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January 19, 2016

BY EMAIL & CERTIFIED MAIL

Egbert L. J. Perry, Non-Executive Chairman of the Board
Amy E. Alving
William T. Forrester
Hugh R. Frater
Brenda J. Gaines
Renee L. Glover
Frederick B. Harvey III
Robert H. Herz
Timothy J. Mayopoulos
Diane C. Nordin
Jonathan Plutzik
David H. Sidwell

Board of Directors
Federal National Mortgage Association
Office of the Secretary of the Corporation
3900 Wisconsin Avenue, NW (MS 1H 2S 05)
Washington, DC 20016-2892
board@fanniemae.com

RE: Demand for Action Concerning Improper Dividend Payments

Dear Ladies and Gentlemen of the Board:

We represent Timothy Pagliara, the beneficial owner of stock in the Federal National Mortgage Association ("Fannie Mae" or the "Company"). We write on our client's behalf to urge you, as members of the Board of Directors of the Company (the "Board" or the "Board of Directors"), to satisfy your fiduciary duty under Delaware law by taking the following steps:

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i. Publicly clarify the Board's role in declaring and paying dividends to the United States Treasury ("Treasury") on account of its senior preferred stock (the "Senior Preferred Stock");

ii. Publicly declare, for reasons detailed herein, including out of concern for the financial soundness of the Company, that the Board does not agree with the declaration and payment of dividends to Treasury on account of the Senior Preferred Stock; and

iii. Exercise your authority under Delaware law to cause the Company to immediately stop declaring and paying dividends to Treasury on account of the Senior Preferred Stock.

As you know, Fannie Mae is a federally-chartered corporation established pursuant to the Federal National Mortgage Association Charter Act (the "Charter Act"). Also as you know, it is owned by private stockholders, including our client. To the extent not inconsistent with the Charter Act and other federal law, Delaware law is the law of decision governing Fannie Mae's corporate governance practices and procedures. Fannie Mae Bylaws § 1.05. Delaware law governs the Board's ability to declare and pay dividends.

Under Delaware law, dividends are voluntary. Their declaration and payment is subject to the discretion of the Board. Section 170 of the Delaware General Corporation Law (the "DGCL") states that the "directors of every corporation . . . *may* declare and pay dividends upon the shares of its capital stock . . ." under specified circumstances. 8 *Del. C.* § 170(a) (emphasis added). The Charter Act states that Fannie Mae may make distributions, including dividends, "as may be declared by the board of directors." 12 U.S.C. §1717(c)(1). In addition, Treasury's Amended and Restated Senior Preferred Stock Certificate, executed *after* the Fannie Mae Board was reconstituted by the Federal Housing Finance Agency ("FHFA"), states that holders of such stock are only entitled to cash dividend payments "when, as and if declared by the Board of Directors, in its sole discretion, out of funds legally available therefor." Fannie Mae Amended and Restated Senior Preferred Stock Certificate of Designation ¶ 2(a).

Fannie Mae is prohibited from paying dividends to Treasury except in strict compliance with section 170 of the DGCL and Fannie Mae's corporate charter. 8 *Del. C.* § 173. Under Section 170, a Delaware corporation's board of directors may only declare and pay dividends in a manner consistent with the charter, and only out of the corporation's surplus or, if no surplus exists, the corporation's net profits. 8 *Del. C.* § 170(a). Delaware law imposes joint and several personal liability on any director of a corporation under whose administration an unlawful dividend is paid. 8 *Del. C.* § 174.

Moreover, under Delaware law, mere compliance with Section 170 is not sufficient; the Board must also comply with its fiduciary duties in declaring and paying

dividends. *See, e.g.*, *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 721 (Del. 1971). For example, Fannie Mae is prohibited from paying dividends that amount to corporate waste or are driven by improper motives. *See id.* at 722. Also, where a dividend is paid to a controlling stockholder to the detriment of other minority stockholders, as in the case of Fannie Mae's dividend payments to Treasury (the Company's controlling stockholder, a related party and FHFA's sister agency), Delaware law applies the intrinsic fairness standard to assess the board's decision to declare and pay the dividend. *See In re Primedia Inc., Deriv. Litig.*, 910 A.2d 248, 260 (Del. Ch. 2006) ("[I]n certain circumstances, when a controlling entity or stockholder causes a corporation to enter into a self-dealing transaction and controls the terms of the transaction, the business judgment rule is inapplicable[.]") (citing *Sinclair*, 280 A.2d at 720). The Board may be held liable for breach of fiduciary duty in approving such dividends. *See* 8 *Del. C.* § 174(a) ("In case of any willful or negligent violation of . . . § 173 of this title, the directors under whose administration the same may happen shall be jointly and severally liable, at any time within 6 years after paying such unlawful dividend or after such unlawful stock purchase or redemption, to the corporation . . . to the full amount of the dividend unlawfully paid . . . with interest from the time such liability accrued.").

To date, public disclosure on the Board's role in declaring and paying dividends has been far from clear. In recent years, the Board has tried to claim that it has no role in the declaration of dividends, stating that FHFA as conservator has "assumed all rights, powers, and privileges of the company, including those of the board of directors… [and] has retained certain authorities for its exclusive determination and control, as provided by federal statute, including all decisions relating to the declaration and payment of dividends to the United States Treasury." *Statement from Philip A. Laskawy, Chairman, Fannie Mae* (Mar. 2, 2014). However, when this Board was initially reconstituted by FHFA, the delegation of authority to the Board implied that the Board was delegated a role in declaring dividends, stating that the Board may take actions related to dividends (as is required under Delaware law), but must "consult with and obtain the consent of the conservator before taking . . . actions involving capital stock, dividends, [and] the Senior Preferred Stock Purchase Agreement between [Treasury and the Company]." *Fannie Mae Current Report on Form 8-K*, p. 2 (Dec. 19, 2008).

Stockholders in Fannie Mae, a publicly-traded, SEC-registered Delaware corporation, deserve to know the extent to which the Board, FHFA and others are responsible for the allocation of the Company's capital and the distribution of dividends to Treasury. For this reason, we strongly urge you to remove the cloud hanging over these decisions and publicly clarify your role in the declaration and payment of dividends.

In addition, regardless of whether the dividends have been declared and paid with Board approval or as a result of the Board's inaction, the director liability imposed on Fannie Mae directors by Delaware law for the payment of unlawful dividends is not assumed by FHFA as conservator. Several statements by FHFA and the Company have

made clear that the Board is a legally constituted board subject to Delaware law. As FHFA stated in a 2012 letter to its Inspector General regarding the decision to reconstitute the Fannie Mae Board, "FHFA views part of its 'preserve and conserve' mandate to include preserving the entities as private companies with the capacity and responsibility to make business decisions following normal corporate governance procedures." Fannie Mae has also made statements confirming that the Board was reconstituted pursuant to, and remains subject to, Delaware corporate law for corporate governance purposes, even under conservatorship. *See, e.g.*, *Fannie Mae 2014 Annual Report on Form 10*-K, p. 164 (Feb. 20, 2015).

Despite the statutory liabilities and fiduciary duties imposed on directors subject to Delaware law, there is no indication that the Fannie Mae Board has made any effort to ensure that, under its administration, the cash dividends being declared and paid by the Company to Treasury on a quarterly basis are lawful. At a minimum, the Board of Directors must confirm that there is sufficient surplus from which to make the dividend payments and that the dividends are entirely fair to the Company, do not constitute corporate waste, and have a rational business purpose. Instead, Fannie Mae's Board has seemingly resolved itself to inaction. This is never an acceptable method of satisfying one's fiduciary duty.

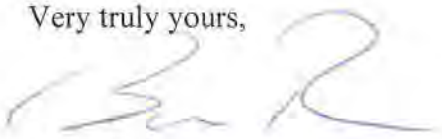
The risk to the Company is obvious. As of November 5, 2015, Fannie Mae expected to pay Treasury a voluntary cash dividend of $2.2 billion in the fourth quarter of 2015, leaving it with a net worth of only $1.8 billion. *Fannie Mae Quarterly Report on Form 10-Q*, p. 8 (Nov. 5, 2015).[1] At the same time, the Company has stated that it "could experience a net worth deficit in a future quarter, particularly as [the Company's] capital reserve approaches or reaches zero [pursuant to the terms of the Senior Preferred Stock.]" *Id.* at 14. Fannie Mae has paid out, and continues to pay out, billions of dollars in discretionary cash dividends to Treasury under this Board's administration while the contractual restraints on capital preservation imposed by the Senior Preferred Stock have left it teetering perilously on the edge of insolvency. Courts applying Delaware law have repeatedly confirmed that a director's "conscious disregard of a known risk" is a breach of his or her fiduciary duty and does not absolve such director from personal liability for failure to affirmatively consider a risk. *See, e.g.*, *In re Abbott Labs. Derivative Shareholders Litig.*, 325 F.3d 795, 811 (7th Cir. 2003). Other legal commenters have similarly noted that the payment of these dividends to Treasury "sets a horrible precedent and it violates the Housing and Economic Recovery Act of 2008 as well as traditional corporate law practices." Gretchen Morgenson, *Fannie and Freddie's Government Rescue Has Come with Claws*, N.Y. Times (Dec. 12, 2015) (quoting Logan Beirne, a fellow at the Information Society Project at Yale Law School).

[1] Fannie Mae has not yet released its 2015 Annual Report on Form 10-K confirming whether this dividend was actually paid.

Each of you, as a member of a Delaware-law governed corporate board of directors, has a duty to the Company, and to our client as a stockholder, to prevent Fannie Mae from making improperly motivated and unlawful dividend payments that threaten the Company's solvency, and you may be held personally liable for failure to do so. The Board's compliance with the wishes of FHFA and Treasury cannot absolve the Board of breaches of its fiduciary duties to the Company. *See, e.g.*, 8 *Del. C.* § 102(b)(7). As explained in our separate letter, the Board remains subject to liability for breaches of statutory and fiduciary duties despite the pendency of the conservatorship. Even if this were not so, the conservatorship will inevitably end,[2] at which time the Board will undoubtedly be subject to liability for its actions during the conservatorship.

We urge you to take your fiduciary duty as a director seriously, and to make your voice heard by publicly declaring that the Board does not agree with the payment and declaration of unlawful dividends to Treasury. Delaware law obligates directors to continue to exercise every remedy at their disposal even where a controlling stockholder holds substantial blocking rights. *See, e.g.*, *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 937 (Del. 2003) (noting that the board of directors "could not abdicate its fiduciary duties to the minority [stockholders] by leaving it to the stockholders alone to approve or disapprove [a] merger agreement [where] two stockholders had already combined to establish a majority of the voting power that made the outcome of the stockholder vote a foregone conclusion"). We also urge you to take whatever steps you have at your disposal to cause Fannie Mae to immediately cease declaring and paying dividends to Treasury.

Very truly yours,



C. Barr Flinn

CBF:KLL

cc: Brian P. Brooks, Esq. (via e-mail)

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[2] Debate in Congress recently confirmed, in connection with approving the Consolidated Appropriations Act, 2016 – Section 702, that the conservatorship has a finite duration, regardless of the Third Amendment and other developments. For example, in discussing provisions in the Consolidated Appropriations Act concerning Treasury's preferred stock, Senate Minority Leader Harry Reid noted that "As then-Secretary Paulson described, conservatorship was meant to be a 'time out' not an indefinite state of being." Banking Committee Ranking Member Sen. Sherrod Brown then added: ". . . The FHFA and Treasury Department could have placed the GSEs into receivership if the intent was to liquidate them. The purpose of a conservatorship is to preserve and conserve the assets of the entities in conservatorship until they are in a safe and solvent condition as determined by their regulator."