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Cc: Drozdowski, Sara S <[REDACTED]>; Groobey, Carolyn <[REDACTED]>
Subject: CONFIDENTIAL: Cambridge Summary
Attach: Highlights from the Cambridge SMG offsite.doc; Cambridge pyramid summary for EC only.ppt; Cambridge pyramid summary for SMG.ppt

TO: Executive Committee

The summary of Cambridge, which Carolyn discussed at today's Executive Committee meeting, is attached. Two version of the "pyramid" are included as well – a version for the EC only and one for distribution to the entire senior management group. Each is labeled accordingly.

Please let us know by first thing Monday morning if you have any comments to the memo or pyramid. Carolyn plans to distribute the two documents at the 8:30 SMG meeting.

Thanks,
Gary

P.S. To print a hard-copy of the pyramid, it is necessary to do so on 11x17 paper.

Highlights from the Cambridge Senior Management Group Offsite

Thanks to all of you for your participation in our Senior Management Group (SMG) offsite at Cambridge and for the hours many of you spent preparing ahead of time. While the weather didn't cooperate (sorry to you golfers), the meeting was very productive and gave us an opportunity to spend time connecting with our colleagues, many of who are new SVPs or new to Fannie Mae.

This memo documents and the attachment document what we accomplished, the key take-aways from our sessions, the open issues to address, and Corporate Strategy's next steps.

1. What we accomplished

Our meeting in Cambridge was an important milestone in developing our reintroduction plan, the components of which include strategy, performance, culture, and positioning (the "iron triangle" illustrated at the January officers' meeting). At this meeting, we discussed the key elements of our strategy and the resultant financial performance. We also had the opportunity to explore some new ideas to meet our liquidity and affordable housing missions (e.g., reverse mortgage products and a new "buy all loans" front-end to the business.) Most importantly, we created an open, honest, and constructive forum for questions and debate. There were more good questions than we had time to answer. That's a good sign that our culture is changing. As Dan encouraged, let's replicate that forum with our staffs here.

To synthesize the overall strategy, we created a pyramid with the key points for each of the building blocks. You may recall seeing it in the back of the room. We've documented this pyramid and have used it to capture the key discussion points and next steps we discussed at Cambridge. It is included with this summary and as well as a pared down version that you can use to communicate the results of the meeting with your department (both require printing on 11x17 paper).

2. Key take-aways

There was so much discussed at Cambridge, it's hard to boil it down. But the following points give the highlights:

New business model and growth initiatives

- ¶ Fannie Mae's business model and performance will increasingly be driven by the guaranty businesses (Single Family and Housing and Community Development) as our portfolio shifts to a market value model.
- ¶ Each of the three business units is pursuing initiatives that generate attractive returns and improve market relevance. As they pursue new business opportunities, each is putting in place the necessary controls and infrastructure.

- Single Family's strategy is to say "yes" to our customers by increasing purchases of sub-prime and Alt-A loans, reducing "cut outs", and implementing new customer strategies.
- Housing and Community Development (HCD) is creating a more dynamic approach to the Multifamily business and growing the commercial housing equity and small loans businesses. Acquisition, development, and construction lending will require further discussion with OFHEO and HUD.
- Growth in Capital Markets is more strategic – value portfolio – resulting in both buying and selling assets and purchasing of new asset classes. They will maintain their returns.
- We discussed additional growth ideas that warrant further exploration: a new acquisitions method to "buy all loans", new reverse mortgage products, and an approach to accelerate the transformation of communities.

Modest GAAP results, but positive economic returns and capital generation

- ¶ Despite the income contributions from new business initiatives, our GAAP net income will grow only 5% annually, from 2006 to 2010, due to low growth of the portfolio and a significant reduction in net interest margin. The biggest effect will be felt between 2006 and 2007.
- ¶ The businesses all earn more than their cost of capital and, thus, generate positive economic returns and contribute to an increase in company value over time.
- ¶ With the current 30% capital surcharge, we are holding twice as much regulatory capital as economic capital. This surplus reduces our overall corporate return to 8 percent, though the businesses earn more than 12 percent.
- ¶ As our businesses generate more cash over time, our excess capital grows significantly. We will need to determine how to distribute this excess capital (e.g., through share repurchase or dividends).

Solid plans to remediate operational deficiencies and build new capabilities

- The Chief Risk Officer will build out the corporate risk functions and work with the businesses to develop an approach to both enable growth and ensure the necessary controls are in place.
- Operations and Technology (O&T) outlined a three-pronged approach to supporting the business strategies – cleaning up what is broken, enabling the business short term, and building the "end state". The O&T organization is being redesigned to better support the businesses and company priorities.

- Human Resources/Talent identified new themes needed to help grow the employee base and support the strategy: 1) a recruiting factory; 2) redesigned on-boarding process; 3) differentiated treatment of high performers and low performers; and, 4) improved career paths.
- Our credit-guaranty pricing remains too conservative (e.g., safety margins are layered on multiple times) and is being addressed through the newly created Business Analysis and Decisions group.

3. Open issues to address

In the course of our discussions, we raised issues that we agreed to take offline and address. These issues include:

- Sequencing HCD investments (including controls and risk management) to ensure successful execution of their strategy.
- Determining the optimal size of the portfolio required to meet our mission and maintain the liquidity of our mortgage-backed securities (MBS).
- Developing a communication strategy to explain the difference between Total Return and GAAP results.
- Scaling up the recruiting factory and overhauling the on-boarding process to streamline the hiring of new employees.
- Build the skills, processes, and organization to capture the full value of the Risk Transformation Facility (RTF).
- Assess the impact of our plans on our ability to meet the housing goals and develop an approach toward the goals, which is consistent with the rest of our plans.

4. Next steps: Reintroduction

As we know... change, progress, more to do. Our most immediate next step is to shape this material for discussion at the Board strategic retreat July 17 and 18. Many of you have been asked to help with this next step. Thank you for that help.

Following the July Board strategic retreat, we will complete the work on elements of the reintroduction. Those elements include:

- ¶ **Strategy:** Identify next steps on new growth initiatives and create a synthesized document describing our strategy.
- ¶ **Positioning:** Shape choices and develop recommendations. NOTE: In Cambridge, we didn't have time to fully discuss our positioning strategy, so the entire SMG will be invited to participate in the next Corporate Positioning Council meeting on July 28, where we'll do this work.

¶ **Performance:** Continue our work on shareholder value-based performance metrics and determine how to make them part of the “wiring” at Fannie Mae.

¶ **Culture:** Assess where we are on our culture transformation and identify any additional steps we need to take to accelerate our progress.

Across all these elements, we will develop a roadmap that reflects our priorities and sequencing and establishes key milestones. In addition, we will put in place the program management and infrastructure to successfully drive the successful implementation of our reintroduction program.

* * *

In the meantime, if you have any questions, please don't hesitate to call me.

Regards,

Carolyn

Office of Corporate Strategy

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