Basis Points        | +0.5%                                 | +3.9%                          |
| +10 Basis Points        | -0.5%                                 | -3.9%                          |
| +25 Basis Points        | -1.3%                                 | -9.8%                          |

Spread sensitivity is derived from models that are dependent on inputs and assumptions provided by third parties as well as by our Manager, assumes there are no changes in interest rates and assumes a static portfolio. Actual results could differ materially from these estimates.

2. Includes the effect of derivatives and other securities used for hedging purposes.

3. Estimated dollar change in investment portfolio value expressed as a percent of the total fair value of our investment portfolio as of such date.

4. Estimated dollar change in portfolio value expressed as a percent of stockholders' equity, net of the Series A and Series B Preferred Stock liquidation preference, as of such date.

#### Liquidity Risk

The primary liquidity risk for us arises from financing long-term assets with shorter-term borrowings through repurchase agreements. Our assets that are pledged to secure repurchase agreements are agency securities, U.S. Treasury securities and cash. As of June 30, 2015, we had unrestricted cash and cash equivalents of \$1.5 billion and unpledged securities of approximately \$3.2 billion, including securities pledged to us, available to meet margin calls on our repurchase agreements and derivative contracts and for other corporate purposes. However, should the value of our collateral or the value of our derivative instruments suddenly decrease, margin calls relating to our repurchase and derivative agreements could increase, causing an adverse change in our liquidity position. Further, there is no assurance that we will always be able to renew (or roll) our repurchase agreements. In addition, our counterparties have the option to increase our haircuts (margin requirements) on the assets we pledge, against repurchase agreements thereby reducing the amount that can be borrowed against an asset even if they agree to renew or roll the repurchase agreement. Significantly higher haircuts can reduce our ability to leverage our portfolio or even force us to sell assets, especially if correlated with asset price declines or faster prepayment rates on our assets.

In addition, we may utilize TBA dollar roll transactions as a means of investing in and financing agency mortgage-backed securities. Under certain economic conditions it may be uneconomical to roll our TBA dollar roll transactions prior to the settlement date and we could have to take physical delivery of the underlying securities and settle our obligations for cash, which could negatively impact our liquidity position, result in defaults or force us to sell assets under adverse conditions.

Extension Risk

The projected weighted-average life and estimated duration (or interest rate sensitivity) of our investments is based on our Manager's assumptions regarding the rate at which the borrowers will prepay the underlying mortgage loans. In general, we use



interest rate swaps and swaptions to help manage our funding cost on our investments in the event that interest rates rise. These swaps (or swaptions) allow us to reduce our funding exposure on the notional amount of the swap for a specified period of time by establishing a fixed rate to pay in exchange for receiving a floating rate that generally tracks our financing costs under our repurchase agreements.

However, if prepayment rates decrease in a rising interest rate environment, the average life or duration of our fixed rate assets generally extends. This could have a negative impact on our results from operations, as our interest rate swap maturities are fixed and will, therefore, cover a smaller percentage of our funding exposure on our mortgage assets to the extent that their average lives increase due to slower prepayments. This situation may also cause the market value of our fixed rate agency securities to decline by more than otherwise would be the case while most of our hedging instruments would not receive any incremental offsetting gains. In extreme situations, we may be forced to sell assets to maintain adequate liquidity, which could cause us to incur realized losses.

#### Counterparty Credit Risk

We are exposed to counterparty credit risk relating to potential losses that could be recognized in the event that the counterparties to our repurchase agreements, other debt and derivative contracts fail to perform their obligations under such agreements. The amount of assets we pledge as collateral in accordance with our agreements varies over time based on the market value and notional amount of such assets as well as the value of our derivative contracts. In the event of a default by a counterparty, we may not receive payments provided for under the terms of our agreements and may have difficulty obtaining our assets pledged as collateral under such agreements. Our credit risk related to certain derivative transactions is largely mitigated through daily adjustments to collateral pledged based on changes in market value and we limit our counterparties to major financial institutions with acceptable credit ratings. However, there is no guarantee our efforts to manage counterparty credit risk will be successful and we could suffer significant losses if unsuccessful.

#### Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934, as amended (the "Exchange Act") reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based on the definition of "disclosure controls and procedures" as promulgated under the Exchange Act and the rules and regulations thereunder. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2015. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

#### Changes in Internal Controls over Financial Reporting

There have been no changes in our "internal control over financial reporting" (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

From time to time, we may be involved in various claims and legal actions arising in the ordinary course of business. Neither we, nor any of our consolidated subsidiaries, are currently subject to any material litigation nor, to our knowledge, is any material litigation threatened against us or any consolidated subsidiary.

### Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

#### Stock Repurchase Program

The following table presents information with respect to purchases of our common stock made during the three months ended June 30, 2015 by us or any "affiliated purchaser" of us, as defined in Rule 10b-18(a)(3) under the Exchange Act (in millions, except per share amounts):

| Settlement Date    | Total Number of Shares Purchased | Average Net Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>1</sup> | Maximum Number of Shares That May Yet Be Purchased Under the Publicly Announced Plans or Programs |
|--------------------|----------------------------------|----------------------------------|---|---|
| June 12 - 17, 2015 | 4.0                              | \$19.86                          | 4.0   | N/A   |

<sup>1</sup> All shares were purchased by us pursuant to the stock repurchase program described in Note 9 of our accompanying Consolidated Financial Statements in this Form 10-Q.

### Item 3. Defaults upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None.

### Item 6. Exhibits and Financial Statement Schedules

#### (a) Exhibit Index

Edgar Filing: American Capital Agency Corp - Form 10-Q

Exhibit No. Description

- \*3.1 American Capital Agency Corp. Amended and Restated Certificate of Incorporation, as amended, incorporated herein by reference to Exhibit 3.1 of Form 10-Q for the quarter ended March 31, 2012 (File No. 001-34057), filed May 9, 2012.
- \*3.2 American Capital Agency Corp. Second Amended and Restated Bylaws, as amended, incorporated herein by reference to Exhibit 3.2 of Form 10-K for the year ended December 31, 2011 (File No. 001-34057), filed February 23, 2012.
- \*3.3 Certificate of Designations of 8.000% Series A Cumulative Redeemable Preferred Stock, incorporated herein by reference to Exhibit 3.1 of Form 8-K (File No 001-34057), filed April 3, 2012.
- \*3.4 Certificate of Designations of 7.750% Series B Cumulative Redeemable Preferred Stock, incorporated herein by reference to Exhibit 3.3 to Form 8-A (File No. 001-34057), filed May 7, 2014.
- \*4.1 Instruments defining the rights of holders of securities: See Article IV of our Amended and Restated Certificate of Incorporation, as amended, incorporated herein by reference to Exhibit 3.1 of Form 10-Q for the quarter ended March 31, 2012 (File No. 001-34057), filed May 9, 2012.
- \*4.2 Instruments defining the rights of holders of securities: See Article VI of our Second Amended and Restated Bylaws, as amended, incorporated herein by reference to Exhibit 3.2 of Form 10-K for the year ended December 31, 2011 (File No. 001-34057), filed February 23, 2012.
- \*4.3 Form of Certificate for Common Stock, incorporated herein by reference to Exhibit 4.1 to Amendment No. 4 to the Registration Statement on Form S-11 (Registration No. 333-149167), filed May 9, 2008.
- \*4.4 Specimen 8.000% Series A Cumulative Redeemable Preferred Stock Certificate, incorporated herein by reference to Exhibit 4.1 of Form 8-K (File No. 001-34057), filed April 3, 2012.
- \*4.5 Specimen 7.750% Series B Cumulative Redeemable Preferred Stock Certificate, incorporated herein by reference to Exhibit 4.1 to Form 8-A (File No. 001-34057), filed May 7, 2014.
- \*4.6 Deposit Agreement, dated May 8, 2014, among American Capital Agency Corp., Computershare Inc. and Computershare Trust Company, N.A., jointly as depositary, incorporated herein by reference to Exhibit 4.2 to Form 8-K (File No. 001-34067), filed May 8, 2014.
- \*4.7 Form of Depositary Receipt, incorporated herein by reference to Exhibit 4.3 to Form 8-K (File No. 001-34067), filed May 8, 2014.
- 31.1 Certification of CEO Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of CFO Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
- 32 Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS\*\* XBRL Instance Document

101.SCH\*\* XBRL Taxonomy Extension Schema Document

101.CAL\*\* XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB\*\* XBRL Taxonomy Extension Labels Linkbase Document

101.PRE\*\* XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF\*\* XBRL Taxonomy Extension Definition Linkbase Document

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\* Previously filed

\*\* This exhibit is being furnished rather than filed, and shall not be deemed incorporated by reference into any filing, in accordance with Item 601 of Regulation S-K

(b) Exhibits

See the exhibits filed herewith.

(c) Additional financial statement schedules

NONE

SIGNATURES

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

AMERICAN CAPITAL AGENCY CORP.

By: /s/ MALON WILKUS  
Malon Wilkus  
Chair of the Board of Directors and  
Chief Executive Officer

Date: August 5, 2015