|  |  |  |
| --- | --- | --- |
|  |  | **UNITED STATES** |
|  |  | **SECURITIES AND EXCHANGE COMMISSION** |
|  |  | **Washington, D.C. 20549** |
|  |  | **FORM 10-K** |
| ☒ | | **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934** |
|  |  | **For the year ended December 31, 2015** |
|  |  | **OR** |
| o | | **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934** |
|  |  | **Commission file number 001-34057** |



**AMERICAN CAPITAL AGENCY CORP.**

**(Exact name of registrant as specified in its charter)**

|  |  |
| --- | --- |
| **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)** | |
| **Securities registered pursuant to section 12(b) of the Act:** |  |
|  | **Name of each exchange** |
| **Title of each class** | **on which registered** |
| **Common Stock, $0.01 par value per share** | **The NASDAQ Global Select Market** |
| **8.000% Series A Cumulative Redeemable Preferred Stock** | **The NASDAQ Global Select Market** |
| **7.750% Series B Cumulative Redeemable Preferred Stock** | **The NASDAQ Global Select Market** |

**Securities registered pursuant to section 12(g) of the Act: NONE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐ Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ☐ No ☒

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 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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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 the 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 ☒

As of June 30, 2015, the aggregate market value of the Registrant's common stock held by non-affiliates of the Registrant was approximately $5.9 billion based upon the closing price of the Registrant's common stock of $18.37 per share as reported on The NASDAQ Global Select Market on that date. (For this computation, the Registrant has excluded the market value of all shares of its common stock reported as beneficially owned by executive officers and directors of the Registrant and certain other stockholders; such an exclusion shall not be deemed to constitute an admission that any such person is an "affiliate" of the Registrant.)

The number of shares of the issuer's common stock, $0.01 par value, outstanding as of January 31, 2016 was 337,466,421.

DOCUMENTS INCORPORATED BY REFERENCE. The Registrant's definitive proxy statement for the 2016 Annual Meeting of Stockholders is incorporated by reference into certain sections of Part III herein.

Certain exhibits previously filed with the Securities and Exchange Commission are incorporated by reference into Part IV of this report.



|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **AMERICAN CAPITAL AGENCY CORP.** | | | | | | | |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **TABLE OF CONTENTS** | | | | | | | |  |  |
| **PART I.** | | |  | | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Item 1. |  | | | | | | Business |  | | | | | | | | | | | | | | | | | [2](#page3) |  |
| Item 1A. | | |  | | | | Risk Factors | | | | | | | | | | | | | | | | | | [16](#page16) | |
|  |  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Item 1B. | | |  | | | | Unresolved Staff Comments | | | | | | | | | | | | | | | | | | [34](#page35) | |
|  |  |  |  |  |  |  |  | |  | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Item 2. |  | |  | | | | Properties | |  | | | | |  | | | | | | | | | | | [34](#page35) | |
|  |  |  |  |  |  |  |  | |  | |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |
| Item 3. |  | | | | | | Legal Proceedings | | | |  | | | | | | | | | | | | | | [35](#page35) | |
|  |  |  |  |  |  |  |  | | | |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |
| Item 4. |  | | | | | | Mine Safety Disclosures | | | | | | | | | | | | | | | | | | [35](#page36) | |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **PART II.** | | | | | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Item 5. |  | | |  | | | Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities | | | | | | | | | | | | | | | | |  | [36](#page37) | |
|  |  |  |  | |  |  |  | | | |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |
| Item 6. |  | | | | | | Selected Financial Data | | | | |  | | | | | | | | | | | |  | [39](#page39) | |
|  |  |  |  | |  |  |  | | | |  |  |  | |  |  |  |  |  |  |  |  |  | |  |  |
| Item 7. |  | | | | | | Management's Discussion and Analysis of Financial Condition and Results of Operations | | | | | | | | | | | | | |  | | | | [41](#page42) | |
|  |  |  |  | |  |  |  | | | |  | |  | |  |  |  |  |  |  |  |  |  | |  |  |
| Item 7A. | | |  | | | | Quantitative and Qualitative Disclosures About Market Risk | | | | | | | | | | | | | | | | | | [68](#page68) | |
|  | |  |  | |  |  |  | | | |  | |  | |  |  |  |  |  |  | |  |  | |  |  |
| Item 8. |  | |  | | | | Financial Statements and Supplementary Data | | | | | | | | | |  | |  | | | | | | [72](#page72) | |
|  |  |  |  | |  |  |  | | | |  | |  | |  |  |  |  | |  | |  |  | |  |  |
| Item 9. |  | | | | | | Changes in and Disagreements with Accountants on Accounting and Financial Disclosure | | | | | | | | | | | | | | | | | | [107](#page107) | |
|  |  |  |  | |  |  |  | | | |  | |  | |  |  | |  | |  | |  |  | |  | |
| Item 9A. | | |  | | | | Controls and Procedures | | | | | | | | | | | | | | | | | | [107](#page108) | |
| Item 9B. | | |  | | | | Other Information | | | | |  | | | | | | | | | | | | | [107](#page108) | |
|  | |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **PART III.** | | | | | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Item 10. | | |  | | |  | Directors, Executive Officers and Corporate Governance | | | | | | | | | | | | | | | | | | [108](#page109) | |
| Item 11. | | |  | | | | Executive Compensation | | | | | | | | | | |  | | | | | | | [108](#page109) | |
|  | |  |  | |  |  |  | | | | | |  | |  |  | | | |  | | |  | |  | |
| Item 12. | | |  | | | | Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters | | | | | | | | | | | | | | | | | | [108](#page109) | |
| Item 13. | | |  | | | | Certain Relationships and Related Transactions, and Director Independence | | | | | | | | | | | | | | | |  | | [108](#page109) | |
| Item 14. | | |  | | | | Principal Accounting Fees and Services | | | | | | | |  | | | | |  | | | | | [108](#page109) | |
| **PART IV.** | | | | |  | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Item 15. | | |  | | | | Exhibits and Financial Statement Schedules | | | | | | | | |  | | | | | | | | | [109](#page110) | |
| Signatures | | | | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | [111](#page111) | |

1

**PART I.**

**Item 1. *Business***

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 other assets reasonably related to agency securities and up to 10% of our assets in AAA non-agency and commercial mortgage-backed securities (collectively referred to as "AAA non-agency MBS").

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.

**Our Investment Strategy**

Our investment strategy is designed to:

* manage an investment portfolio consisting primarily of agency securities that seeks to generate attractive risk-adjusted returns;
* capitalize on discrepancies in the relative valuations in the agency and AAA non-agency securities market;
* manage financing, interest rate, prepayment and extension risks;
* preserve our net book value;
* provide regular monthly 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").

**Our Targeted Investments**

*Agency Mortgage-Backed Securities*

The agency MBS in which we invest consist of agency residential pass-through certificates and collateralized mortgage obligations:

* ***Agency Residential Pass-Through Certificates*.**Agency residential pass-through certificates are securities representing interests in "pools" ofmortgage loans secured by residential real property. Monthly payments of principal and interest made by the individual borrowers on the mortgage loans that underlie the securities, which are guaranteed by a GSE to holders of the securities, are in effect "passed through," net of fees paid to the issuer/guarantor and servicers of the securities, to the holders of the securities. In general, mortgage pass-through certificates distribute cash flows from the underlying collateral on a pro rata basis among the holders of the securities. Holders of the securities also receive guarantor advances of principal and interest for delinquent loans in the mortgage pools.
  + ***Agency Collateralized Mortgage Obligations.*** Agency CMOs are securities that are structured instruments representing interests in agencyresidential pass-through certificates. Agency CMOs consist of multiple classes of securities, with

2

each class having specified characteristics, including stated maturity dates, weighted average lives and rules governing principal and interest distribution. Monthly payments of principal and interest, including prepayments, are typically returned to different classes based on rules described in the trust documents. Principal and interest payments may also be divided between holders of different securities in the agency CMO and some securities may only receive interest payments while others may only receive principal payments.

The agency MBS that we acquire provide funds for mortgage loans made to residential homeowners. These securities generally represent interests in pools of mortgage loans made by mortgage bankers, commercial banks, savings and loan institutions, and other mortgage lenders. These pools of mortgage loans are assembled for sale to investors, such as us, by various government-related or private organizations.

Agency MBS differ from other forms of traditional debt securities, which normally provide for periodic payments of interest in fixed amounts with principal payments at maturity or on specified call dates. Instead, agency MBS provide for a monthly payment, which may consist of both principal and interest. In addition, principal may be prepaid, without penalty, at par at any time due to prepayments on the underlying mortgage loans. These differences can result in significantly greater price and yield volatility than is the case with traditional fixed-income securities.

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 guarantee fees, 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.

When interest rates are declining, the value of agency MBS with prepayment options may not increase as much as other fixed income securities or could even decrease. The rate of prepayments on underlying mortgages affect the price and volatility of agency MBS and may have the effect of shortening or extending the duration of the security beyond what was anticipated at the time of purchase. When interest rates rise, our holdings of agency MBS may experience reduced returns if the owners of the underlying mortgages pay off their mortgages slower than anticipated. This could cause the prices of our mortgage assets to fall more than we anticipated and for our hedge portfolio to underperform relative to the decline in the value of our mortgage assets, thus reducing our net book value. This is generally referred to as "extension risk".

Agency MBS are collateralized by pools of either fixed-rate mortgage loans, adjustable-rate mortgage loans ("ARMs") or hybrid ARMs. Hybrid ARMs are mortgage loans that have interest rates that are fixed for an initial period (typically three, five, seven or 10 years) and, thereafter, reset at regular intervals subject to interest rate caps. Our allocation of investments among securities collateralized by fixed-rate mortgage loans, ARMs or hybrid ARMs depends on our assessment of the relative value of the securities, which is based on numerous factors including, but not limited to, expected future prepayment trends, supply and demand, costs of financing, costs of hedging, expected future interest rate volatility and the overall shape of the U.S. Treasury and interest rate swap yield curves.

*Fannie Mae and Freddie Mac:*

We primarily invest in Fannie Mae and Freddie Mac agency MBS. Fannie Mae and Freddie Mac are stockholder-owned corporations chartered by Congress with a public mission to provide liquidity, stability, and affordability to the U.S. housing market. Fannie Mae and Freddie Mac are currently regulated by the Federal Housing Finance Agency ("FHFA"), the U.S. Department of Housing and Urban Development ("HUD"), the U.S. Securities and Exchange Commission, and the U.S. Department of the Treasury ("U.S. Treasury") and are currently operating under the conservatorship of FHFA. The U.S. Treasury has agreed to support the continuing operations of Fannie Mae and Freddie Mac with any necessary capital contributions while in conservatorship. However, the U.S. government does not guarantee the securities, or other obligations, of Fannie Mae or Freddie Mac.

Fannie Mae and Freddie Mac operate in the secondary mortgage market. They purchase residential mortgage loans and mortgage-related securities from primary mortgage market institutions, such as commercial banks, savings and loan associations, mortgage banking companies, seller/servicers, securities dealers and other investors. Through the mortgage securitization process, they package mortgage loans into guaranteed MBS for sale to investors, such as us, in the form of pass-through certificates and guarantee the payment of principal and interest on the securities, in exchange for guarantee fees. The underlying loans must meet certain underwriting standards established by Fannie Mae and Freddie Mac (referred to as "conforming loans") and may be fixed or adjustable rate loans with original terms to maturity generally up to 40 years.

3

*Ginnie Mae:*

Ginnie Mae is a wholly-owned corporate instrumentality of the United States within HUD. Ginnie Mae guarantees the timely payment of the principal and interest on certificates that represent an interest in a pool of mortgages insured by the Federal Housing Administration ("FHA"), partially guaranteed by the Department of Veterans Affairs or otherwise eligible for inclusion in mortgage pools underlying Ginnie Mae certificates. Section 306(g) of the Housing Act provides that the full faith and credit of the United States is pledged to the payment of all amounts that may be required to be paid under any guaranty by Ginnie Mae. Ginnie Mae certificates are primarily backed by single-family mortgage loans.

*Non-Agency Mortgage-Backed Securities*

Non-agency mortgage investments in which we may invest consist of investment grade, AAA rated MBS backed by residential or commercial mortgages, for which the payment of principal and interest is not guaranteed by a GSE or government agency. Instead, a private institution such as a commercial bank will package residential or commercial mortgage loans and securitize them through the issuance of MBS. Non-agency MBS backed by residential loans are often referred to as private label MBS and MBS backed by commercial loans as CMBS. Investment grade, AAA rated non-agency MBS benefit from credit enhancements derived from structural elements, such as subordination, overcollateralization or insurance; however, they carry a higher level of credit exposure relative to agency MBS.

**Investment Methods**

We purchase mortgage securities either in initial offerings or on the secondary market through broker-dealers or similar entities. We may also utilize to-be-announced forward contracts ("TBA securities") in order to invest in agency MBS or to hedge our investments. A TBA security is a forward contract for the purchase or the sale of agency securities at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date, 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 position (referred to as a "pair off"), net settling the paired off positions for cash, and simultaneously entering into a similar TBA contract for a later settlement date, which is commonly collectively referred to as a "dollar roll" transaction.

**Our Active Portfolio Management Strategy**

Our Manager employs on our behalf an active management strategy to achieve our principal objectives of generating attractive risk-adjusted returns and preservation of our net book value. Our active management strategy primarily involves buying and selling securities in all sectors of the agency securities market, including fixed-rate agency securities, adjustable-rate agency securities, agency CMOs and options on agency securities. We may also invest in other assets reasonably related to agency securities and up to 10% of our investment portfolio in AAA non-agency securities. The specific securities in which we invest are based on our Manager's continual assessment of the relative risk-return profile of these securities and our ability to hedge a portion of our exposure to market risks. Therefore, the composition of our portfolio and hedging strategies will vary as our Manager believes changes to market conditions, risks and valuations warrant. Consequently, we may experience investment gains or losses when we sell securities that our Manager no longer believes will provide attractive risk-adjusted returns or when our Manager believes more attractive alternatives are available elsewhere in the agency or AAA non-agency securities market. We may also experience gains or losses as a result of our hedging strategies. Our leverage may also fluctuate as we pursue our active management strategy, but we generally would expect our leverage to be six to eleven times our stockholders' equity.

**Investment Committee and Investment Guidelines**

The investment committee established by our Manager consists of Messrs. Malon Wilkus, John R. Erickson, Samuel A. Flax and Thomas A. McHale, each of whom is an officer of our Manager. The role of the investment committee is to monitor the performance of our Manager with respect to our investment guidelines and investment strategy, to monitor our investment portfolio and to monitor our compliance requirements related to our intention to qualify as a REIT and to remain exempt from registration as an investment company under the Investment Company Act. The investment committee meets as frequently as it believes is required to maintain prudent oversight of our investment activities. Our Board of Directors receives an investment report and reviews our investment portfolio and related compliance with the investment guidelines on at least a quarterly basis. Our Board of Directors does not review or approve individual investments, but receives notification in the event that we operate outside of our operating policies or investment guidelines.

4

Our Board of Directors has approved the following investment guidelines:

* all of our investments (other than for hedging purposes and investments in approved broker-dealers) shall be in agency securities or in assets reasonably related to agency securities, with up to 10% of our portfolio consisting of AAA non-agency securities;
* no investment shall be made that would cause us to fail to qualify as a REIT for federal income tax purposes;
* no investment shall be made that would cause us to be regulated as an investment company under the Investment Company Act; and
* prior to entering into any proposed investment transaction with American Capital or any of its affiliates, a majority of our independent directors must approve the terms of the transaction.

The investment committee may change these investment guidelines at any time, including a change that would permit us to invest in other mortgage related investments, with the approval of our Board of Directors (which must include a majority of our independent directors). Changes to our investment guidelines do not require stockholder approval.

**Our Financing Strategy**

As part of our investment strategy, we leverage our investment portfolio to increase potential returns to our stockholders. Our primary source of financing is through short-term repurchase agreements. A repurchase transaction acts as a financing arrangement under which we effectively pledge our investment securities as collateral to secure a short-term loan. Our borrowings pursuant to these repurchase transactions generally have maturities that range from 30 days to one year, but may have maturities of fewer than 30 days or up to five or more years. Under our repurchase agreements we typically pay a floating rate based on the one, three or six month London Interbank Offered Rate, or LIBOR, plus or minus a fixed spread.

Our leverage may vary periodically depending on market conditions, our Manager's assessment of risk and returns and our ability to continue to borrow funds sufficient to fund acquisitions of mortgage securities. 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.

We had master repurchase agreements with 36 financial institutions as of December 31, 2015. The terms of the repurchase transaction borrowings under our master repurchase agreements generally conform to the terms in the standard master repurchase agreement as published by the Securities Industry and Financial Markets Association ("SIFMA") as to repayment, margin requirements and the segregation of all securities we have initially sold under the repurchase transaction. In addition, each lender typically requires that we include supplemental terms and conditions to the standard master repurchase agreement. Typical supplemental terms and conditions include changes to the margin maintenance requirements, required "haircuts," purchase price maintenance requirements, requirements that all controversies related to the repurchase agreement be litigated in a particular jurisdiction and cross default provisions. These provisions differ for each of our lenders and certain of these terms are not determined until we engage in a specific repurchase transaction.

We may also seek to obtain other sources of financing depending on market conditions. We may finance the acquisition of agency MBS by entering into TBA dollar roll transactions in which we would sell a TBA contract for current month settlement and simultaneously purchase a similar TBA contract for a forward settlement date. Prior to the forward settlement date, we may choose to roll the position out to a later date by entering into an offsetting TBA position, net settling the paired off positions for cash, and simultaneously entering into a similar TBA contract for a later settlement date. In such transactions, the TBA contract purchased for a forward settlement date is priced at a discount to the TBA contract sold for settlement/pair off 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 MBS over the roll period (interest income less implied financing cost) and is commonly referred to as "dollar roll income." Consequently, dollar roll transactions represent a form of off-balance sheet financing. In evaluating our overall leverage at risk, we consider both our on-balance and off-balance sheet financing.

5

In April 2015, our wholly-owned captive insurance subsidiary, Old Georgetown Insurance Co., LLC ("OGI"), was approved as a member of the Federal Home Loan Bank ("FHLB") of Des Moines. The FHLBs provide a variety of products and services to their members, including short and long-term secured loans, called "advances." FHLB members may use a variety of real estate related assets, including agency MBS and AAA non-agency securities, as collateral for such advances. Membership in the FHLB obligates OGI to purchase membership and activity-based stock in the FHLB, the latter dependent upon the aggregate amount of advances obtained from the FHLB. On January 12, 2016, the FHFA released its final rule on proposed changes to regulations concerning FHLB membership criteria previously issued in September 2014. The final rule terminates OGI's FHLB membership and requires repayment of all advances at the earlier of their contractual maturity dates or one year after the effective date of the final rule (February 2017).

During 2015, we formed a wholly-owned captive broker-dealer subsidiary, Bethesda Securities, LLC ("BES"). BES is currently in the regulatory application process and expects to be operational in mid-2016. BES intends to become a member of the Fixed Income Clearing Corporation ("FICC"), thereby providing us with access to additional repurchase agreement funding and TBA trade clearing capabilities. There can be no assurances that BES will be successful in receiving the regulatory approvals required to become operational or that BES will be successful in becoming a member of the FICC.

**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. Our hedging strategies are generally not designed to protect our net book value from "spread risk" (also referred to as "basis risk"). Consequently, while we use interest rate swaps and other supplemental hedges to attempt to protect our net book value against moves in interest rates, 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. Furthermore, such instruments typically will not protect our net book value against spread risk and, therefore, the value of our investment securities and our net book value could decline.

* ***Interest Rate Risk.*** We hedge a portion of our exposure to potential interest rate mismatches between the interest we earn on our longer terminvestments 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 willexperience 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 theirmortgage loans, we face the risk that a return of capital on our investment will occur slower

6

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.

* ***Spread Risk.*** Because the market spread between the yield on our investments and the yield on benchmark interest rates, such as U.S. Treasury ratesand interest rate swap rates, may increase, we are exposed to spread risk. The inherent spread risk associated with our investment 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.

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 in the TBA market on a generic 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 invest in mortgage and other types of derivative instruments, such as interest and principal-only securities.

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 (see "*Real Estate Investment Trust Requirements"*). 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.

**Other Investment Strategies**

We may enter into other short or long term investment strategies as the opportunities arise.

**Our Manager**

We are externally managed and advised by our Manager pursuant to the terms of a management agreement. Our Manager is an indirect subsidiary of American Capital Asset Management, LLC, which is a portfolio company of American Capital, Ltd., a publicly-traded private equity firm and global asset manager (NASDAQ: ACAS). American Capital both directly and through its asset management business, originates, underwrites and manages investments in middle market private equity, leveraged finance, real estate, energy & infrastructure and structured products. American Capital, founded in 1986, manages $21 billion of assets, including assets on its balance sheet and fee earning assets under management by affiliated managers, with $73 billion of total assets under management (including levered assets) as of December 31, 2015. American Capital and its affiliates operate out of seven offices in the United States and Europe.

On January 7, 2016, American Capital announced that its Board of Directors authorized American Capital to solicit offers to purchase American Capital or its various business lines, in whole or in part. American Capital has issued no further information on the status of the solicitation or the nature of any possible transaction that may result from it. Thus, while it is possible that a transaction could have an impact on us or our Manager, it is impractical to provide information on the nature of any impacts. Moreover, there is no assurance that the solicitation will result in a transaction that will have an impact on us or our Manager.

The sister company of our Manager is the external manager of American Capital Mortgage Investment Corp. (NASDAQ: MTGE) ("MTGE"), a publicly-traded REIT that invests in agency mortgage investments, non-agency mortgage investments and other mortgage related investments. In connection with our initial public offering, American Capital committed not to sponsor another investment vehicle that invests predominantly in agency securities that represent undivided beneficial interests in a group or pool of one or more mortgages, or whole-pool agency securities, for so long as we are managed by an affiliate of American Capital. Thus, MTGE's investment portfolio is expected to consist of assets that are not predominantly whole-pool agency securities for so long as we are managed by an affiliate of American Capital.

Our Manager is responsible for administering our business activities and day-to-day operations, subject to the supervision and oversight of our Board of Directors. All of our officers and the members of our mortgage investment team and other support

7

personnel, other than employees of BES, are employees of either the parent company of our Manager or American Capital. Our Manager has entered into an administrative services agreement with American Capital and the parent company of our Manager, pursuant to which our Manager has access to their employees, infrastructure, business relationships, management expertise, information technologies, capital raising capabilities, legal and compliance functions, and accounting, treasury and investor relations capabilities, to enable our Manager to fulfill all of its responsibilities under the management agreement. We are not a party to the administrative services agreement.

Malon Wilkus is our Chair and Chief Executive Officer and the Chief Executive Officer of our Manager and its parent company, American Capital Mortgage Management, LLC. Mr. Wilkus is also the Chair and Chief Executive Officer of MTGE and the Chief Executive Officer of its manager, American Capital MTGE Management, LLC. In addition, Mr. Wilkus is the Chair and Chief Executive Officer of American Capital Senior Floating, Ltd. (NASDAQ: ACSF), a publicly traded non-diversified closed-end investment management company. Mr. Wilkus is the founder of American Capital, and has served as its Chief Executive Officer and Chairman of the Board of Directors since 1986, except for the period from 1997 to 1998 during which he served as Chief Executive Officer and Vice Chairman of the Board of Directors. He also served as President of American Capital from 2001 to 2008 and from 1986 to 1999. Mr. Wilkus has also been the Chairman of European Capital Limited, a European private equity and mezzanine fund, since its formation in 2005. Additionally, Mr. Wilkus is the Chief Executive Officer and President of American Capital Asset Management, LLC, which is the asset fund management portfolio company of American Capital. He has also served on the board of directors of over a dozen middle-market companies in various industries.

Gary Kain is the President of our Manager and also serves as our President and Chief Investment Officer, with primary oversight for all of our investments. He is also the President and Chief Investment Officer of MTGE and the President of its manager. Mr. Kain joined American Capital in January 2009 as a Senior Vice President and Managing Director and has served in various other roles with American Capital and its affiliates. Prior to joining American Capital, Mr. Kain served as Senior Vice President of Investments and Capital Markets of Freddie Mac from May 2008 to January 2009. He also served as Senior Vice President of Mortgage Investments & Structuring of Freddie Mac from February 2005 to April 2008, during which time he was responsible for managing all of Freddie Mac's mortgage investment activities for its $700 billion retained portfolio. From 2001 to 2005, Mr. Kain served as Vice President of Mortgage Portfolio Strategy at Freddie Mac. From 1995 to 2001, he served as head trader in Freddie Mac’s Securities Sales & Trading Group, where he was responsible for managing all trading decisions, including REMIC structuring and underwriting, hedging all mortgage positions, income generation, and risk management. Prior to that, he served as a senior trader, responsible for managing the adjustable-rate mortgage and REMIC sectors.

John R. Erickson is our Executive Vice President and Chief Financial Officer and a member of our Board of Directors, and Executive Vice President and Treasurer of our Manager and American Capital Mortgage Management, LLC. Mr. Erickson is also the Executive Vice President and Chief Financial Officer and a member of the board of directors of MTGE and the Executive Vice President and Treasurer of its manager, American Capital MTGE Management, LLC. In addition, he is the Executive Vice President and Chief Financial Officer of American Capital Senior Floating, Ltd. and the Executive Vice President and Treasurer of American Capital Asset Management, LLC. Mr. Erickson has also served as President, Structured Finance of American Capital since 2008 and as its Chief Financial Officer since 1998. From 1991 to 1998, Mr. Erickson was the Chief Financial Officer of Storage USA, Inc., a REIT formerly traded on the New York Stock Exchange (NYSE: SUS).

Samuel A. Flax is our Executive Vice President and Secretary and a member of our Board of Directors, and Executive Vice President, Chief Compliance Officer and Secretary of our Manager and American Capital Mortgage Management, LLC. Mr. Flax is also Executive Vice President and Secretary and a member of the board of directors of MTGE and the Executive Vice President, Chief Compliance Officer and Secretary of its manager, American Capital MTGE Management, LLC. In addition, he is the Executive Vice President, Chief Compliance Officer and Secretary of American Capital Senior Floating, Ltd. and American Capital Asset Management, LLC. Mr. Flax has also served as the Executive Vice President, General Counsel, Chief Compliance Officer and Secretary of American Capital, Ltd. since January 2005. Mr. Flax was a partner in the corporate and securities practice group of the Washington, D.C. law firm of Arnold & Porter LLP from 1990 to January 2005. At Arnold & Porter LLP, he represented American Capital in raising debt and equity capital, advised the company on corporate, securities and other legal matters and represented the company in many of its investment transactions.

Peter J. Federico is the Senior Vice President and Chief Risk Officer of our Manager and also serves as our Senior Vice President and Chief Risk Officer. He is also the Senior Vice President and Chief Risk Officer of MTGE and its manager. He is primarily responsible for overseeing risk management activities for us and other funds managed by affiliates of our Manager. Mr. Federico joined the parent company of our Manager in May 2011. Prior to that, Mr. Federico served as Executive Vice President and Treasurer of Freddie Mac from October 2010 through May 2011, where he was primarily responsible for managing the company's investment activities for its retained portfolio and developing, implementing and managing risk mitigation strategies. He was also responsible for managing Freddie Mac's $1.2 trillion interest rate derivative portfolio and short and long-term debt

8

issuance programs. Mr. Federico also served in a number of other capacities at Freddie Mac, including as Senior Vice President, Asset & Liability Management, after he joined the company in 1988.

Christopher J. Kuehl is a Senior Vice President of our Manager and also serves as our Senior Vice President, Agency Portfolio Investments. He is also the Senior Vice President, Agency Portfolio Investments of MTGE and Senior Vice President of its manager. He is primarily responsible for directing purchases and sales of agency securities for us and other funds managed by affiliates of our Manager. Mr. Kuehl joined the parent Company of our Manager in August 2010. Prior to that, Mr. Kuehl served as Vice President of Mortgage Investments & Structuring of Freddie Mac, where he was primarily responsible for directing Freddie Mac's purchases, sales and structuring activities for all MBS products, including fixed-rate mortgages, ARMs and CMOs. Prior to joining Freddie Mac in 2000, Mr. Kuehl was a Portfolio Manager with TeleBanc/Etrade Bank.

**The Management Agreement**

We have entered into a management agreement with our Manager with a current term through May 20, 2016, and automatic one-year extension options thereafter. The management agreement may only be terminated by either us or our Manager without cause, as defined in the management agreement, after the completion of the current renewal term or the expiration of any automatic subsequent renewal term, provided that either party provides 180-days prior written notice of non-renewal of the management agreement. If we were not to renew the management agreement without cause, we must pay a termination fee on the last day of the applicable term, equal to three times the average annual management fee earned by our Manager during the prior 24-month period immediately preceding the most recently completed month prior to the effective date of termination. We may only not renew the management agreement with or without cause with the consent of a majority of our independent directors. Our Manager is responsible for, among other things, performing all of our day-to-day functions, determining investment criteria in conjunction with our Board of Directors, sourcing, analyzing and executing investments, asset sales and financings and performing asset management duties.

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 other comprehensive income ("OCI") (a separate component of stockholders' equity), each as computed in accordance with GAAP. There is no incentive compensation payable to our Manager pursuant to the management agreement.

In addition, we reimburse our Manager for expenses directly related to our operations incurred by our Manager, but excluding employment-related expenses of our Manager's officers and employees and any American Capital employees who provide services to us pursuant to the management agreement.

**Exemption from Regulation under the Investment Company Act**

We conduct our business so as not to become regulated as an investment company under the Investment Company Act, in reliance on the exemption provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires us to invest at least 55% of our assets in "mortgages and other liens on and interest in real estate" or "qualifying real estate interests" and at least 80% of our assets in qualifying real estate interests and "real estate-related assets." In satisfying this 55% requirement, based on pronouncements of the SEC staff, we treat agency MBS issued with respect to an underlying pool of mortgage loans in which we hold all of the certificates issued by the pool ("whole pool" securities) as qualifying real estate interests. We currently treat agency MBS in which we hold less than all of the certificates issued by the pool ("partial pool" securities) as real estate-related assets. We treat CMO securities and AAA non-agency securities as real-estate related assets.

**Real Estate Investment Trust Requirements**

We have elected to be taxed as a REIT under the Internal Revenue Code. As long as we qualify as a REIT, we generally will not be subject to federal income taxes on our taxable income to the extent that we annually distribute all of our taxable income to stockholders. We believe that we have been organized and operate in such a manner as to qualify for taxation as a REIT.

Qualification and taxation as a REIT depends on our ability to meet on a continuing basis various qualification requirements imposed upon REITs by the Internal Revenue Code. Our ability to qualify as a REIT also requires that we satisfy certain asset tests, some of which depend upon the fair market values of assets that we own directly or indirectly. Such values may not be susceptible to precise determination. Accordingly, no assurance can be given that the actual results of our operations for any taxable year will satisfy such requirements for qualification and taxation as a REIT.

*Taxation of REITs in General*

Provided that we continue to qualify as a REIT, we will generally be entitled to a deduction for dividends that we pay and, therefore, will not be subject to federal corporate income tax on our taxable income that is currently distributed to our stockholders. This treatment substantially eliminates the "double taxation" at the corporate and stockholder levels that generally results from

9

investment in a domestic corporation. In general, the income that we generate is taxed only at the stockholder level upon a distribution of dividends to our stockholders.

As a REIT, we will nonetheless be subject to federal tax under certain circumstances including the following:

* We will be taxed at regular corporate rates on any undistributed taxable income, including undistributed net capital gains.
* We may be subject to the "alternative minimum tax" on our items of tax preference, including any deductions of net operating losses.
* If we have net income from prohibited transactions, which are, in general, sales or other dispositions of inventory or property held primarily for sale to customers in the ordinary course of business, other than foreclosure property, such income will be subject to a 100% tax.
* If we should fail to satisfy the 75% gross income test or the 95% gross income test, as discussed below, but nonetheless maintain our qualification as a REIT because we satisfy other requirements, we will be subject to a 100% tax on an amount based on the magnitude of the failure, as adjusted to reflect the profit margin associated with our gross income.
* If we should violate the asset tests (other than certain *de minimis* violations) or other requirements applicable to REITs, as described below, and yet maintain our qualification as a REIT because there is reasonable cause for the failure and other applicable requirements are met, we may be subject to a penalty tax. In that case, the amount of the penalty tax will be at least $50,000 per failure, and, in the case of certain asset test failures, will be determined as the amount of net income generated by the assets in question multiplied by the highest corporate tax rate (currently 35%) if that amount exceeds $50,000 per failure.
* If we should fail to distribute during each calendar year at least the sum of (a) 85% of our REIT ordinary income for such year, (b) 95% of our REIT capital gain net income for such year, and (c) any undistributed taxable income from prior periods, we would be subject to a nondeductible 4% excise tax on the excess of the required distribution over the sum of (i) the amounts that we actually distributed, (ii) the amounts we retained and upon which we paid income tax at the corporate level and (iii) any over distributions from prior periods.
* We may be required to pay monetary penalties to the Internal Revenue Service ("IRS") in certain circumstances, including if we fail to meet record keeping requirements intended to monitor our compliance with rules relating to the composition of a REIT's stockholders, as described below in "Requirements for Qualification-General."
* A 100% tax may be imposed on transactions between us and our TRSs (as described below), that do not reflect arm's-length terms.
* If we acquire appreciated assets from a corporation that is not a REIT (i.e., a corporation taxable under subchapter C of the Internal Revenue Code) in a transaction in which the adjusted tax basis of the assets in our hands is determined by reference to the adjusted tax basis of the assets in the hands of the subchapter C corporation, we may be subject to tax on such appreciation at the highest corporate income tax rate then applicable if we subsequently recognize a gain on a disposition of any such assets during the ten-year period following their acquisition from the subchapter C corporation.
* The earnings of our subsidiaries, including our TRSs, are subject to federal corporate income tax to the extent that such subsidiaries are subchapter C corporations and are not qualified REIT subsidiaries ("QRS").

*Requirements for Qualification-General*

The Internal Revenue Code defines a REIT as a corporation, trust or association:

1. that is managed by one or more trustees or directors;
2. the beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest;
3. that would be taxable as a domestic corporation but for its election to be subject to tax as a REIT;
4. that is neither a financial institution nor an insurance company subject to specific provisions of the Internal Revenue Code;

10

1. the beneficial ownership of which is held by 100 or more persons;
2. in which, during the last half of each taxable year, not more than 50% in value of the outstanding stock is owned, directly or indirectly, by five or fewer "individuals" (as defined in the Internal Revenue Code to include specified tax-exempt entities); and
3. which meets other tests described below, including with respect to the nature of its income and assets.

The Internal Revenue Code provides that conditions (1) through (4) must be met during the entire taxable year, and that condition (5) must be met during at least 335 days of a taxable year of 12 months. Our amended and restated articles of incorporation provides restrictions regarding the ownership and transfers of our stock, which are intended to assist us in satisfying the stock ownership requirements described in conditions (5) and (6) above.

To monitor compliance with the stock ownership requirements, we generally are required to maintain records regarding the actual ownership of our stock. To do so, we must demand written statements each year from the record holders of significant percentages of our stock pursuant to which the record holders must disclose the actual owners of the stock (i.e., the persons required to include our dividends in their gross income). We must maintain a list of those persons failing or refusing to comply with this demand as part of our records. We could be subject to monetary penalties if we fail to comply with these record-keeping requirements. If a stockholder fails or refuses to comply with the demands, the stockholder will be required by U.S. Treasury regulations to submit a statement with their tax return disclosing their actual ownership of our stock and other information.

The Internal Revenue Code provides relief from violations of the REIT gross income requirements, as described below under "Income Tests," in cases where a violation is due to reasonable cause and not to willful neglect and other requirements are met, including the payment of a penalty tax that is based upon the magnitude of the violation. In addition, certain provisions of the Internal Revenue Code extend similar relief in the case of certain violations of the REIT asset requirements (see "Asset Tests" below) and other REIT requirements, again provided that the violation is due to reasonable cause and not willful neglect and other conditions are met, including the payment of a penalty tax. If we fail to satisfy any of the various REIT requirements, there can be no assurance that these relief provisions would be available to enable us to maintain our qualification as a REIT, and, if such relief provisions are available, the amount of any resultant penalty tax could be substantial.

*Effect of Taxable Subsidiaries*

In general, we may jointly elect with a subsidiary corporation, whether or not wholly-owned, to treat such subsidiary corporation as a taxable REIT subsidiary. We generally may not own more than 10% of the securities of a taxable corporation, as measured by voting power or value, unless we and such taxable corporation elect to treat such corporation as a taxable REIT subsidiary. The separate existence of a taxable REIT subsidiary or other taxable corporation is not ignored for federal income tax purposes. Accordingly, such entities generally are subject to corporate income tax on their earnings, which may reduce the cash flow that we and our subsidiaries generate in the aggregate, and may reduce our ability to make distributions to our stockholders.

For determining compliance with the "Income Tests" and "Asset Tests" applicable to REITs described below, the gross income and assets of TRSs and other taxable subsidiaries are excluded. Instead, actual dividends paid to the REIT from such taxable subsidiaries, if any, are included in the REIT's gross income tests and the value of the REIT's net investment in such entities is included in the gross asset tests. Because the gross income and assets of a TRS or other taxable subsidiary corporations are excluded in determining compliance with the REIT requirements, we may use such entities to undertake indirectly activities that the REIT rules might otherwise preclude us from doing directly or through pass-through subsidiaries. For example, we may use our TRS or other taxable subsidiary corporations to conduct activities that give rise to certain categories of income or to conduct activities that, if conducted by us directly, could be treated in our hands as non-real estate related or prohibited transactions.

We jointly elected to treat our wholly-owned subsidiary American Capital Agency TRS, LLC as a TRS.

The TRS rules limit the deductibility of interest paid or accrued by a TRS to its parent REIT to assure that the TRS is subject to an appropriate level of corporate taxation. Further, the rules impose a 100% excise tax on transactions between a TRS and its parent REIT that are not conducted on an arm's-length basis. We intend that all of our transactions with our TRSs will be conducted on an arm's-length basis.

*Disregarded Entities*

Our wholly-owned subsidiaries Bethesda Securities, LLC and Old Georgetown Insurance Co., LLC are disregarded entities for federal income tax purposes. As such, their assets, liabilities and income would generally be treated as our assets, liabilities and income for purposes of each of the below REIT qualification tests.

11

*Income Tests*

In order to continue to qualify as a REIT, we must satisfy two gross income requirements on an annual basis.

1. At least 75% of our gross income for each taxable year, excluding gross income from sales of inventory or dealer property in "prohibited transactions" and certain hedging transactions, generally must be derived from investments relating to real property or mortgages on real property, including interest income derived from mortgage loans secured by real property (including, generally, agency MBS and certain other types of mortgage-backed securities), "rents from real property," dividends received from other REITs, and gains from the sale of real estate assets (excluding nonqualified debt instruments from publically offered REITs), as well as specified income from temporary investments.
2. At least 95% of our gross income in each taxable year, excluding gross income from prohibited transactions and certain hedging transactions, must be derived from some combination of income that qualifies under the 75% gross income test described above, as well as other dividends, interest, and gains from the sale or disposition of stock or securities, which need not have any relation to real property.

Interest income constitutes qualifying mortgage interest for purposes of the 75% gross income test described above to the extent that the obligation upon which such interest is paid is secured by a mortgage on real property. If we receive interest income with respect to a mortgage loan that is secured by both real property and other property that has an aggregate value in excess of 15% of the combined value of the real and other property, and the highest principal amount of the loan outstanding during a taxable year exceeds the fair market value of the real property on the date that we acquired or originated the mortgage loan, the interest income will be apportioned between the real property and the other collateral, and our income from the arrangement will qualify for purposes of the 75% gross income test only to the extent that the interest is allocable to the real property. Even if a loan is not secured by real property, or is under secured, the income that it generates may nonetheless qualify for purposes of the 95% gross income test.

We treat our investments in agency and AAA non-agency MBS either as interests in a grantor trust or as interests in a real estate mortgage investment conduit ("REMIC") for federal income tax purposes and, therefore, treat all interest income from such investments as qualifying income for the 95% gross income test. In the case of agency MBS treated as interests in grantor trusts, we treat these as owning an undivided beneficial ownership interest in the mortgage loans held by the grantor trust. Such mortgage loans generally qualify as real estate assets to the extent that they are secured by real property. The interest on such mortgage loans is qualifying income for purposes of the 75% gross income test to the extent that the obligation is secured by real property, as discussed above. In the case of agency and AAA non-agency MBS treated as interests in a REMIC, income derived from REMIC interests is generally treated as qualifying income for purposes of the 75% gross income tests. If less than 95% of the assets of the REMIC are real estate assets, however, then only a proportionate part of our interest in the REMIC and income derived from the interest qualifies for purposes of the 75% gross income test. In addition, some REMIC securitizations include embedded interest rate swap or cap contracts or other derivative instruments that potentially could produce non-qualifying income for the holder of the related REMIC securities. We expect that substantially all of our income from our agency and AAA non-agency MBS will continue to be qualifying income for purposes of the REIT gross income tests.

We purchase and sell agency MBS through TBA contracts and recognize income or gains from the disposition of those TBAs, through dollar roll transactions or otherwise, and may continue to do so in the future. While there is no direct authority with respect to the qualification of income or gains from dispositions of TBAs as gains from the sale of real property (including interests in real property and interests in mortgages on real property) or other qualifying income for purposes of the 75% gross income test, we treat income and gains from our TBAs as qualifying income for purposes of the 75% gross income test, based on an opinion of Skadden, Arps, Slate, Meagher & Flom LLP substantially to the effect that, for purposes of the 75% REIT gross income test, any gain recognized by us in connection with the settlement of our TBA contracts should be treated as gain from the sale or disposition of the underlying agency securities. Opinions of counsel are not binding on the IRS, and no assurance can be given that the IRS will not successfully challenge the conclusions set forth in such opinions. In addition, it must be emphasized that the opinion of Skadden, Arps, Slate, Meagher & Flom LLP is based on various assumptions relating to our TBAs and is conditioned upon fact-based representations and covenants made by our management regarding our TBAs. No assurance can be given that the IRS would not assert that such income is not qualifying income. If the IRS were to successfully challenge the opinion of Skadden, Arps, Slate, Meagher & Flom LLP, we could be subject to a penalty tax or we could fail to qualify as a REIT if a sufficient portion of our income consists of income or gains from the disposition of TBAs.

We may directly or indirectly receive distributions from our TRSs or other corporations that are not REITs or qualified REIT subsidiaries. These distributions generally are treated as dividend income to the extent of the earnings and profits of the distributing corporation. Such distributions will generally constitute qualifying income for purposes of the 95% gross income test, but not for purposes of the 75% gross income test. Any dividends that we receive from a REIT, however, will be qualifying income for purposes of both the 95% and 75% gross income tests.

12

Any income or gain that we derive from instruments that hedge the risk of changes in interest rates will generally be excluded from both the numerator and the denominator for purposes of the 75% and 95% gross income test, provided that specified requirements are met, including the requirement that: the instrument is entered into during the ordinary course of our business; the instrument hedges risks associated with indebtedness issued by us that is incurred to acquire or carry "real estate assets" (as described below under "Asset Tests") or that the instrument is entered into to offset the hedging effect achieved by the original hedge upon a disposition of all or a portion of the real estate indebtedness being hedged; and the instrument is properly identified as a hedge along with the risk that it hedges within prescribed time periods. Income and gain from all other hedging transactions will not be qualifying income for either the 95% or 75% gross income test.

Under The Housing and Economic Recovery Tax Act of 2008, the Secretary of the Treasury has been given broad authority to determine whether particular items of gain or income recognized after July 30, 2008 qualify or not under the 75% and 95% gross income tests, or are to be excluded from the measure of gross income for such purposes.

*Asset Tests*

At the close of each calendar quarter, we must also satisfy four tests relating to the nature of our assets.

1. At least 75% of the value of our total assets must be represented by some combination of "real estate assets," cash, cash items, U.S. Government securities, and, under some circumstances, temporary investments in stock or debt instruments purchased with new capital. For this purpose, real estate assets include some kinds of MBS and mortgage loans, as well as interests in real property, stock of other corporations that qualify as REITs and debt instruments of publically offered REITs (limited to 25% of the value of our total assets). Assets that do not qualify for purposes of the 75% asset test are subject to the additional asset tests described below.
2. The value of any one issuer's securities that we own may not exceed 5% of the value of our total assets.
3. We may not own more than 10% of any one issuer's outstanding securities, as measured by either voting power or value. The 5% and 10% asset tests do not apply to securities of TRSs and qualified REIT subsidiaries and the 10% asset test does not apply to "straight debt" having specified characteristics and to certain other securities.
4. For tax years beginning on or before December 31, 2017, the aggregate value of all securities of all TRSs that we hold may not exceed 25% of the value of our total assets. For tax years beginning after December 31, 2017, the aggregate value of all securities of all TRSs that we hold may not exceed 20% of the value of our total assets.

We enter into sale and repurchase agreements under which we nominally sell certain of our investment securities to a counterparty and simultaneously enter into an agreement to repurchase the sold assets in exchange for a purchase price that reflects a financing charge. We believe that we would be treated for REIT asset and income test purposes as the owner of the collateral that is the subject of any such agreement notwithstanding that such agreement may transfer record ownership of the assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own such collateral during the term of the sale and repurchase agreement, in which case we could fail to qualify as a REIT.

As discussed above, we purchase and sell agency MBS through TBAs and may continue to do so in the future. While there is no direct authority with

respect to the qualification of TBAs as real estate assets or U.S. Government securities for purposes of the 75% asset test, we treat our TBAs as qualifying assets for purposes of the REIT asset tests, based on an opinion of Skadden, Arps, Slate, Meagher & Flom LLP substantially to the effect that, for purposes of the REIT asset tests, our ownership of a TBA should be treated as ownership of the underlying agency MBS. Opinions of counsel are not binding on the IRS, and no assurance can be given that the IRS will not successfully challenge the conclusions set forth in such opinions. In addition, it must be emphasized that the opinion of Skadden, Arps, Slate, Meagher & Flom LLP is based on various assumptions relating to our TBAs and is conditioned upon fact-based representations and covenants made by our management regarding our TBAs. No assurance can be given that the IRS would not assert that such assets are not qualifying assets. If the IRS were to successfully challenge the opinion of Skadden, Arps, Slate, Meagher & Flom LLP, we could be subject to a penalty tax or we could fail to qualify as a REIT if a sufficient portion of our assets consists of TBAs.

No independent appraisals have been obtained to support our conclusions as to the value of our total assets or the value of any particular security or securities. Moreover, values of some assets, including instruments issued in securitization transactions, may not be susceptible to a precise determination, and values are subject to change in the future. Furthermore, the proper classification of an instrument as debt or equity for federal income tax purposes may be uncertain in some circumstances, which could affect the application of the REIT asset requirements. Accordingly, there can be no assurance that the IRS will not contend that our interests in our subsidiaries or in the securities of other issuers will not cause a violation of the REIT asset tests.

13

If we should fail to satisfy the asset tests at the end of a calendar quarter, such a failure would not cause us to lose our REIT qualification if we

1. satisfied the asset tests at the close of the preceding calendar quarter and (2) the discrepancy between the value of our assets and the asset requirements was not wholly or partly caused by an acquisition of non-qualifying assets, but instead arose from changes in the market value of our assets. If the condition described in (2) were not satisfied, we still could avoid disqualification by eliminating any discrepancy within 30 days after the close of the calendar quarter in which it arose or by making use of relief provisions described under "*Failure to Qualify*" below.

*Annual Distribution Requirements*

In order to qualify as a REIT, we are required to distribute dividends, other than capital gain dividends, to our stockholders in an amount at least equal

to:

1. the sum of
   1. 90% of our "REIT taxable income," computed without regard to our net capital gains and the deduction for dividends paid, and
   2. 90% of our net income after tax, if any, from foreclosure property minus
2. the sum of specified items of non-cash income.

We generally must make these distributions in the taxable year to which they relate, or in the following taxable year if declared before we timely file our tax return for the year and if paid with or before the first regular dividend payment after such declaration.

To the extent that we distribute at least 90%, but less than 100%, of our "REIT taxable income," within the period described above, we will be subject to tax at the applicable corporate tax rates on the retained portion. We may elect to retain, rather than distribute, our net long-term capital gains and pay tax on such gains if required. In this case, we could elect for our stockholders to include their proportionate shares of such undistributed long-term capital gains in income, and to receive a corresponding credit for their share of the tax that we paid. Our stockholders would then increase their adjusted basis of their stock by the difference between (a) the amounts of capital gain dividends that we designated and that they include in their taxable income, minus (b) the tax that we paid on their behalf with respect to that income.

To the extent that we may have available net operating losses carried forward from prior tax years, such losses may reduce the amount of distributions that we must make in order to comply with the REIT distribution requirements. Such losses, however, will generally not affect the character, in the hands of our stockholders, of any distributions that are actually made as ordinary or capital gain dividends.

If we should fail to distribute during each calendar year at least the sum of (a) 85% of our REIT ordinary income for such year, (b) 95% of our REIT capital gain net income for such year, and (c) any undistributed taxable income from prior periods, we would be subject to a non-deductible 4% excise tax on the excess of such required distribution over the sum of (x) the amounts actually distributed, (y) the amounts of income we retained and on which we have paid corporate income tax and (z) any excess distributions over required distributions from prior periods.

It is also possible that, from time to time, we may not have sufficient cash to meet the distribution requirements due to timing differences between our actual receipt of cash and our inclusion of items in income for federal income tax purposes. For example, mortgage-backed securities that are issued at a discount generally require the accrual of taxable economic interest in advance of receipt in cash.

*Derivatives and Hedging Transactions*

We maintain a risk management strategy, under which we may use a variety of derivative instruments to hedge some of our exposure to market risks, including interest rate, prepayment and extension risk. To the extent that we enter into a hedging transaction to manage interest rate risk on indebtedness incurred to acquire or carry real estate assets, or to offset the hedging effect achieved by the original hedging transaction, and the instrument is properly identified as a hedge along with the risk it hedges within prescribed time periods, any periodic income from the instrument, or gain from the disposition of such instrument, would be excluded altogether from the 75% and 95% gross income test.

To the extent that we hedge in other situations, the resultant income may not qualify under the 75% or the 95% gross income tests. We intend to structure any hedging transactions in a manner that does not jeopardize our status as a REIT. We may conduct some of our hedging activities through our TRS, the income from which would be subject to federal and state income tax, rather than by participating in the arrangements directly.

14

*Failure to Qualify*

If we should fail to satisfy one or more requirements for REIT qualification, we may still qualify as a REIT if there is reasonable cause for the failure and not due to willful neglect and other applicable requirements are met, including completion of applicable IRS filings. It is not possible to state whether we would be entitled to the benefit of these relief provisions in all circumstances. If these relief provisions are inapplicable to a particular set of circumstances, we will not qualify as a REIT. Furthermore, if we satisfy the relief provisions and maintain our qualification as a REIT, we may be still subject to a penalty tax. The amount of the penalty tax will be at least $50,000 per failure, and, in the case of certain asset test failures, will be determined as the amount of net income generated by the assets in question multiplied by the highest corporate tax rate (currently 35%) if that amount exceeds $50,000 per failure, and, in case of income test failures, will be a 100% tax on an amount based on the magnitude of the failure, as adjusted to reflect the profit margin associated with our gross income.

If we fail to qualify for taxation as a REIT in any taxable year, and the relief provisions described above do not apply, we would be subject to federal and state income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates. We cannot deduct distributions to stockholders in any year in which we are not a REIT, nor would we be required to make distributions in such a year. In this situation, to the extent of current and accumulated earnings and profits, distributions to domestic common stockholders that are individuals, trusts and estates will generally be taxable as a qualified dividend eligible for the maximum federal tax rate of 20% provided that the shares have been held for more than 60 days during the 121 day period beginning 60 days before the ex-dividend date. For certain distributions to preferred stockholders, the relevant holding period is at least 91 days out of the 181 day period beginning 90 days before the ex–dividend date. In addition, subject to the limitations of the Internal Revenue Code, corporate distributees may be eligible for the dividends received deduction. Unless we are entitled to relief under specific statutory provisions, we would also be disqualified from re-electing to be taxed as a REIT for the four taxable years following the year during which we lost qualification. It is not possible to state whether, in all circumstances, we would be entitled to this statutory relief.

**Corporate Information**

Our executive offices are located at Two Bethesda Metro Center, 14th Floor, Bethesda, MD 20814 and our telephone number is (301) 968-9300.

We make available all of our Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports as well as our Code of Ethics and Conduct free of charge on our internet website at www.AGNC.com as soon as reasonably practical after such material is electronically filed with or furnished to the Securities and Exchange Commission ("SEC"). These reports are also available on the SEC internet website at www.sec.gov.

**Competition**

Our success depends, in large part, on our ability to acquire assets at favorable spreads over our borrowing costs. In acquiring mortgage assets, we compete with mortgage REITs, mortgage finance and specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, other lenders, governmental bodies and other entities. These entities and others that may be organized in the future may have similar asset acquisition objectives and increase competition for the available supply of mortgage assets suitable for purchase. Additionally, our investment strategy is dependent on the amount of financing available to us in the repurchase agreement market, which may also be impacted by competing borrowers. Our investment strategy will be adversely impacted if we are not able to secure financing on favorable terms, if at all.

**Employees**

We are managed by our Manager pursuant to the management agreement between our Manager and us. Prior to the formation of BES, we did not have any employees. As of December 31, 2015, BES had three employees.

15

**Item 1A. *Risk Factors***

You should carefully consider the risks described below and all other information contained in this Annual Report on Form 10-K, including our annual consolidated financial statements and the related notes thereto before making a decision to purchase our securities. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties not presently known to us, or not presently deemed material by us, may also impair our operations and performance.

If any of the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. If that happens, the trading price of our securities could decline, and you may lose all or part of your investment.

**Risks Related to Our Investing, Portfolio Management and Financing Activities**

***Our Board of Directors has approved broad investment guidelines for our Manager and will not approve each investment and financing decision made by our Manager.***

Our Manager is authorized to follow broad investment guidelines that may be amended from time to time. Our Board of Directors periodically reviews our investment guidelines and our investment portfolio but does not, and will not be required to, review all of our proposed investments on an individual basis. In conducting periodic reviews, our Board of Directors relies primarily on information provided to it by our Manager. Furthermore, our Manager may use complex strategies and transactions that may be costly, difficult or impossible to unwind if our Board of Directors determines that they are not consistent with our investment guidelines. In addition, because our Manager has a certain amount of discretion in investment, financing and hedging decisions, our Manager's decisions could result in investment returns that are substantially below expectations or that result in losses, which would materially and adversely affect our business, financial condition and results of operations.

***We may experience significant short-term gains or losses and, consequently, greater earnings volatility as a result of our active portfolio management strategy.***

Our Manager employs an active management strategy on our behalf to achieve our principal objective of preserving our net book value while generating attractive risk-adjusted returns. Our active management strategy involves buying and selling financial instruments in all sectors of the agency securities market, including fixed-rate and adjustable-rate agency securities, CMOs, mortgage-related derivatives, and other assets similar or reasonably or related to agency securities, such as AAA non-agency securities and marketable equity securities of other agency focused mortgage REITs, based on our Manager's continual assessment of the relative risk/return of those investments. Therefore, the composition of our investment portfolio will vary as our Manager believes changes to market conditions, risks and valuations warrant. Consequently, we may experience significant investment gains or losses when we sell investments that our Manager no longer believes provide attractive risk-adjusted returns or when our Manager believes more attractive alternatives are available. With an active management strategy, our Manager may be incorrect in its assessment of our investment portfolio and select an investment portfolio that could generate lower returns than a more static management strategy. Also, investors are less able to assess the changes in our valuation and performance by observing changes in the mortgage market since we may have changed our strategy and portfolio from the last publicly available data. We may also experience fluctuations in leverage as we pursue our active management strategy.

***Purchases and sales of agency mortgage-backed securities by the Federal Reserve may adversely affect the price and return associated with agency securities.***

From time to time, the Federal Reserve may engage in large scale purchases of agency MBS and U.S. Treasury securities in the private market through a competitive process, with the goal of supporting mortgage markets and promoting its monetary policy objectives. We cannot predict the impact of the Fed's actions on the prices and liquidity of agency MBS. During periods in which the Federal Reserve purchases significant volumes of agency MBS, yields on agency MBS will likely be lower, refinancing volumes will likely be higher, and market volatility will likely be considerably higher than would have been absent its large scale purchases. Further, there is also a risk that when the Fed reduces its purchases of agency MBS, or sells some or all of its holdings of agency MBS, the pricing of our agency MBS portfolio and our net book value could be adversely affected.

16

***Our strategy involves significant leverage, which increases the risk that we may incur substantial losses.***

We expect our leverage to vary with market conditions and our assessment of risk/return on investments. We incur this leverage by borrowing against a substantial portion of the market value of our assets. By incurring this leverage, we could enhance our returns. Nevertheless, this leverage, which is fundamental to our investment strategy, also creates significant risks. For example, because of our significant leverage, we may incur substantial losses if our borrowing costs increase or if the value of our investments declines.

***Failure to procure adequate repurchase agreement and other financing or to renew or replace existing repurchase agreement and other financing as it matures (to which risk we are specifically exposed due to the short-term nature of our financing arrangements we employ) would adversely affect our financial condition and results of operations.***

We use debt financing as a strategy to increase our return on equity. However, we may not be able to achieve our desired leverage ratio for a number of reasons, including the following:

* our lenders do not make repurchase or other financing agreements available to us at acceptable rates;
* lenders with whom we enter into repurchase or other financing agreements subsequently exit the market;
* our lenders require that we pledge additional collateral to cover our borrowings, which we may be unable to do; or
* we determine that the leverage would expose us to excessive risk.

Furthermore, because we rely primarily on short-term borrowings, our ability to achieve our investment objectives depends not only on our ability to borrow money in sufficient amounts and on favorable terms, but also on our ability to renew or replace on a continuous basis our maturing short-term borrowings. Additionally, on January 12, 2016, the FHFA released its final rule on changes to regulations concerning FHLB membership criteria. The final rule terminates OGI's FHLB membership and requires repayment of all advances at the earlier of their contractual maturity dates or one year after the effective date of the final rule (February 2017).

If we are not able to renew or replace maturing borrowings, we may have to sell some or all of our assets, possibly under adverse market conditions. In addition, if the regulatory capital requirements imposed on our repurchase agreement lenders change, they may be required to significantly increase the cost of the financing that they provide to us. Our lenders also may revise their eligibility requirements for the types of assets they are willing to finance or the terms of such financings, based on, among other factors, the regulatory environment and their management of perceived risk, particularly with respect to assignee liability. Consequently, we cannot assure you that any, or sufficient, financing will be available to us in the future on terms that are acceptable to us. In the event that we cannot obtain sufficient funding on acceptable terms, there may be a negative impact on the value of our common and preferred stock and our ability to make distributions on our common and preferred stock.

***An increase in our borrowing costs would adversely affect our financial condition and results of operations.***

Our borrowing costs may increase for any of the following reasons:

* short-term interest rates increase;
* the market value of our investments decreases;
* the "haircut" applied to our assets under our repurchase agreements increases;
* interest rate volatility increases; or
* the availability of financing in the market decreases.

An increase in our borrowing costs will reduce the difference, or spread, that we may earn between the yield on the investments we make and the cost of the leverage we employ to finance such investments. Moreover, due to the short-term or adjustable rate nature of the majority of our repurchase agreements used to finance our investments, our borrowing costs are particularly sensitive to increases in short-term interest rates. It is possible that due to higher borrowing costs, the spread on investments could be reduced to a point at which the profitability from investments would be significantly reduced. This would adversely affect the returns on our assets, financial condition and results of operations and could require us to liquidate certain or all of our assets.

***Differences in the stated maturity of our fixed rate assets, or in timing of interest rate adjustments on our adjustable-rate assets, and our borrowings may adversely affect our profitability.***

We rely primarily on short-term and/or variable rate borrowings to acquire fixed-rate securities with long-term maturities. In addition, we may have adjustable rate assets with interest rates that vary over time based upon changes in an objective index, such as LIBOR or the U.S. Treasury rate. These indices generally reflect short-term interest rates but these assets may not reset in a manner that matches our borrowings.

17

The relationship between short-term and longer-term interest rates is often referred to as the "yield curve." Ordinarily, short-term interest rates are lower than longer-term interest rates. If short-term interest rates rise disproportionately relative to longer-term interest rates (a "flattening" of the yield curve), our borrowing costs may increase more rapidly than the interest income earned on our assets. Because our investments generally bear interest at longer-term rates than we pay on our borrowings, a flattening of the yield curve would tend to decrease our net interest income and the market value of our investment portfolio. Additionally, to the extent cash flows from investments that return scheduled and unscheduled principal are reinvested, the spread between the yields on the new investments and available borrowing rates may decline, which would likely decrease our net income. It is also possible that short-term interest rates may exceed longer-term interest rates (a yield curve "inversion"), in which event, our borrowing costs may exceed our interest income and we could incur operating losses and our ability to make distributions to our stockholders could be hindered.

***Interest rate caps on mortgages backing our adjustable rate securities may adversely affect our profitability.***

Adjustable-rate mortgages that we may purchase or that may back securities that we purchase will typically be subject to periodic and lifetime interest rate caps. Periodic interest rate caps limit the amount an interest rate can increase during any given period. Lifetime interest rate caps limit the amount an interest rate can increase through the maturity of a mortgage loan we may purchase or that may back securities that we may purchase. Our borrowings typically will not be subject to similar restrictions. Accordingly, in a period of rapidly increasing interest rates, the interest rates paid on our borrowings could increase without limitation while caps on mortgages could limit the interest rates on our investments in ARMs. This problem is magnified for hybrid ARMs and ARMs that are not fully indexed. Further, some hybrid ARMs and ARMs may be subject to periodic payment caps on the mortgages that result in a portion of the interest being deferred and added to the principal outstanding. As a result, we may receive less cash income on hybrid ARMs and ARMs than we need to pay interest on our related borrowings. These factors could reduce our net interest income and cause us to suffer a loss.

***Declines in value of the assets in which we invest will adversely affect our financial condition and results of operations, and make it more costly to finance these assets.***

We use our investments as collateral for our financings. A decline in their value, or perceived market uncertainty about their value, could make it difficult for us to obtain financing on favorable terms or at all, or maintain our compliance with terms of any financing arrangements already in place. Any fixed-rate securities we invest in generally will be more negatively affected by increases in interest rates than adjustable-rate securities. Our investments in mortgage-related securities are recorded at fair value with changes in fair value reported in net income or other comprehensive income (a component of equity). As a result, a decline in the fair value of our mortgage-related securities could reduce both our comprehensive income and stockholders' equity. If market conditions result in a decline in the fair value of our assets it will decrease the amounts we may borrow to purchase additional mortgage-related investments, which may restrict our ability to increase our net income, and our financial condition and results of operations could be adversely affected.

***Our hedging strategies may not be successful in mitigating the risks associated with changes in interest rates.***

Subject to complying with REIT tax requirements, we employ techniques that limit, or "hedge," the adverse effects of changes in interest rates on our repurchase agreements and our net book value. In general, our hedging strategy depends on our Manager's view of our entire investment portfolio, consisting of assets, liabilities and derivative instruments, in light of prevailing market conditions. Our hedging activities are generally designed to limit certain exposures and not to eliminate them. In addition, they may be unsuccessful and we could misjudge the condition of our investment portfolio or the market. Our hedging activity will vary in scope based on the level and volatility of interest rates and principal repayments, credit market conditions, the type of assets held and other changing market conditions. Our actual hedging decisions will be determined in light of the facts and circumstances existing at the time and may differ from our currently anticipated hedging strategy. These techniques may include entering into interest rate swap agreements, interest rate swaptions, TBAs, short sales, caps, collars, floors, forward contracts, options, futures or other types of hedging transactions. We may conduct certain hedging transactions through a TRS, which may subject those transactions to federal, state and, if applicable, local income tax.

There are no perfect hedging strategies, and interest rate hedging may fail to protect us from loss. Additionally, our business model calls for accepting certain amounts of interest rate, mortgage spread, prepayment, extension and liquidity risks and other exposures and thus some risks will generally not be hedged. Alternatively, our Manager may fail to properly assess a risk to our investment portfolio or may fail to recognize a risk entirely, leaving us exposed to losses without the benefit of any offsetting hedging activities. The derivative financial instruments we select may not have the effect of reducing our risk. The nature and timing of hedging transactions may influence the effectiveness of these strategies. Poorly designed hedging strategies or improperly executed transactions could actually increase our risk and losses. In addition, hedging activities could result in losses if the event against which we hedge does not occur. For example, interest rate hedging could fail to protect us or adversely affect us because, among other things:

18

* interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;
* available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought;
* the duration of the hedge may not match the duration of the related liability;
* the amount of income that a REIT may earn from hedging transactions, other than hedging transactions that satisfy certain requirements of the Internal Revenue Code or that are done through a TRS, is limited by federal tax provisions governing REITs;
* the party owing money in the hedging transaction may default on its obligation to pay;
* the credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
* the value of our interest rate hedges declines due interest rate fluctuations, lapse of time or other factors, reducing our stockholders' equity.

Furthermore, our hedging strategies may adversely affect us because hedging activities involve costs that we incur regardless of the effectiveness of the hedging activity. Those costs may be higher in periods of market volatility, both because the counterparties to our derivative agreements may demand a higher payment for taking risks, and because repeated adjustments of our hedges during periods of interest rate changes also may increase costs. Consequently, we could incur significant hedging-related costs without any corresponding economic benefits, especially if our hedging strategies are not effective.

***Our hedging strategies are generally not designed to mitigate spread risk.***

When the market spread widens between the yield on our mortgage assets and benchmark interest rates, our net book value could decline if the value of our mortgage assets falls 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 is an inherent risk to our business and 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 Federal Reserve, 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, which could adversely affect our financial condition and results of operations.

***Changes in prepayment rates may adversely affect our profitability and are difficult to predict.***

Our investment portfolio includes securities backed by pools of mortgage loans. For securities backed by pools of mortgage loans, we receive payments, generally, from the payments that are made on these underlying mortgage loans. When borrowers prepay their mortgage loans at rates that are faster or slower than expected, it results in prepayments that are faster or slower than expected on our assets. These faster or slower than expected payments may adversely affect our profitability.

We may purchase securities that have a higher interest rate than the then prevailing market interest rate. In exchange for this higher interest rate, we may pay a premium to par value to acquire the security. In accordance with GAAP, we amortize this premium over the expected term of the security based on our prepayment assumptions. If a security is prepaid in whole or in part at a faster than expected rate, however, we must expense all or a part of the remaining unamortized portion of the premium that was paid at the time of the purchase, which would adversely affect our profitability.

We also may purchase securities that have a lower interest rate than the then prevailing market interest rate. In exchange for this lower interest rate, we may receive a discount to par value to acquire the security. We accrete this discount over the expected term of the security based on our prepayment assumptions. If a security is prepaid at a slower than expected rate, however, we must accrete the remaining portion of the discount at a slower than expected rate, which would result in a lower than expected yield on securities purchased at a discount to par.

Moreover, if prepayment rates decrease due to a rising interest rate environment, the average life or duration of our fixed-rate assets or the fixed-rate portion of our hybrid ARMs and other assets will generally extend. 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 assets collateralized by fixed rate mortgages or hybrid ARMs 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.

Although prepayment rates generally increase when interest rates fall and decrease when interest rates rise, changes in prepayment rates are difficult to predict. Prepayments can also occur when borrowers sell the property and use the sale proceeds to prepay the mortgage or when borrowers default on their mortgages and the mortgages are prepaid from the proceeds of a foreclosure sale of the property. Fannie Mae and Freddie Mac will generally, among other conditions, purchase mortgages that

19

are 120 days or more delinquent from mortgage-backed securities trusts when the cost of guarantee payments to security holders, including advances of interest at the security coupon rate, exceeds the cost of holding the nonperforming loans in their portfolios. Consequently, prepayment rates also may be affected by conditions in the housing and financial markets, which may result in increased delinquencies on mortgage loans, the government-sponsored entities cost of capital, general economic conditions and the relative interest rates on fixed and adjustable rate loans, which could lead to an acceleration of the payment of the related principal. Additionally, changes in the government-sponsored entities' decisions as to when to repurchase delinquent loans can materially impact prepayment rates.

In addition, the introduction of new government programs could increase the availability of mortgage credit to a large number of homeowners in the United States, which could impact the prepayment rates for the entire mortgage securities market, and in particular for Fannie Mae and Freddie Mac agency securities. These new programs or changes to existing programs could cause substantial uncertainty around the magnitude of changes in prepayment speeds. To the extent that actual prepayment speeds differ from our expectations, it could adversely affect our operating results.

***Market conditions may disrupt the historical relationship between interest rate changes and prepayment trends, which may make it more difficult for our Manager to analyze our investment portfolio.***

Our success depends, in part, on our Manager's ability to analyze the relationship of changing interest rates on prepayments of the mortgage loans that underlie securities we may own. Changes in interest rates and prepayments affect the market price of the assets that we purchase and any assets that we may hold at a given time. As part of our overall portfolio risk management, our Manager analyzes interest rate changes and prepayment trends separately and collectively to assess their effects on our investment portfolio. In conducting its analysis, our Manager depends on certain assumptions based upon historical trends with respect to the relationship between interest rates and prepayments under normal market conditions. Dislocations in the residential mortgage market and other developments may disrupt the relationship between the way that prepayment trends have historically responded to interest rate changes and, consequently, may negatively impact our Manager's ability to (i) assess the market value of our investment portfolio, (ii) implement our hedging strategies and (iii) implement techniques to reduce our prepayment rate volatility, which could materially adversely affect our financial condition and results of operations.

***Investments in non-agency MBS are subject to delinquency, foreclosure and related losses on the underlying mortgage loans.***

We may invest in non-agency mortgage securities for which the payment of principal and interest is not guaranteed by a GSE or government agency. Instead, a private institution such as a commercial bank will package residential or commercial mortgage loans and securitize them through the issuance of residential MBS ("RMBS") or commercial MBS ("CMBS") (collectively referred to as "non-agency MBS"). Accordingly, these securities may be subject to all of the risks of the respective underlying mortgage loans as described below. Non-agency MBS may benefit from credit enhancements derived from structural elements, such as subordination, overcollateralization or insurance, but they carry a higher level of credit exposure relative to the credit exposure of agency MBS, which could negatively impact our results from operations and financial condition.

Residential mortgage loans are secured by residential property and are subject to risks of delinquency, foreclosure and loss. The ability of a borrower to repay a loan secured by residential property is dependent upon the income or assets of the borrower. A number of factors may impair a borrower's ability to repay its loan, including: loss of employment; divorce; illness; acts of God; acts of war or terrorism; adverse changes in national and local economic and market conditions; changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of complying with such laws and regulations, fiscal policies and ordinances; costs of remediation and liabilities associated with environmental conditions such as mold; and the potential for uninsured or under-insured property losses.

Commercial mortgage loans are generally secured by multifamily or commercial property and are subject to risks of delinquency and foreclosure, and risks of loss that are greater than similar risks associated with loans made on the security of residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income producing property can be affected by, among other things: tenant mix; success of tenant businesses; property management decisions; property location and condition; competition from comparable types of properties; changes in laws that increase operating expense or limit rents that may be charged; any need to address environmental contamination at the property; the occurrence of any uninsured casualty at the property; changes in national, regional or local economic conditions or specific industry segments; declines in regional or local real estate values; declines in regional or local rental or occupancy rates; increases in interest rates; real estate tax rates and other operating expenses; changes in governmental rules, regulations and fiscal policies, including environmental legislation; acts of God, acts of war or terrorism, social unrest and civil disturbances.

20

***Actions of the U.S. Government, including the U.S. Congress, U.S. Federal Reserve, U.S. Treasury and other governmental and regulatory bodies may adversely affect our business.***

U.S. Government actions may not have a beneficial impact on the financial markets. To the extent the markets do not respond favorably to any such actions or such actions do not function as intended they could have broad adverse market implications and could negatively impact our financial condition and results of operations. New regulatory requirements, when implemented, could adversely affect the availability or terms of financing from our lender counterparties, could impose more stringent capital rules on large financial institutions, could restrict the origination of residential mortgage loans and the formation of new issuances of mortgage-backed securities and could limit the trading activities of certain banking entities and other systemically significant organizations that are important to our business. Together or individually these new regulatory requirements could materially affect on our financial condition or the results of our operations in an adverse way.

***Pursuant to the terms of borrowings under master repurchase agreements, we are subject to margin calls that could result in defaults or force us to sell assets under adverse market conditions or through foreclosure.***

We enter into master repurchase agreements with a number of financial institutions. We borrow under these master repurchase agreements to finance the assets for our investment portfolio. Pursuant to the terms of borrowings under our master repurchase agreements, a decline in the value of the collateral may result in our lenders initiating margin calls. A margin call means that the lender requires us to pledge additional collateral to re-establish the ratio of the value of the collateral to the amount of the borrowing. The specific collateral value to borrowing ratio that would trigger a margin call is not set in the master repurchase agreements and is not determined until we engage in a repurchase transaction under these agreements. Our fixed-rate collateral generally may be more susceptible to margin calls as increases in interest rates tend to affect more negatively the market value of fixed-rate securities. In addition, some collateral may be more illiquid than other instruments in which we invest, which could cause them to be more susceptible to margin calls in a volatile market environment. Moreover, collateral that prepays more quickly increases the frequency and magnitude of potential margin calls as there is a significant time lag between when the prepayment is reported (which reduces the market value of the security) and when the principal payment is actually received. If we are unable to satisfy margin calls, our lenders may foreclose on our collateral. The threat of or occurrence of a margin call could force us to sell, either directly or through a foreclosure, our collateral under adverse market conditions. Because of the leverage we expect to have, we may incur substantial losses upon the threat or occurrence of a margin call.

***Our derivative agreements expose us to margin calls that could result in defaults or force us to sell assets under adverse market conditions.***

Our derivative agreements typically require that we pledge collateral on such agreements to 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.

Furthermore, our derivative agreements may also contain cross default provisions under which a default under certain of our other indebtedness in excess of a certain threshold amount causes an event of default under the agreement. Following an event of default, we could be required to settle our obligations under the agreements at their termination values.

The threat of or occurrence of margin calls or the forced settlement of our obligations under our derivative agreements at their termination values could force us to sell, either directly or through a foreclosure, our investments under adverse market conditions. Because of the leverage we have, we may incur substantial losses upon the threat or occurrence of either of these events.

***Increasingly restrictive rules and regulations adopted by the U.S. Commodity Futures Trading Commission and regulators of other countries impose increased margin requirements and require additional operational and compliance costs, which could negatively affect our financial condition and results of operations.***

Title VII of the Dodd-Frank Act and the rules and regulations adopted and to be adopted by the U.S. Commodity Futures Trading Commission (the "CFTC") introduce a comprehensive regulatory regime for swaps (as defined in the Commodity Exchange Act, as amended). The new laws and regulations subject certain swaps to clearing and exchange trading requirements, and subject us to new burdens, including but not limited to, margin requirements, reporting, record keeping and business conduct rules. The final rules under Title VII, including those rules that have already been adopted, for both cleared and non-cleared swap transactions impose increased margin requirements and require additional operational and compliance costs that will likely affect our business and results of operations.

21

As the CFTC and regulators of other countries continue to promulgate new rules and regulations on derivatives, our derivative agreements and ability to engage in derivative transactions with certain counterparties may be adversely affected. Derivative agreements with non-U.S. counterparties are subject to increasingly restrictive local regulations similar to the Dodd-Frank Act. We are required to follow some of these local regulations or help the non-U.S. counterparties comply with these local regulations. It is possible that such regulatory requirements will result in increased costs for OTC derivative counterparties and also lead to an increase in the costs of collateral, which may have an adverse impact on our business and results of operations.

***It may be uneconomical to "roll" our TBA dollar roll transactions or we may be unable to meet margin calls on our TBA contracts, which could negatively affect our financial condition and results of operations.***

We may utilize TBA dollar roll transactions as a means of investing in and financing agency mortgage-backed securities. TBA contracts enable us 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. Prior to settlement of the TBA contract we may choose to move the settlement of the securities out to a later date by entering into an offsetting position (referred to as a "pair off"), net settling the paired off positions for cash, and simultaneously purchasing a similar TBA contract for a later settlement date, collectively referred to as a "dollar roll." The agency securities purchased for a forward settlement date under the TBA contract 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." Consequently, dollar roll transactions and such forward purchases of agency securities represent a form of off-balance sheet financing and increase our "at risk" leverage.

Under certain market conditions, TBA dollar roll transactions may result in negative carry income whereby the agency securities purchased for a forward settlement date under the TBA contract are priced at a premium to agency securities for settlement in the current month. Additionally, sales of some or all of the Fed's holdings of agency MBS or declines in purchases of agency MBS by the Fed could adversely impact the dollar roll market. Under such conditions, it may be uneconomical to roll our TBA positions prior to the settlement date and we could have to take physical delivery of the underlying securities and settle our obligations for cash. We may not have sufficient funds or alternative financing sources available to settle such obligations. In addition, pursuant to the margin provisions established by the Mortgage-Backed Securities Division ("MBSD") of the FICC we are subject to margin calls on our TBA contracts. Further, our prime brokerage agreements may require us to post additional margin above the levels established by the MBSD. Negative carry income on TBA dollar roll transactions or failure to procure adequate financing to settle our obligations or meet margin calls under our TBA contracts could result in defaults or force us to sell assets under adverse market conditions or through foreclosure and adversely affect our financial condition and results of operations.

***Defaults by lenders to our repurchase transactions on their obligations to resell the underlying collateral back to us at the end of the transaction term, declines in the value of our collateral by the end of the term or defaults by us on our obligations under the transaction will cause us to lose money on repurchase transactions.***

When we engage in a repurchase transaction, we initially transfer securities or loans to the financial institution under one of our master repurchase agreements in exchange for cash, and our counterparty is obligated to resell such assets to us at the end of the term of the transaction, which is typically from 30 days to one year, but which may have terms from one day to up to five years or more. The cash we receive when we initially sell the collateral is less than the value of that collateral, which is referred to as the "haircut." As a result, we are able to borrow against a smaller portion of the collateral that we initially sell in these transactions. Increased haircuts require us to post additional collateral. The haircut rates under our master repurchase agreements are not set until we engage in a specific repurchase transaction under these agreements. If our counterparty defaults on its obligation to resell collateral to us, we would incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). Any losses we incur on our repurchase transactions could adversely affect our earnings, and, thus, our cash available for distribution to our stockholders.

If we default on one of our obligations under a repurchase transaction, the counterparty can terminate the transaction and cease entering into any other repurchase transactions with us. In that case, we would likely need to establish a replacement repurchase facility with another financial institution in order to continue to leverage our investment portfolio and carry out our investment strategy. We may not be able to secure a suitable replacement facility on acceptable terms or at all.

Further, financial institutions providing the repurchase agreements may require us to maintain a certain amount of cash uninvested or to set aside non-leveraged assets sufficient to maintain a specified liquidity position which would allow us to satisfy our collateral obligations. As a result, we may not be able to leverage our assets as fully as we would choose, which could reduce our return on equity. If we are unable to meet these collateral obligations, our financial condition could deteriorate rapidly. Additionally, our counterparties can unilaterally choose to cease entering into any further repurchase transactions with us.

22

***Our rights under our repurchase agreements are subject to the effects of the bankruptcy laws in the event of the bankruptcy or insolvency of us or our lenders under the repurchase agreements.***

In the event of our insolvency or bankruptcy, certain repurchase agreements may qualify for special treatment under the U.S. Bankruptcy Code, the effect of which, among other things, would be to allow the lender under the applicable repurchase agreement to avoid the automatic stay provisions of the U.S. Bankruptcy Code and to foreclose on the collateral agreement without delay. In the event of the insolvency or bankruptcy of a lender during the term of a repurchase agreement, the lender may be permitted, under applicable insolvency laws, to repudiate the contract, and our claim against the lender for damages may be treated simply as an unsecured creditor. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970, or an insured depository institution subject to the Federal Deposit Insurance Act, our ability to exercise our rights to recover our assets under a repurchase agreement or to be compensated for any damages resulting from the lender's insolvency may be further limited by those statutes. These claims would be subject to significant delay and, if and when received, may be substantially less than the damages we actually incur.

***Our use of derivative agreements may expose us to counterparty risk.***

Certain hedging instruments are not traded on regulated exchanges or guaranteed by an exchange or its clearinghouse and involves risks and costs that could result in material losses. Consequently, there may not be requirements with respect to record keeping, financial responsibility or segregation of customer funds and positions. Furthermore, the enforceability of agreements underlying hedging transactions may depend on compliance with applicable statutory and commodity and other regulatory requirements and, depending on the domicile of the counterparty, applicable international requirements. Consequently, if a counterparty fails to perform under a derivative agreement we could incur a significant loss.

For example, if a swap counterparty under an interest rate swap agreement that we enter into as part of our hedging strategy cannot perform under the terms of the interest rate swap agreement, we may not receive payments due under that agreement, and, thus, we may lose any potential benefit associated with the interest rate swap. Additionally, we may also risk the loss of any collateral we have pledged to secure our obligations under these swap agreements if the counterparty becomes insolvent or files for bankruptcy. Similarly, if an interest rate swaption counterparty fails to perform under the terms of the interest rate swaption agreement, in addition to not being able to exercise or otherwise cash settle the agreement, we could also incur a loss for the premium paid for that swaption.

***Continued adverse developments in the broader residential mortgage market may adversely affect the value of our investments.***

Since 2008, the residential mortgage market in the United States has experienced a variety of unprecedented difficulties and changed economic conditions, including defaults, credit losses and liquidity concerns. Many of these conditions are expected to continue in 2016 and beyond. These factors have impacted investor perception of the risk associated with real estate related assets, including mortgage-related investments. As a result, values for these assets have experienced a certain amount of volatility. Further increased volatility and deterioration in the broader residential mortgage and MBS markets may adversely affect the performance and market value of the assets in which we invest.

The risks associated with our business may be more severe during economic recessions and are compounded by declining real estate values. Declining real estate values will likely reduce the level of new mortgage loan originations since borrowers often use appreciation in the value of their existing properties to support the purchase of additional properties. Borrowers will also be less able to pay principal and interest on loans underlying the securities in which we invest if the value of residential real estate weakens further. Any sustained period of increased payment delinquencies, foreclosures or losses could increase the rate that the GSEs buy out the delinquent loans from pools underlying the agency securities in which we invest, resulting in an increased rate of prepayments that could adversely affect our net interest income from our agency securities, which could have an adverse effect on our financial condition, results of operations and our ability to make distributions to our stockholders.

***A decrease in the volume of newly issued mortgages or an increase in investor demand for mortgages could adversely affect our ability to acquire assets that satisfy our investment objectives and generate income and pay dividends, whereas an increase in the volume of newly issued mortgages or a decrease in investor demand for mortgages could negatively affect the valuations for our investments and may adversely affect our liquidity.***

A reduction in the volume of mortgage loans originated may affect the volume of investments available to us, which could affect our ability to acquire assets that satisfy our investment objectives. An increase in the volume of mortgage loans originated may negatively impact the valuation for our investment portfolio. A negative impact on valuations of our assets could have an adverse impact on our liquidity profile in the event that we are required to post margin under our repurchase agreements, which could materially and adversely impact our business.

23

***We operate in a highly competitive market for investment opportunities and our competitors may be able to compete more effectively for investment opportunities than we can. This competition may limit our ability to acquire desirable investments in our target assets and could affect the pricing of these investments.***

A number of entities compete with us to make investments. We compete with other REITs and public and private funds, including those that may be managed by affiliates of American Capital, such as American Capital Mortgage Investment Corp., commercial and investment banks, commercial finance and insurance companies and other financial institutions. Our competitors may have greater financial, technical and marketing resources than we do. Some competitors may have a lower cost of funds than we do or access to funding sources that may not be available to us. Many of our competitors are not subject to the operating constraints associated with REIT tax compliance and maintenance of an exemption from the Investment Company Act. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which may allow them to consider a wider variety of investments and establish more relationships than we can. Furthermore, competition for investments in mortgage-related investments may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. The competitive pressures we face could have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, we may not be able to take advantage of attractive investment opportunities from time to time, and we may not be able to identify and make investments that are consistent with our investment objectives.

***We may change our targeted investments, investment guidelines and other operational policies without stockholder approval, which may adversely affect the market price of our common stock and our ability to make distributions to stockholders.***

We may change our targeted investments and investment guidelines at any time without the consent of our stockholders, which could result in our making investments that are different from, and possibly riskier than, the investments described herein. Our Board of Directors also determines our other operational policies and may amend or revise such policies, including our policies with respect to our REIT qualification, acquisitions, dispositions, operations, indebtedness and distributions, or approve transactions that deviate from these policies, without a vote of, or notice to, our stockholders. A change in our targeted investments, investment guidelines or other operational policies may increase our exposure to interest rate, spread, default, credit, prepayment, extension, liquidity and other risks as well as exposure to real estate market fluctuations, all of which could adversely affect our financial condition and our ability to make distributions to our common and preferred stockholders.

***Investments in the common stock of other publicly traded mortgage REITs expose us to incremental risks and costs and may adversely affect our financial condition and results of operations.***

We may invest in other mortgage REITs that primarily invest in agency MBS on a leveraged basis, utilizing short-term repurchase agreements as their primary source of funding, and such mortgage REITs are, therefore, exposed to similar risk factors as those described herein. In addition, our investments in other mortgage REITs expose us to incremental risks and costs due to our lack of control, lack of transparency into their underlying investment portfolios and business operations, stock market volatility and additional management fees, which could adversely affect our financial condition and results of operations.

***Our investments are recorded at fair value and quoted prices or observable inputs may not be readily available to determine such value, resulting in the use of unobservable inputs to determine value, and the fair value of our investments may be materially different from the value that we ultimately realize upon their disposal.***

The values of our investments may not be readily determinable or ultimately realizable. We measure the fair value of our investments quarterly, in accordance with guidance set forth in FASB Accounting Standards Codification ("ASC") Topic 820, *Fair Value Measurements and Disclosures*. Ultimate realization of the value of an asset depends to a great extent on economic and other conditions that are beyond the control of our Manager, our Company or our Board of Directors. Further, fair value is only an estimate based on good faith judgment of the price at which an investment can be sold since market prices of investments can only be determined by negotiation between a willing buyer and seller. If we were to liquidate a particular asset, the realized value may be more than or less than the amount at which such asset is valued. Accordingly, the value of our common stock could be adversely affected by our determinations regarding the fair value of our investments, whether in the applicable period or in the future. Additionally, such valuations may fluctuate over short periods of time.

Our Manager's determination of the fair value of our investments includes inputs provided by third-party dealers and pricing services. Valuations of certain investments in which we invest may be difficult to obtain or unreliable. In general, dealers and pricing services heavily disclaim their valuations. Dealers may claim to furnish valuations only as an accommodation and without special compensation, and so they may disclaim any and all liability for any direct, incidental, or consequential damages arising out of any inaccuracy or incompleteness in valuations, including any act of negligence or breach of any warranty. Depending on the complexity and illiquidity of a security, valuations of the same security can vary substantially from one dealer or pricing service to another. Therefore, our results of operations for a given period could be adversely affected if our determinations regarding the fair market value of these investments are materially different from the values that we ultimately realize upon their disposal.

24

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

The payments of principal and interest we receive on the agency securities in which we invest are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae, collectively referred to as Government Sponsored Enterprises or GSEs. The guarantees on agency securities created by Fannie Mae and Freddie Mac are not backed by the full faith and credit of the United States, whereas the guarantee on securities created by Ginnie Mae are backed by the full faith and credit of the United States.

In response to general market instability and, more specifically, the financial conditions of Fannie Mae and Freddie Mac, in July 2008, the Housing and Economic Recovery Act of 2008, or HERA, established FHFA as the new regulator for Fannie Mae and Freddie Mac. In September 2008, the U.S. Treasury, the FHFA and the U.S. Federal Reserve announced a comprehensive action plan to help stabilize the financial markets, support the availability of mortgage financing and protect taxpayers. Under this plan, among other things, the FHFA was appointed as conservator of both Fannie Mae and Freddie Mac, allowing the FHFA to control the actions of the two GSEs, without forcing them to liquidate, which would be the case under receivership. Importantly, the primary focus of the plan was to increase the availability of mortgage financing by allowing these GSEs to continue to grow their guarantee business without limit, while limiting the size of their retained mortgage and agency security portfolios and requiring that these portfolios be reduced over time.

Although the U.S. Government has committed to support the positive net worth of Fannie Mae and Freddie Mac, the two GSEs could default on their guarantee obligations, which would materially and adversely affect the value of our agency securities. Accordingly, if these government actions are inadequate and the GSEs suffer additional losses or cease to exist, our business, operations and financial condition could be materially and adversely affected.

In addition, the future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantee obligations could be considerably limited relative to historical measurements. Any such changes to the nature of their guarantee obligations could re-define what constitutes an agency security and could have broad adverse implications for the market and our business, operations and financial condition.

Future legislation could change the relationship between Fannie Mae and Freddie Mac and the U.S. Government, and could also nationalize, privatize, or eliminate these entities entirely. Any law affecting these GSEs may create market uncertainty and have the effect of reducing the actual or perceived credit quality of securities issued or guaranteed by Fannie Mae or Freddie Mac. Moreover, if the guarantee obligations of Freddie Mac or Fannie Mae were repudiated by FHFA, payments of principal and/or interest to holders of agency securities issued by Freddie Mac or Fannie Mae would be reduced in the event of any borrower's late payments or failure to pay or a servicer's failure to remit borrower payments to the trust. In that case, trust administration and servicing fees could be paid from mortgage payments prior to distributions to holders of agency securities. Any actual direct compensatory damages owed due to the repudiation of Freddie Mac or Fannie Mae's guarantee obligations may not be sufficient to offset any shortfalls experienced by holders of agency securities.

As a result, such laws or changes could increase the risk of loss on our investments in agency mortgage investments guaranteed by Fannie Mae and/or Freddie Mac and could adversely impact the market for such securities and spreads at which they trade. All of the foregoing could materially and adversely affect our financial condition and results of operations.

***Mortgage loan modification and refinancing programs and future legislative action may adversely affect the value of, and our returns on, agency mortgage-backed securities.***

The U.S. Government has implemented a number of federal programs designed to assist homeowners, including the Home Affordable Modification Program, or HAMP, which provides homeowners with assistance in avoiding residential mortgage loan foreclosures, the Hope for Homeowners Program, or H4H Program, which allows certain distressed borrowers to refinance their mortgages into FHA-insured loans in order to avoid residential mortgage loan foreclosures, and the Home Affordable Refinance Program, or HARP, which for loans sold or guaranteed by the GSEs on or prior to May 31, 2009, allows borrowers who are current on their mortgage payments to refinance and reduce their monthly mortgage payments, with no current loan-to-value ratio upper limit and without requiring new mortgage insurance. HAMP, the H4H Program and other loss mitigation programs may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans (through forbearance and/or forgiveness) and/or the rate of interest payable on the loans, or the extension of payment terms of the loans. These loan modification programs, future legislative or regulatory actions, including possible amendments to the bankruptcy laws, which result in the modification of outstanding residential mortgage loans, as well as changes in the requirements necessary to qualify for refinancing mortgage loans with Fannie Mae, Freddie Mac or Ginnie Mae, may adversely affect the value of, and the returns on, agency mortgage-backed securities that we may purchase.

25

**Risks Related to Our Relationship with Our Manager and American Capital**

***There are conflicts of interest in our relationship with our Manager and American Capital.***

Because we have no employees, except for employees of our wholly-owned subsidiary Bethesda Securities, LLC, or BES, our Manager is responsible for making all of our investment decisions. Certain of our and our Manager's officers are employees of American Capital or its affiliates and these persons do not devote their time exclusively to us. Our Manager's Investment Committee consists of Messrs. Wilkus, Erickson, Flax, Kain and McHale, each of whom is an officer of American Capital or the parent company of our Manager and has significant responsibilities to American Capital and certain of its portfolio companies, affiliated entities or managed funds. Mr. Kain is our President and Chief Investment Officer and also serves as the President of our Manager and its parent company. Mr. Kain is also the President and Chief Investment Officer of American Capital Mortgage Investment Corp. and the President of its manager. Thus, he has, and may in the future have, significant responsibilities for other funds that are managed by the parent company of our Manager or entities affiliated therewith. In addition, because certain of our and our Manager's officers are also responsible for providing services to American Capital and/or certain of its portfolio companies, affiliated entities or managed funds, they may not devote sufficient time to the management of our business operations.

Additionally, our Manager is a wholly-owned subsidiary of American Capital Mortgage Management, LLC, which is also the parent company of the external manager of American Capital Mortgage Investment Corp., a publicly-traded REIT that invests in agency mortgage investments, non-agency mortgage investments and mortgage related investments and may compete with us for purchases of agency mortgage-related investments. American Capital Mortgage Management, LLC is a subsidiary of American Capital Asset Management, LLC, which is a wholly-owned portfolio company of American Capital. There are no restrictions on American Capital that prevent American Capital from sponsoring another investment vehicle that competes with us. Accordingly, American Capital or one or more of its affiliates may also compete with us for investments, except that American Capital has agreed that so long as our Manager or affiliate of American Capital continues to manage our company, it will not sponsor another investment vehicle that invests predominantly in whole pool agency mortgage-backed securities.

Although our Manager and its affiliates have policies in place that seek to mitigate the effects of conflicts of interest, including any potential conflict relating to the allocation of certain types of securities that meet our investment objectives and those of other managed funds or affiliates of our Manager, these policies do not eliminate the conflicts of interest that our officers and the officers and employees of our Manager and its affiliates face in making investment decisions on behalf of American Capital, any other American Capital-sponsored investment vehicles and us. Further, we do not have any agreement or understanding with American Capital that would give us any priority over American Capital, any of its affiliates, or any such American Capital-sponsored investment vehicle in opportunities to invest in mortgage-related investments. Accordingly, we may compete for access to the benefits that we expect from our relationship with our Manager and American Capital.

***American Capital has announced that it is soliciting offers to purchase American Capital or its various business lines.***

On January 7, 2016, American Capital announced that its Board of Directors authorized American Capital to solicit offers to purchase American Capital or its various business lines, in whole or in part. American Capital has issued no information on the status of the solicitation or the nature of any possible transaction that may result from it. Thus, while it is possible that a transaction could have an impact on us or our Manager, it is impractical to provide information on the nature of any impacts. Moreover, there is no assurance that the solicitation will result in a transaction that will have an impact on us or our Manager.

***We are completely dependent upon our Manager and certain personnel of American Capital or the parent company of our Manager who provide services to us through the management agreement and the administrative services agreement and we may not find suitable replacements for our Manager and these personnel if the management agreement and the administrative services agreement are terminated or such personnel are no longer available to us.***

Because we have no employees or separate facilities, except for employees and facilities of BES, we are completely dependent on our Manager and its affiliates to conduct our operations pursuant to the management agreement. Our Manager does not have any employees and relies upon certain employees of its parent company and American Capital to conduct our day-to-day operations pursuant to an administrative services agreement. Under the administrative services agreement, our Manager is provided services and resources necessary for our Manager to perform its obligations and responsibilities under the management agreement in exchange for certain fees payable by our Manager. Neither the administrative services agreement nor the management agreement requires our Manager or its parent company or American Capital to dedicate specific personnel to our operations. It also does not require any specific personnel of our Manager or its parent company or American Capital to dedicate a specific amount of time to our business. Additionally, because our Manager is relying upon American Capital, we may be negatively impacted by events or factors that negatively impact American Capital's business, financial condition or results of operations. American Capital or the parent company of our Manager has entered into employment agreements with certain of their employees who are officers of our Manager and AGNC. However, none of these individuals' continued service is guaranteed. Furthermore, if the management

26

agreement is terminated or these individuals leave the parent company of our Manager or American Capital, we may be unable to execute our business plan.

***If we elect not to renew our management agreement without cause, we would be required to pay our Manager a substantial termination fee. We would also be restricted from employing employees of our Manager and any of its affiliates, including American Capital. These and other provisions in our management agreement make non-renewal of our management agreement difficult and costly.***

Electing not to renew the management agreement without cause would be difficult and costly for us. With the consent of the majority of the independent members of our Board of Directors, we may elect not to renew our management agreement upon the expiration of any automatic annual renewal term, upon 180-days prior written notice. If we elect not to renew the management agreement because of a decision by our Board of Directors that the management fee is unfair, our Manager has the right to renegotiate a mutually agreeable management fee. If we elect to not renew the management agreement without cause, we are required to pay our Manager a termination fee equal to three times the average annual management fee earned by our Manager during the prior 24-month period immediately preceding the most recently completed month prior to the effective date of termination. These provisions may increase the effective cost to us of electing to not renew the management agreement.

Furthermore, if we terminate the management agreement without cause, we may not, without the consent of our Manager, employ any employee of the Manager or any of its affiliates, including American Capital, or any person who has been employed by our Manager or any of its affiliates at any time within the two-year period immediately preceding the date on which the person commences employment with us for two years after such termination of the management agreement. We believe that the successful implementation of our investment, financing and hedging strategies depends upon the experience of certain of American Capital and our Manager's officers; therefore, if the management agreement is terminated without cause we may be unable to execute our business plan.

***We have no recourse to American Capital if it does not fulfill its obligations under the administrative services agreement.***

Neither we nor our Manager have any employees or separate facilities, except for employees and facilities of BES. Our day-to-day operations are conducted by employees of American Capital or the parent company of our Manager pursuant to an administrative services agreement among our Manager, its parent company and American Capital. Under the administrative services agreement, our Manager is also provided with the services and other resources necessary for our Manager to perform its obligations and responsibilities under the management agreement in exchange for certain fees payable by our Manager. Although the administrative services agreement may not be terminated unless the management agreement has been terminated pursuant to its terms, American Capital and the parent company of our Manager may assign their rights and obligations thereunder to any of their affiliates, including American Capital Asset Management, LLC, which owns the parent company of our Manager. In addition, because we are not a party to the administrative services agreement, we do not have any recourse to American Capital or the parent company of our Manager if they do not fulfill their obligations under the administrative services agreement or if they elect to assign the agreement to one of their affiliates. Also, our Manager only has nominal assets and we will have limited recourse against our Manager under the Management Agreement to remedy any liability to us from a breach of contract or fiduciary duties.

***Our management agreement was not negotiated on an arm's-length basis and the terms, including fees payable, may not be as favorable to us as if they were negotiated with an unaffiliated third party.***

The management agreement was originally negotiated between related parties, and we did not have the benefit of arm's-length negotiations of the type normally conducted with an unaffiliated third party. The terms of the management agreement, including fees payable, may not reflect the terms that we may have received if it were negotiated with an unrelated third party. In addition, we may choose not to enforce, or to enforce less vigorously, our rights under the management agreement because of our desire to maintain our ongoing relationship with our Manager.

***Our Manager's management fee is based on the amount of our Equity and is payable regardless of our performance, which could result in a conflict of interest between our Manager and our stockholders with respect to the timing and terms of our equity issuances, share repurchases and the realization of gains and losses on our investment portfolio.***

Our Manager is entitled to receive a monthly management fee from us that is based on the amount of our "Equity" (as defined in our management agreement), regardless of the performance of our investment portfolio. For example, we would pay our Manager a management fee for a specific period even if we experienced a net unrealized loss during the same period. The amount of the monthly management fee is equal to one-twelfth of 1.25% of our Equity and, therefore, is only increased or decreased by changes in our Equity. Increases to our Equity, and a corresponding increase to our management fee, will primarily result from equity issuances and realization of gains from our investment portfolio, whereas decreases to our Equity, and a corresponding decrease to our management fee, will primarily result from repurchases of our common stock and realization of losses on our investment portfolio, each of which could result in a conflict of interest between our Manager and our stockholders with respect to the timing

27

and terms of our equity issuances, share repurchases and realization of gains and losses on our investment portfolio. Thus, while our stockholders bear the risk of our future equity issuances reducing the price of our common stock and diluting the value of their stock holdings in us, the compensation payable to our Manager will increase as a result of future issuances of our equity securities. Similarly, even though the value of our common stock could potentially increase if we repurchase shares at a discount to our net book value per common share, the compensation payable to our Manager would be reduced if we execute share repurchases, creating a conflict of interest. This conflict of interest could harm the market price of our common stock.

***Our Manager's liability is limited under the management agreement, and we have agreed to indemnify our Manager against certain liabilities.***

The management agreement provides that our Manager will not assume any responsibility other than to provide the services specified in the management agreement. The agreement further provides that our Manager is not responsible for any action of our Board of Directors in following or declining to follow its advice or recommendations. In addition, our Manager and its respective affiliates, managers, officers, directors, employees and members will be held harmless from, and indemnified by us against, certain liabilities on customary terms.

***Our results are dependent upon the efforts of our Manager.***

Our Manager's success, which is largely determinative of our own success, depends on many factors, including the availability of attractive risk-adjusted investment opportunities that satisfy our targeted investment strategies and then identifying and consummating them on favorable terms, the level and volatility of interest rates, its ability to access on our behalf short-term and long-term financing on favorable terms and conditions in the financial markets, real estate market and the economy, as to which no assurances can be given. In addition, our Manager may face substantial competition for attractive investment opportunities. Our Manager may not be able to successfully cause us to make investments with attractive risk-adjusted returns.

**Risks Related to Our Taxation as a REIT**

***If we fail to remain qualified as a REIT, we will be subject to tax as a regular corporation and could face a substantial tax liability, which would reduce the amount of cash available for distribution to our stockholders.***

We operate in a manner that allows us to qualify as a REIT for federal income tax purposes. Although we do not intend to request a ruling from the IRS as to our REIT qualification, we have received an opinion of Skadden, Arps, Slate, Meagher & Flom LLP with respect to our qualification as a REIT. Investors should be aware, however, that opinions of counsel are not binding on the IRS or any court. The opinion of Skadden, Arps, Slate, Meagher & Flom LLP represents only the view of our counsel based on our counsel's review and analysis of existing law and on certain representations as to factual matters and covenants made by us and our Manager, including representations relating to the values of our assets and the sources of our income. The opinion is expressed as of the date issued and does not cover subsequent periods. Skadden, Arps, Slate, Meagher & Flom LLP has no obligation to advise us or the holders of our common stock of any subsequent change in the matters stated, represented or assumed, or of any subsequent change in applicable law. Furthermore, both the validity of the opinion of Skadden, Arps, Slate, Meagher & Flom LLP, and our qualification as a REIT depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis, the results of which are not monitored by Skadden, Arps, Slate, Meagher & Flom LLP. Our ability to satisfy the asset tests depends upon our analysis of the characterization and fair market values of our assets, some of which are not susceptible to a precise determination, and for which we will not obtain independent appraisals. Our compliance with the annual REIT income and quarterly asset requirements also depends upon our ability to successfully manage the composition of our income and assets on an ongoing basis. Moreover, the proper classification of an instrument as debt or equity for federal income tax purposes may be uncertain in some circumstances, which could affect the application of the REIT qualification requirements as described below. Accordingly, there can be no assurance that the IRS will not contend that our interests in subsidiaries or in securities of other issuers will not cause a violation of the REIT requirements.

If we were to fail to qualify as a REIT in any taxable year, we would be subject to federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates, and dividends paid to our stockholders would not be deductible by us in computing our taxable income. Any resulting corporate tax liability could be substantial and would reduce the amount of cash available for distribution to our stockholders, which in turn could have an adverse impact on the value of our common stock. Unless we were entitled to relief under certain Internal Revenue Code provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year in which we failed to qualify as a REIT.

***Distributions payable by REITs do not qualify for the reduced tax rates available for some dividends.***

The maximum tax rate applicable to income from "qualified dividends" payable to domestic stockholders that are individuals, trusts and estates is currently 20%. Distributions of ordinary income payable by REITs, however, generally are not eligible for the

28

reduced rates. Although this legislation does not adversely affect the taxation of REITs or distributions payable by REITs, the more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the stock of REITs, including our common stock.

***REIT distribution requirements could adversely affect our ability to execute our business plan.***

We generally must distribute annually at least 90% of our taxable income, subject to certain adjustments and excluding any net capital gain, in order for federal corporate income tax not to apply to earnings that we distribute. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a non-deductible 4% excise tax if the actual amount distributed to our stockholders in a calendar year is less than a minimum amount specified under federal tax laws. We intend to make distributions to our stockholders to comply with the REIT qualification requirements of the Internal Revenue Code.

From time to time, we may generate taxable income greater than our income for financial reporting purposes prepared in accordance with GAAP, or differences in timing between the recognition of taxable income and the actual receipt of cash may occur. For example, if we purchase mortgage securities at a discount, we are generally required to accrete the discount into taxable income prior to receiving the cash proceeds of the accreted discount at maturity. Additionally, if we incur capital losses in excess of capital gains, such net capital losses are not allowed to reduce our taxable income for purposes of determining our distribution requirement. Such net capital losses may be carried forward for a period of up to five years and applied against future capital gains subject to the limitation of our ability to generate sufficient capital gains, which cannot be assured. If we do not have other funds available in these situations we could be required to borrow funds on unfavorable terms, sell investments at disadvantageous prices or distribute amounts that would otherwise be invested in future acquisitions to make distributions sufficient to maintain our qualification as a REIT, or avoid corporate income tax and the 4% excise tax in a particular year. These alternatives could increase our costs or reduce our stockholders' equity. Thus, compliance with the REIT requirements may hinder our ability to grow, which could adversely affect the value of our common stock.

***We may in the future choose to pay dividends in our own stock, in which case you may be required to pay income taxes in excess of the cash dividends you receive.***

We may in the future distribute taxable dividends that are payable in cash and shares of our common stock at the election of each stockholder. Taxable stockholders receiving such dividends will be required to include the full amount of the dividend as ordinary income to the extent of our current and accumulated earnings and profits for U.S. federal income tax purposes. As a result, stockholders may be required to pay income taxes with respect to such dividends in excess of the cash dividends received. If a U.S. stockholder sells the stock that it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore, with respect to certain non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in stock. In addition, if a significant number of our stockholders determine to sell shares of our common stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock.

***Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.***

Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, excise taxes, state or local income, property and transfer taxes, such as mortgage recording taxes, and other taxes. In addition, in order to meet the REIT qualification requirements, prevent the recognition of certain types of non-cash income, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory, we may hold some of our assets through our TRS or other subsidiary corporations that will be subject to corporate level income tax at regular rates. In addition, if we lend money to a TRS, the TRS may be unable to deduct all or a portion of the interest paid to us, which could result in an even higher corporate level tax liability. Any of these taxes would decrease cash available for distribution to our stockholders.

***Complying with REIT requirements may cause us to forgo otherwise attractive opportunities.***

To remain qualified as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts that we distribute to our stockholders and the ownership of our stock. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution, and may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source-of-income or asset-diversification requirements for qualifying as a REIT. Thus, compliance with the REIT requirements may hinder our ability to make and, in certain cases, to maintain ownership of, certain attractive investments.

29

***Complying with REIT requirements may force us to liquidate otherwise attractive investments.***

To remain qualified as a REIT, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and qualified real estate assets. The remainder of our investment in securities (other than government securities and qualified real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities and qualified real estate assets) can consist of the securities of any one issuer, and, for tax years beginning on or before December 31, 2017, no more than 25% of the value of our total assets can be represented by securities of one or more TRSs. For tax years beginning after December 31, 2017, no more than 20% of the value of our total assets can be represented by securities of one or more TRSs. If we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate from our investment portfolio otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

***The failure of assets subject to repurchase agreements to qualify as real estate assets could adversely affect our ability to remain qualified as a REIT.***

We enter into certain financing arrangements that are structured as sale and repurchase agreements pursuant to which we nominally sell certain of our assets to a counterparty and simultaneously enter into an agreement to repurchase these assets at a later date in exchange for a purchase price. Economically, these agreements are financings that are secured by the assets sold pursuant thereto. We believe that we would be treated for REIT asset and income test purposes as the owner of the assets that are the subject of any such sale and repurchase agreement notwithstanding that such agreement may transfer record ownership of the assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the assets during the term of the sale and repurchase agreement, in which case we could fail to remain qualified as a REIT.

***Distributions to tax-exempt investors may be classified as unrelated business taxable income.***

Neither ordinary nor capital gain distributions with respect to our common stock nor gain from the sale of common stock should generally constitute unrelated business taxable income to a tax-exempt investor. However, there are certain exceptions to this rule. In particular:

* part of the income and gain recognized by certain qualified employee pension trusts with respect to our common stock may be treated as unrelated business taxable income if shares of our common stock are predominantly held by qualified employee pension trusts, and we are required to rely on a special look-through rule for purposes of meeting one of the REIT ownership tests, and we are not operated in a manner to avoid treatment of such income or gain as unrelated business taxable income;
* part of the income and gain recognized by a tax-exempt investor with respect to our common stock would constitute unrelated business taxable income if the investor incurs debt in order to acquire the common stock;
* part or all of the income or gain recognized with respect to our common stock by social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts and qualified group legal services plans which are exempt from federal income taxation under the Internal Revenue Code may be treated as unrelated business taxable income; and
* to the extent that we are (or a part of us, or a disregarded subsidiary of ours, is) a "taxable mortgage pool," or if we hold residual interests in a REMIC, a portion of the distributions paid to a tax-exempt stockholder that is allocable to excess inclusion income may be treated as unrelated business taxable income.

***Liquidation of assets may jeopardize our REIT qualification or create additional tax liability for us.***

To remain qualified as a REIT, we must comply with requirements regarding the composition of our assets and our sources of income. If we are compelled to liquidate our investments to repay obligations to our lenders, we may be unable to comply with these requirements, ultimately jeopardizing our qualification as a REIT, or we may be subject to a 100% tax on any resultant gain if we sell assets that are treated as dealer property or inventory.

***Complying with REIT requirements may limit our ability to hedge effectively and may cause us to incur tax liabilities.***

The REIT provisions of the Internal Revenue Code could substantially limit our ability to hedge our liabilities. Any income from a properly designated hedging transaction we enter into to manage risk of interest rate changes with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, to acquire or carry real estate assets generally does not constitute "gross income" for purposes of the 75% or 95% gross income tests. To the extent that we enter into other types of hedging transactions, the income from those transactions is likely to be treated as non-qualifying income for purposes of both of

30

the gross income tests. As a result of these rules, we may have to limit our use of advantageous hedging techniques or implement those hedges through our TRS. This could increase the cost of our hedging activities because our TRS would be subject to tax on gains or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear. In addition, losses in our TRS will generally not provide any tax benefit, except for being carried forward against future taxable income in the TRS.

***Uncertainty exists with respect to the treatment of our TBAs for purposes of the REIT asset and income tests.***

We purchase and sell agency mortgage-backed securities through TBAs and recognize income or gains from the disposition of those TBAs, through dollar roll transactions or otherwise, and may continue to do so in the future. While there is no direct authority with respect to the qualification of TBAs as real estate assets or U.S. Government securities for purposes of the 75% asset test or the qualification of income or gains from dispositions of TBAs as gains from the sale of real property (including interests in real property and interests in mortgages on real property) or other qualifying income for purposes of the 75% gross income test, we treat our TBAs as qualifying assets for purposes of the REIT 75% asset test, and we treat income and gains from our TBAs as qualifying income for purposes of the 75% gross income test, based on an opinion of Skadden, Arps, Slate, Meagher & Flom LLP substantially to the effect that (i) for purposes of the REIT asset tests, our ownership of a TBA should be treated as ownership of the underlying agency securities, and (ii) for purposes of the 75% REIT gross income test, any gain recognized by us in connection with the settlement of our TBAs should be treated as gain from the sale or disposition of the underlying agency securities. Opinions of counsel are not binding on the IRS, and no assurance can be given that the IRS will not successfully challenge the conclusions set forth in such opinions. In addition, it must be emphasized that the opinion of Skadden, Arps, Slate, Meagher & Flom LLP is based on various assumptions relating to our TBAs and is conditioned upon fact-based representations and covenants made by our management regarding our TBAs. No assurance can be given that the IRS would not assert that such assets or income are not qualifying assets or income. If the IRS were to successfully challenge the opinion of Skadden, Arps, Slate, Meagher & Flom LLP, we could be subject to a penalty tax or we could fail to remain qualified as a REIT if a sufficient portion of our assets consists of TBAs or a sufficient portion of our income consists of income or gains from the disposition of TBAs.

***Qualifying as a REIT involves highly technical and complex provisions of the Internal Revenue Code.***

Qualification as a REIT involves the application of highly technical and complex Internal Revenue Code provisions for which only limited judicial and administrative authorities exist. Even a technical or inadvertent violation could jeopardize our REIT qualification. Our qualification as a REIT depends on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. In addition, our ability to satisfy the requirements to remain qualified as a REIT depends in part on the actions of third parties over which we have no control or only limited influence, including in cases where we own an equity interest in an entity that is classified as a partnership for federal income tax purposes.

***The tax on prohibited transactions will limit our ability to engage in transactions, including certain methods of structuring CMOs, which would be treated as prohibited transactions for federal income tax purposes.***

Net income that we derive from a prohibited transaction is subject to a 100% tax. The term "prohibited transaction" generally includes a sale or other disposition of property (including agency securities, but other than foreclosure property, as discussed below) that is held primarily for sale to customers in the ordinary course of a trade or business by us or by a borrower that has issued a shared appreciation mortgage or similar debt instrument to us. We could be subject to this tax if we were to dispose of or structure CMOs in a manner that was treated as a prohibited transaction for federal income tax purposes.

We intend to conduct our operations at the REIT level so that no asset that we own (or are treated as owning) will be treated as, or as having been, held for sale to customers, and that a sale of any such asset will not be treated as having been in the ordinary course of our business. As a result, we may choose not to engage in certain transactions at the REIT level, and may limit the structures we utilize for our CMO transactions, even though the sales or structures might otherwise be beneficial to us. In addition, whether property is held "primarily for sale to customers in the ordinary course of a trade or business" depends on the particular facts and circumstances. No assurance can be given that any property that we sell will not be treated as property held for sale to customers, or that we can comply with certain safe-harbor provisions of the Internal Revenue Code that would prevent such treatment. The 100% tax does not apply to gains from the sale of property that is held through a TRS or other taxable corporation, although such income will be subject to tax in the hands of the corporation at regular corporate rates. We intend to structure our activities to avoid prohibited transaction characterization.

***New legislation or administrative or judicial action, in each instance potentially with retroactive effect, could make it more difficult or impossible for us to remain qualified as a REIT.***

The present federal income tax treatment of REITs may be modified, possibly with retroactive effect, by legislative, judicial or administrative action at any time, which could affect the federal income tax treatment of an investment in us. The federal income tax rules dealing with REITs constantly are under review by persons involved in the legislative process, the IRS and the U.S.

31

Treasury Department, which results in statutory changes as well as frequent revisions to regulations and interpretations. Revisions in federal tax laws and interpretations thereof could affect or cause us to change our investments and commitments and affect the tax considerations of an investment in us.

**Risks Related to Our Business Structure**

***Loss of our exemption from regulation pursuant to the Investment Company Act would adversely affect us.***

We conduct our business so as not to become regulated as an investment company under the Investment Company Act in reliance on the exemption provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires that: (i) at least 55% of our investment portfolio consist of "mortgages and other liens on and interest in real estate," or "qualifying real estate interests," and (ii) at least 80% of our investment portfolio consist of qualifying real estate interests plus "real estate-related assets."

In satisfying this 55% requirement, based on pronouncements of the SEC staff, we treat agency mortgage-backed securities issued with respect to an underlying pool of mortgage loans in which we hold all of the certificates issued by a pool, or a "whole pool," as qualifying real estate interests. However, the real estate related assets that we acquire are limited by the provisions of the Investment Company Act and the rules and regulations promulgated thereunder. If the SEC determines that any of these securities are not qualifying interests in real estate or real estate-related assets, adopts a contrary interpretation with respect to these securities or otherwise believes we do not satisfy the above exceptions or changes its interpretation of the above exceptions, we could be required to restructure our activities or sell certain of our assets. We may be required at times to adopt less efficient methods of financing certain of our mortgage related investments and we may be precluded from acquiring certain types of higher yielding securities. The net effect of these factors would be to lower our net interest income. If we fail to qualify for an exemption from registration as an investment company or an exclusion from the definition of an investment company, our ability to use leverage would be substantially reduced. Our business will be materially and adversely affected if we fail to qualify for this exemption from regulation pursuant to the Investment Company Act.

**Risks Related to Our Common Stock**

***The market price and trading volume of our common stock may be volatile.***

The market price of our common stock may be highly volatile and be subject to wide fluctuations. In addition, the trading volume in our common stock may fluctuate and cause significant price variations to occur. The stock market has experienced extreme price and volume fluctuations that have affected the market price of many companies in industries similar or related to ours and that have been unrelated to these companies' operating performances. If the market price of our common stock declines significantly, you may be unable to resell your shares at a gain. Further, fluctuations in the trading price of our common stock may adversely affect the liquidity of the trading market for our common stock and, in the event that we seek to raise capital through future equity financings, our ability to raise such equity capital.

Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our common stock include:

* actual or anticipated variations in our quarterly operating results or distributions;
* changes in our earnings estimates or publication of research reports about us or the real estate or specialty finance industry;
* increases in market interest rates that lead purchasers of our shares of common stock to demand a higher yield;
* changes in market valuations of similar companies;
* adverse market reaction to any increased indebtedness we incur in the future;
* issuance of additional equity securities;
* our repurchases of shares of our common stock;
* actions by institutional stockholders;
* additions or departures of key management personnel, or changes in our relationship with our Manager or American Capital;
* speculation in the press or investment community;
* price and volume fluctuations in the stock market from time to time, which are often unrelated to the operating performance of particular companies;
* changes in regulatory policies, tax laws and financial accounting and reporting standards, particularly with respect to REITs, or applicable exemptions from the Investment Company Act of 1940, as amended;

32

* actual or anticipated changes in our dividend policy and earnings or variations in operating results;
* any shortfall in revenue or net income or any increase in losses from levels expected by securities analysts;
* decreases in our net asset value per share;
* loss of major repurchase agreement providers; and
* general market and economic conditions.

In addition, the price of our common stock may be below our reported net book value per common share. We cannot assure you that the market price of our common stock will not fluctuate or decline significantly in the future.

***Future offerings of debt securities, which would rank senior to our preferred and common stock upon our liquidation, and future offerings of equity securities, which would dilute our existing stockholders and may be senior to our common stock for the purposes of dividend and liquidating distributions, may adversely affect the market price of our common stock.***

In the future, we may raise capital through the issuance of debt or equity securities. Upon liquidation, holders of our debt securities, if any, preferred stock and lenders with respect to other borrowings will be entitled to our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing stockholders or reduce the market price of our common stock, or both. Our preferred stock has a preference on liquidating distributions and a preference on dividend payments that could limit our ability to pay dividends to the holders of our common stock. Sales of substantial amounts of our common stock, or the perception that these sales could occur, could have a material adverse effect on the price of our common stock. Because our decision to issue debt or equity securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus holders of our common stock bear the risk of our future offerings reducing the market price of our common stock and diluting the value of their stock holdings in us.

***Future sales of shares of our common stock may depress the price of our shares.***

We cannot predict the effect, if any, of future sales of our common stock or the availability of shares for future sales on the market price of our common stock. Any sales of a substantial number of our shares in the public market, or the perception that sales might occur, may cause the market price of our shares to decline.

***We have not established a minimum dividend payment level and we cannot assure you of our ability to pay dividends in the future.***

We intend to pay monthly dividends to our common stockholders and to distribute all or substantially all of our taxable income within the limits prescribed by the Internal Revenue Code. However, we have not established a minimum dividend payment level and the amount of our dividend will fluctuate. Our ability to pay dividends may be adversely affected by the risk factors described herein. All distributions will be made at the discretion of our Board of Directors and will depend on our earnings, our financial condition, the requirements for REIT qualification and such other factors as our Board of Directors may deem relevant from time to time. We may not be able to make distributions in the future or our Board of Directors may change our dividend policy in the future. In addition, some of our distributions may include a return of capital. To the extent that we decide to pay dividends in excess of our current and accumulated tax earnings and profits, such distributions would generally be considered a return of capital for federal income tax purposes. A return of capital reduces the basis of a stockholder's investment in our common stock to the extent of such basis and is treated as capital gain thereafter.

***An increase in market interest rates may cause a material decrease in the market price of our common stock.***

One of the factors that investors may consider in deciding whether to buy or sell shares of our common stock is our distribution rate as a percentage of our share price relative to market interest rates. If the market price of our common stock is based primarily on the earnings and return that we derive from our investments and income with respect to our investments and our related distributions to stockholders, and not from the market value of the investments themselves, then interest rate fluctuations and capital market conditions are likely to affect adversely the market price of our common stock. For instance, if market rates rise without an increase in our distribution rate, the market price of our common stock could decrease as potential investors may require a higher distribution yield on our common stock or seek other securities paying higher distributions or interest. In addition, rising interest rates would result in increased interest expense on our variable rate debt, thereby reducing cash flow and our ability to service our indebtedness and pay distributions.

***The stock ownership limit imposed by the Internal Revenue Code for REITs and our amended and restated certificate of incorporation may restrict our business combination opportunities.***

To qualify as a REIT under the Internal Revenue Code, not more than 50% in value of our outstanding stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the Internal Revenue Code to include certain entities) at any time

33

during the last half of each taxable year in which we qualify as a REIT. Our amended and restated certificate of incorporation, with certain exceptions, authorizes our Board of Directors to take the actions that are necessary and desirable to qualify as a REIT. Pursuant to our amended and restated certificate of incorporation, no person may beneficially or constructively own more than 9.8% in value or in number of shares, whichever is more restrictive, of our common or capital stock.

Our Board of Directors may grant an exemption from this 9.8% stock ownership limitation, in its sole discretion, subject to such conditions, representations and undertakings as it may determine are reasonably necessary. Pursuant to our amended and restated certificate of incorporation, our Board of Directors has the power to increase or decrease the percentage of common or capital stock that a person may beneficially or constructively own. However, any decreased stock ownership limit will not apply to any person whose percentage ownership of our common or capital stock, as the case may be, is in excess of such decreased stock ownership limit until that person's percentage ownership of our common or capital stock, as the case may be, equals or falls below the decreased stock ownership limit. Until such a person's percentage ownership of our common or capital stock, as the case may be, falls below such decreased stock ownership limit, any further acquisition of our common or capital stock will be in violation of the decreased stock ownership limit.

The ownership limits imposed by the tax law are based upon direct or indirect ownership by "individuals," but only during the last half of a tax year. The ownership limits contained in our amended and restated certificate of incorporation apply to the ownership at any time by any "person," which term includes entities. Any attempt to own or transfer shares of our common stock or capital stock in violations of these restrictions may result in the shares being transferred to a charitable trust or may be void. These ownership limitations are intended to assist us in complying with the tax law requirements, and to minimize administrative burdens. However, these ownership limits might also delay or prevent a transaction or a change in our control that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders.

***The stock ownership limitation contained in our amended and restated certificate of incorporation generally does not permit ownership in excess of 9.8% of our common or capital stock, and attempts to acquire our common or capital stock in excess of these limits will be ineffective unless an exemption is granted by our Board of Directors.***

As described above, our amended and restated certificate of incorporation generally prohibits beneficial or constructive ownership by any person of more than 9.8% (by value or by number of shares, whichever is more restrictive) of our common or capital stock, unless exempted by our Board of Directors. Our amended and restated certificate of incorporation's constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than these percentages of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of these percentages of the outstanding stock and thus be subject to our amended and restated certificate of incorporation's ownership limit. Any attempt to own or transfer shares of our common or preferred stock in excess of the ownership limit without the consent of the Board of Directors will result in the shares being automatically transferred to a charitable trust or, if the transfer to a charitable trust would not be effective, such transfer being treated as invalid from the outset.

***Anti-takeover provisions in our amended and restated certificate of incorporation and bylaws could discourage a change of control that our stockholders may favor, which could also adversely affect the market price of our common stock.***

Provisions in our amended and restated certificate of incorporation and bylaws may make it more difficult and expensive for a third party to acquire control of us, even if a change of control would be beneficial to our stockholders. We could issue a series of preferred stock to impede the completion of a merger, tender offer or other takeover attempt. The anti-takeover provisions in our amended and restated certificate of incorporation and bylaws may impede takeover attempts, or other transactions, that may be in the best interests of our stockholders and, in particular, our common stockholders. In addition, the market price of our common stock could be adversely affected to the extent that provisions of our amended and restated certificate of incorporation and bylaws discourage potential takeover attempts, or other transactions, that our stockholders may favor.

**Item 1B. *Unresolved Staff Comments***

None.

**Item 2. *Properties***

We do not own any property. Our executive offices are located in Bethesda, Maryland in office space shared with American Capital.

34

**Item 3. *Legal Proceedings***

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, other than routine litigation and administrative proceedings arising in the ordinary course of business. Such proceedings are not expected to have a material adverse effect on the business, financial conditions, or results of our operations.

**Item 4. *Mine Safety Disclosures***

Not applicable.

35

**PART II.**

**Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities* Quarterly Stock Prices and Dividend Declarations**

Our common stock is listed on the NASDAQ Global Select Market under the symbol "AGNC." As of January 31, 2016, we had 1,063 stockholders of record. Most of the shares of our common stock are held by brokers and other institutions on behalf of stockholders.

The following table sets forth the range of high and low sales prices of our common stock as reported on the NASDAQ Global Select Market and dividends declared on our common stock for fiscal years 2015 and 2014:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **Common Stock** | |  |  |  |
|  |  |  | | | |  |  |  |
|  |  | **Sales Prices** | | | |  | **Dividends** |  |
|  |  |  |  |  |  |  |  |
|  |  | **High** |  | **Low** | |  | **Declared** |  |
|  |  |  |  |  |  |  |  |  |
| **Fiscal Year 2015** |  |  |  |  |  |  |  |  |
| Fourth Quarter | $ | 19.54 | $ | 16.89 |  | $ | 0.60 |  |
|  |  |  |  |  |  |  |  |  |
| Third Quarter | $ | 20.08 | $ | 18.21 |  | $ | 0.60 |  |
| Second Quarter | $ | 21.83 | $ | 18.31 |  | $ | 0.62 |  |
|  |  |  |  |  |  |  |  |  |
| First Quarter | $ | 22.36 | $ | 20.74 |  | $ | 0.66 |  |
| **Fiscal Year 2014** |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Fourth Quarter | $ | 23.44 | $ | 21.25 |  | $ | 0.66 |  |
| Third Quarter | $ | 23.97 | $ | 21.08 |  | $ | 0.65 |  |
|  |  |  |  |  |  |  |  |  |
| Second Quarter | $ | 24.06 | $ | 21.29 |  | $ | 0.65 |  |
| First Quarter | $ | 22.84 | $ | 19.29 |  | $ | 0.65 |  |

We intend to pay monthly dividends to our common stockholders and to distribute all of our annual taxable income in a timely manner. This will enable us to qualify for the tax benefits accorded to a REIT under the Internal Revenue Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected for the reasons described under the caption "Risk Factors."

In addition, holders of our 8.000% Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock") and our 7.750% Series B Cumulative Redeemable Preferred Stock ("Series B Preferred Stock") (each underlying depositary share representing a 1/1000th interest in a share of our Series B Preferred Stock) are entitled to receive cumulative cash dividends at a rate of 8.000% and 7.750% per annum, respectively, of their aggregate liquidation preference of $173 million and $175 million, respectively, before holders of our common stock are entitled to receive any dividends. Under certain circumstances upon a change of control, the Series A and Series B Preferred Stock are convertible to shares of our common stock. All distributions will be made at the discretion of our Board of Directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our Board of Directors may deem relevant from time to time.

The following table summarizes the tax characterization of dividends declared on our common stock for fiscal years 2015 and 2014:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **Tax Characterization** |  |  |  |
| **Dividends Declared per Share of** | **Dividends Declared** | | **Ordinary Income Per** | | **Qualified Dividends** | |  | **Long-Term Capital** |  |
| **Common Stock** |  | **Per Share** |  | **Share** |  | **Gains Per Share** |  |
| Fiscal Year 2015 | $ | 2.48 | $ | 2.480000 | $ | — | $ | — |  |
| Fiscal Year 2014 | $ | 2.61 | $ | 2.610000 | $ | — | $ | — |  |

Our stock transfer agent and registrar is Computershare Investor Services. Requests for information from Computershare can be sent to Computershare Investor Services, P.O. Box 43078, Providence, RI 02940-3078 and their telephone number is 1-800-733-5001.

36

**Stock Repurchase Program**

The following table presents information with respect to purchases of our common stock made during the fourth quarter ended December 31, 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.

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  | **Total Number of Shares** | | **Maximum Number of** |  |
|  |  |  |  |  |  |  |  | **Shares That May Yet Be** |  |
|  |  |  | **Total Number of Shares** | |  | **Average Price Paid Per** | | **Purchased as Part of** | | **Purchased Under the** |  |
|  | **Settlement Date** |  |  | **Publicly Announced Plans** | | **Publicly Announced Plans** |  |
|  | **Purchased** |  |  | **Share 1** |  | **or Programs 2** |  | **or Programs** |  |
|  | November 3 - 24, 2015 | | 8.7 |  | $ | 17.91 |  | 8.7 |  | N/A |  |
|  | December 17 - 18, 2015 | | 0.3 |  |  | 17.03 |  | 0.3 |  | N/A |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | Fourth quarter 2015 | | 9.0 |  | $ | 17.88 |  | 9.0 |  | N/A |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ | |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |

1. Average price paid per share includes transaction costs.
2. All shares were purchased by us pursuant to the stock repurchase program adopted by our Board of Directors described in Note 10 of our accompanying Consolidated Financial Statements in this Form 10-K.

**Equity Compensation Plan Information**

We have adopted a long term stock incentive plan, or Incentive Plan, to provide for the issuance of equity-based awards, including stock options, restricted stock units and unrestricted stock awards to our independent directors.

The following table provides information as of December 31, 2015 concerning shares of our common stock authorized for issuance under our existing Incentive Plan.

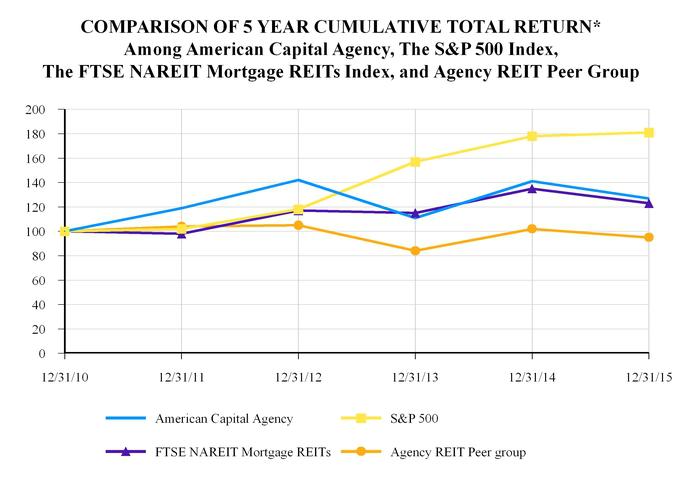
|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Number of securities to be** | |  | **Weighted average** | | **Number of securities remaining** |  |
|  |  |  |  | **available for future issuance** |  |
|  |  |  | **issued upon exercise of** | |  | **exercise price of** | | **under equity compensation plans** |  |
|  | **Plan Category** |  | **outstanding options,** | |  | **outstanding options,** | | **(excluding securities reflected in** |  |
|  | **warrants and rights** |  |  | **warrants and rights** |  | **the first column of this table)** |  |
|  | Equity compensation plans approved by security holders 1 | | 31,431 |  | $ | — | | 1,850 |  |
|  | Equity compensation plans not approved by security holders | | — | |  | — | | — |  |
|  |  |  |  |  |  |  |  |  |  |
|  | Total | | 31,431 |  | $ | — |  | 1,850 |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ | |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |

1. Represents unvested restricted stock units granted to our independent directors, including accrued dividend equivalent shares. Table excludes 5,000 shares of unvested restricted common stock granted to our independent directors, which were issued and outstanding on the date of grant.

**Performance Graph**

The following graph and table compare a stockholder's cumulative total return, assuming $100 invested at December 31, 2010 , with the reinvestment of all dividends, as if such amounts had been invested in: (i) our common stock; (ii) the stocks included in the Standard & Poor's 500 Stock Index ("S&P 500"); (iii) the stocks included in the FTSE NAREIT Mortgage REIT Index; (iv) an index of selected issuers in our Agency REIT Peer group, composed of Annaly Capital Management, Inc., Anworth Mortgage Asset Corporation, Capstead Mortgage Corporation, Hatteras Financial Corporation, CYS Investments, Inc. and Armour Residential REIT, Inc. ("Agency REIT Peer Group").

37



\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

* $100 invested on 12/31/10 in stock or index, including reinvestment of dividends. Fiscal year ending December 31.

Copyright © 2016 S&P, a division of The McGraw-Hill Companies Inc. All rights reserved.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **December 31,** | | |  |  |  |  |  |
|  |  | **2015** |  |  | **2014** |  |  | **2013** |  |  | **2012** |  |  | **2011** |
| American Capital Agency | $ | 126.80 |  | $ | 140.72 |  | $ | 110.67 |  | $ | 142.46 |  | $ | 118.62 |
| S&P 500 | $ | 180.75 |  | $ | 178.29 |  | $ | 156.82 |  | $ | 118.45 |  | $ | 102.11 |
| FTSE NAREIT Mortgage REITs | $ | 123.21 |  | $ | 135.21 |  | $ | 114.70 |  | $ | 116.99 |  | $ | 97.58 |
| Agency REIT Peer Group | $ | 95.00 |  | $ | 101.77 |  | $ | 84.11 |  | $ | 105.37 |  | $ | 103.89 |

The information in the share performance graph and table has been obtained from sources believed to be reliable, but neither its accuracy nor its completeness can be guaranteed. The historical information set forth above is not necessarily indicative of future performance. Accordingly, we do not make or endorse any predictions as to future share performance.

38

***Item 6. Selected Financial Data***

The following selected financial data is derived from our audited financial statements for the five fiscal years ended December 31, 2015. The selected financial data should be read in conjunction with the more detailed information contained in the Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Annual Report on Form 10-K.

**($ in millions, except per share amounts)**

**Balance Sheet Data**



Investment portfolio, at fair value

Total assets

Repurchase agreements, Federal Home Loan Bank advances and other debt

Total liabilities

Total stockholders' equity

Net asset value per common share as of period end 1

**December 31,**



|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **2015** |  | **2014** |  | **2013** |  | **2012** |  | **2011** |
| $52,473 |  | $56,748 |  | $65,941 |  | $85,245 |  | $54,683 |
| $57,021 |  | $67,766 |  | $76,255 |  | $100,453 |  | $57,972 |
| $46,102 |  | $51,057 |  | $64,443 |  | $75,415 |  | $47,735 |
| $49,050 |  | $58,338 |  | $67,558 |  | $89,557 |  | $51,760 |
| $7,971 |  | $9,428 |  | $8,697 |  | $10,896 |  | $6,212 |
| $22.59 |  | $25.74 |  | $23.93 |  | $31.64 |  | $27.71 |



**Fiscal Year**



|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Statement of Comprehensive Income Data (unaudited)** |  |  | **2015** |  |  | **2014** |  |  | **2013** |  |  | **2012** |  |  | **2011** |
| Interest income | | $ | 1,466 |  | $ | 1,472 |  | $ | 2,193 |  | $ | 2,109 |  | $ | 1,109 |
| Interest expense 2 | |  | 330 |  |  | 372 |  |  | 536 |  |  | 512 |  |  | 285 |
| Net interest income | |  | 1,136 |  |  | 1,100 |  |  | 1,657 |  |  | 1,597 |  |  | 824 |
| Other gain (loss), net 2 | |  | (782) |  |  | (1,192) |  |  | (217) |  |  | (157) |  |  | 26 |
| Expenses | |  | 139 |  |  | 141 |  |  | 168 |  |  | 144 |  |  | 74 |
| Income (loss) before income tax | |  | 215 |  |  | (233) |  |  | 1,272 |  |  | 1,296 |  |  | 776 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Provision for income tax, net | |  | — | |  | — | |  | 13 |  |  | 19 |  |  | 6 |
| Net income (loss) | |  | 215 |  |  | (233) |  |  | 1,259 |  |  | 1,277 |  |  | 770 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Dividend on preferred stock | |  | 28 |  |  | 23 |  |  | 14 |  |  | 10 |  |  | — |
| Net income (loss) available (attributable) to common stockholders | | $ | 187 |  | $ | (256) |  | $ | 1,245 |  | $ | 1,267 |  | $ | 770 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net income (loss) | | $ | 215 |  | $ | (233) |  | $ | 1,259 |  | $ | 1,277 |  | $ | 770 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Other comprehensive income (loss) 2 | |  | (496) |  |  | 1,813 |  |  | (2,938) |  |  | 1,244 |  |  | 379 |
| Comprehensive income (loss) | |  | (281) |  |  | 1,580 |  |  | (1,679) |  |  | 2,521 |  |  | 1,149 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Dividend on preferred stock | |  | 28 |  |  | 23 |  |  | 14 |  |  | 10 |  |  | — |
| Comprehensive income (loss) available (attributable) to common stockholders | | $ | (309) |  | $ | 1,557 |  | $ | (1,693) |  | $ | 2,511 |  | $ | 1,149 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Weighted average number of common shares outstanding - basic and diluted | |  | 348.6 |  |  | 353.3 |  |  | 379.1 |  |  | 303.9 |  |  | 153.3 |
| Net income (loss) per common share - basic and diluted | | $ | 0.54 |  | $ | (0.72) |  | $ | 3.28 |  | $ | 4.17 |  | $ | 5.02 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Comprehensive income (loss) per common share - basic and diluted | | $ | (0.89) |  | $ | 4.41 |  | $ | (4.47) |  | $ | 8.26 |  | $ | 7.50 |
| Dividends declared per common share | | $ | 2.48 |  | $ | 2.61 |  | $ | 3.75 |  | $ | 5.00 |  | $ | 5.60 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

39

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **Fiscal Year** | |  |  |  |
| **Other Data (unaudited)** |  | **2015** |  | **2014** |  | **2013** |  | **2012** |  | **2011** |
| Average investment securities - at par | | $51,759 |  | $53,578 |  | $75,263 |  | $71,002 |  | $33,243 |
| Average investment securities - at cost | | $54,019 |  | $56,051 |  | $79,056 |  | $74,588 |  | $34,726 |
|  |  |  |  |  |  |  |  |  |  |  |
| Average total assets - at fair value | | $63,674 |  | $67,007 |  | $96,956 |  | $86,172 |  | $38,548 |
| Net TBA dollar roll position - at par *(as of period end)* | | $7,295 |  | $14,412 |  | $2,119 |  | $12,477 |  | NM |
|  |  |  |  |  |  |  |  |  |  |  |
| Net TBA dollar roll position - at cost *(as of period end)* | | $7,430 |  | $14,576 |  | $2,276 |  | $12,775 |  | NM |
| Net TBA dollar roll position - at market value *(as of period end)* | | $7,444 |  | $14,768 |  | $2,271 |  | $12,870 |  | NM |
|  |  |  |  |  |  |  |  |  |  |  |
| Net TBA dollar roll position - at carrying value *(as of period end)* 3 | | $14 |  | $192 |  | $(5) |  | $95 |  | NM |
| Average net TBA portfolio - at cost | | $7,547 |  | $13,212 |  | $11,383 |  | $3,294 |  | NM |
|  |  |  |  |  |  |  |  |  |  |  |
| Average mortgage borrowings outstanding 4 | | $48,641 |  | $50,015 |  | $71,753 |  | $68,810 |  | $31,840 |
| Average stockholders' equity 5 | | $8,817 |  | $9,295 |  | $10,394 |  | $9,473 |  | $4,169 |
| Average coupon 6 | | 3.62 % |  | 3.63 % |  | 3.59 % |  | 3.90 % |  | 4.42 % |
| Average asset yield 7 | | 2.71 % |  | 2.63 % |  | 2.77 % |  | 2.82 % |  | 3.19 % |
| Average cost of funds 8 | | (1.49)% |  | (1.40)% |  | (1.34)% |  | (1.11)% |  | (1.00)% |
| Average net interest rate spread | | 1.22 % |  | 1.23 % |  | 1.43 % |  | 1.71 % |  | 2.19 % |
|  |  |  |  |  |  |  |  |  |  |  |
| Average net interest rate spread, including estimated TBA dollar roll income 9 | | 1.48 % |  | 1.75 % |  | 1.63 % |  | 1.77 % |  | NM |
| Average coupon *(as of period end)* | | 3.63 % |  | 3.65 % |  | 3.58 % |  | 3.69 % |  | 4.23 % |
|  |  |  |  |  |  |  |  |  |  |  |
| Average asset yield *(as of period end)* | | 2.78 % |  | 2.74 % |  | 2.70 % |  | 2.61 % |  | 3.07 % |
| Average cost of funds *(as of period end)* 10 | | (1.65)% |  | (1.40)% |  | (1.31)% |  | (1.22)% |  | (1.13)% |
| Average net interest rate spread *(as of period end)* | | 1.13 % |  | 1.34 % |  | 1.39 % |  | 1.39 % |  | 1.94 % |
| Net comprehensive income (loss) return on average common equity11 | | (3.6)% |  | 17.3 % |  | (16.6)% |  | 26.9 % |  | 27.6 % |
| Economic return (loss) on common equity 12 | | (2.6)% |  | 18.5 % |  | (12.5)% |  | 32.2 % |  | 37.4 % |
| Average leverage 13 | | 5.6:1 |  | 5.5:1 |  | 6.9:1 |  | 7.3:1 |  | 7.6:1 |
| Average "at risk" leverage, inclusive of the net TBA position 14 | | 6.4:1 |  | 7.0:1 |  | 8.0:1 |  | 7.6:1 |  | NM |
| Leverage *(as of period end)* 15 | | 5.8:1 |  | 5.3:1 |  | 7.3:1 |  | 7.0:1 |  | 7.9:1 |
| "At risk" leverage, inclusive of net TBA position *(as of period end)* 16 | | 6.8:1 |  | 6.9:1 |  | 7.5:1 |  | 8.2:1 |  | NM |
| Expenses % of average total assets | | 0.22 % |  | 0.21 % |  | 0.17 % |  | 0.17 % |  | 0.19 % |
|  |  |  |  |  |  |  |  |  |  |  |
| Expenses % of average assets, including average net TBA position | | 0.20 % |  | 0.18 % |  | 0.15 % |  | 0.16 % |  | NM |
| Expenses % of average stockholders' equity | | 1.58 % |  | 1.52 % |  | 1.61 % |  | 1.52 % |  | 1.77 % |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |

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

1. 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.
2. 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 in *Management's* *Discussion and Analysis of Financial Condition and Results of Operations* and Notes 2 and 5 of our *Consolidated Financial Statements* in this Annual Report on Form 10-K foradditional information regarding our discontinuance of hedge accounting.
3. The carrying value of our net TBA position 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 on our accompanying consolidated balance sheets.
4. Average mortgage borrowings include agency repo, FHLB advances and debt of consolidated VIEs. Amount excludes U.S. Treasury repo agreements and TBA contracts.
5. Average stockholders' equity calculated as our average month-end stockholders' equity during the period.
6. Average coupon for the period was calculated by dividing our total coupon (or cash) interest income on investment securities by our average investment securities held at par.
7. Average asset yield for the period was calculated by dividing our total cash interest income on investment securities, adjusted for amortization of premiums and discounts, by our average amortized cost of investment securities held.
8. Average cost of funds includes mortgage borrowings and interest rate swap periodic costs. Amount excludes interest rate swap termination fees, forward starting swaps and costs associated with other supplemental hedges, such as interest rate swaptions and U.S. Treasury positions. Average cost of funds for the period was calculated by dividing our total cost of funds by our average mortgage borrowings outstanding for the period.
9. 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.
10. Average cost of funds as of period end includes mortgage borrowings outstanding, plus the impact of interest rate swaps. Amount excludes costs associated with other supplemental hedges such as swaptions, U.S. Treasuries and TBA positions.
11. 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.
12. 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.

40

1. Average leverage during the period was calculated by dividing our daily weighted average mortgage 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.
2. 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.
3. Leverage at period end is calculated by dividing the sum of our mortgage borrowings outstanding and our receivable / payable for unsettled investment 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.
4. "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.

**Item 7. *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 eight sections:

* Executive Overview
* Financial Condition
* Summary of Critical Accounting Estimates
* Results of Operations
* Liquidity and Capital Resources
* Off-Balance Sheet Arrangements
* Aggregate Contractual Obligations
* Forward-Looking Statements

**EXECUTIVE OVERVIEW**

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, evolving regulations or legal settlements that impact servicing practices or other mortgage related activities.

**Trends and Recent Market Impacts**

Fiscal year 2015 was a challenging year for the fixed income markets as global economic weakness, particularly in Europe, Japan and China, created uncertainty for the U.S. economic and interest rate outlook. This uncertainty, in turn, fueled greater interest rate volatility throughout the year and substantially wider spreads between benchmark interest rates and most fixed income securities.

As we entered the year, we positioned our portfolio for a wide range of interest rate scenarios. There was considerable uncertainty with respect to the timing of Federal Reserve short term interest rate hikes, and global deflationary pressures appeared to be gaining strength in part due to declining oil prices. As a result, we prioritized risk management over current period earnings by operating with historically low leverage and a relatively conservative interest rate risk profile. This conservative risk position proved beneficial in light of the significant interest rate volatility and wider spreads the space experienced in 2015.

However, despite these actions, for the year, we incurred an economic loss of 2.6%, comprised of a loss in net book value of $3.15 per common share, or 12%, to $22.59 per common share as of December 31, 2015 and dividends declared per common share of $2.48. The increase in spreads on agency MBS relative to benchmark interest rates, particularly interest rate swap rates, was a significant factor in driving our net book value loss. The widening in agency MBS spreads was, however, less than the corresponding spread widening that occurred in most other fixed income markets, including the corporate, emerging and high yield debt markets.

In December, the Federal Reserve raised the overnight Federal Funds rate for the first time in almost ten years and indicated its intent to increase short term rates further in 2016. As we look ahead into 2016, however, we believe it has become increasingly likely that continued slow global economic growth, persistently low commodity prices, adverse currency moves and the reversal of the flow of foreign funds will negatively impact the U.S. economic growth and inflation outlook. Against this backdrop, we believe the Federal Reserve's ability to raise short term interest rates has been materially reduced. This potentially more favorable

41

interest rate outlook, when combined with the enhanced earnings power of our portfolio stemming from wider MBS spreads, could enhance future earnings, which provides us a reason to be optimistic about 2016. Portfolio returns could be further supported by either higher leverage or a reduction in aggregate hedge cost. Further spread widening on agency MBS, however, would likely have a negative impact on our net book value over the near term. 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 7A of this Annual Report on Form 10-K.

The funding landscape for agency MBS remained favorable over the course of 2015. Despite the reduction in market capacity stemming from new regulatory requirements for large financial intermediaries, we have been able to add new repo counterparties and maintain a significant amount of excess capacity. Moreover, our repo funding was diversified across 36 active repo counterparties as of December 31, 2015. The average rate on our agency repo borrowings increased 20 basis points over the year to 0.61% as of December 31, 2015, reflective of higher funding costs due to implementation of the new regulatory requirements for large financial intermediaries as well as the increase in the target Federal Funds rate implemented by the Federal Reserve in December.

In April 2015, our wholly-owned captive insurance subsidiary, OGI, was approved as a member of the FHLB of Des Moines, which provides an alternative source of funding for agency and certain other non-agency securities. Subsequently, on January 12, 2016, the FHFA released its final rule on proposed changes to regulations concerning FHLB membership criteria previously issued in September 2014. The final rule requires the termination of OGI's FHLB membership in February 2017 and requires repayment of all FHLB advances at the earlier of their contractual maturity dates or one year after the effective date of the final rule (February 2017). Although we are disappointed in the FHFA’s ruling, we do not believe that the loss of OGI’s FHLB membership will have a material adverse impact on our business.

During 2015, we also formed a wholly-owned captive broker-dealer subsidiary, BES. BES is currently in the regulatory application process and expects to be operational in mid-2016. BES intends to become a member of the FICC, thereby providing us with access to additional repo agreement funding and TBA trade clearing capabilities. We view the development of such capabilities as being favorable to our business, but there can be no assurances that BES will be successful in receiving the regulatory approvals required to become operational or that BES will be successful in becoming a member of the FICC.

In October 2015, our Board of Directors approved a modification to our investment guidelines and approved limited investments of up to 10% of our assets in AAA non-agency and commercial mortgage-backed securities, which we refer collectively to as AAA non-agency MBS. We believe this modification to our investment guidelines offers incremental return potential with limited credit exposure, while ensuring that our investment portfolio remains highly liquid.

*Share Repurchases*

During the fiscal year 2015, we repurchased approximately 15.3 million shares, or 4.3%, of our common stock at an average repurchase price of $18.58 per share, including expenses, totaling $285 million. Our decision to repurchase shares of our common stock is based on a variety of factors, including our price to net book value ratio, an assessment of the overall investment landscape for relevant assets, 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 61.7 million shares, or 15.5%, of our outstanding common stock for total consideration of approximately $1.3 billion, including expenses. As of December 31, 2015, we had $707 million available under our current Board of Directors’ authorization for repurchases of our common stock through December 31, 2016.

42

*Market Information*

The following table summarizes interest rates and prices of generic fixed rate agency MBS as of each date presented below:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **Mar. 31,** | | **June 30,** | | **Sept. 30,** | |  |  | **Dec. 31, 2015** | |  |
| **Interest Rate/Security Price 1** |  | **Dec. 31, 2014** |  | **Dec. 31, 2015** |  |  | **vs** |  |
| **2015** |  | **2015** |  | **2015** |  | **Dec. 31, 2014** | |  |
| **LIBOR:** | |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 1-Month | | 0.17% |  | 0.18% |  | 0.19% |  | 0.19% |  | 0.43% |  | +0.26 | bps |  |
| 3-Month | | 0.26% |  | 0.27% |  | 0.28% |  | 0.33% |  | 0.61% |  | +0.35 | bps |  |
| 6-Month | | 0.36% |  | 0.40% |  | 0.44% |  | 0.53% |  | 0.85% |  | +0.49 | bps |  |
| **U.S. Treasury Security Rate:** | |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2-Year U.S. Treasury | | 0.67% |  | 0.56% |  | 0.64% |  | 0.64% |  | 1.06% |  | +0.39 | bps |  |
| 3-Year U.S. Treasury | | 1.08% |  | 0.88% |  | 0.99% |  | 0.92% |  | 1.32% |  | +0.24 | bps |  |
| 5-Year U.S. Treasury | | 1.65% |  | 1.37% |  | 1.63% |  | 1.37% |  | 1.77% |  | +0.12 | bps |  |
| 10-Year U.S. Treasury | | 2.17% |  | 1.93% |  | 2.33% |  | 2.06% |  | 2.27% |  | +0.10 | bps |  |
| 30-Year U.S. Treasury | | 2.75% |  | 2.54% |  | 3.10% |  | 2.88% |  | 3.01% |  | +0.26 | bps |  |
| **Interest Rate Swap Rate:** | |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2-Year Swap | | 0.89% |  | 0.81% |  | 0.89% |  | 0.76% |  | 1.17% |  | +0.28 | bps |  |
| 3-Year Swap | | 1.29% |  | 1.11% |  | 1.24% |  | 0.99% |  | 1.41% |  | +0.12 | bps |  |
| 5-Year Swap | | 1.77% |  | 1.53% |  | 1.77% |  | 1.40% |  | 1.73% |  | -0.04 | bps |  |
| 10-Year Swap | | 2.29% |  | 2.03% |  | 2.44% |  | 2.01% |  | 2.19% |  | -0.10 | bps |  |
| 30-Year Swap | | 2.70% |  | 2.39% |  | 2.92% |  | 2.53% |  | 2.62% |  | -0.08 | bps |  |
| **30-Year Fixed Rate MBS Price:** | |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 3.0% |  | $101.22 |  | $102.25 |  | $99.58 |  | $101.34 |  | $100.01 |  | -$1.21 | |  |
| 3.5% |  | $104.28 |  | $105.05 |  | $103.02 |  | $104.31 |  | $103.18 |  | -$1.10 | |  |
| 4.0% |  | $106.75 |  | $106.92 |  | $105.91 |  | $106.67 |  | $105.83 |  | -$0.92 | |  |
| 4.5% |  | $108.56 |  | $109.08 |  | $108.09 |  | $108.41 |  | $108.00 |  | -$0.56 | |  |
| **15-Year Fixed Rate MBS Price:** | |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2.5% |  | $101.81 |  | $102.71 |  | $101.17 |  | $101.94 |  | $100.80 |  | -$1.01 | |  |
| 3.0% |  | $103.91 |  | $104.83 |  | $103.57 |  | $104.11 |  | $103.02 |  | -$0.89 | |  |
| 3.5% |  | $105.61 |  | $106.09 |  | $105.44 |  | $105.61 |  | $104.72 |  | -$0.89 | |  |
| 4.0% |  | $106.06 |  | $105.59 |  | $105.06 |  | $104.77 |  | $104.41 |  | -$1.65 | |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. 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 investment portfolio during fiscal year 2015:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Annualized Monthly Constant Prepayment** | | **Jan.** | | **Feb.** | | **Mar.** | | **Apr.** | | **May** | | **Jun.** | | **Jul.** | | **Aug.** | | **Sep.** | | **Oct.** | | **Nov.** | | **Dec.** |
| **Rates 1** |  | **2015** |  | **2015** |  | **2015** |  | **2015** |  | **2015** |  | **2015** |  | **2015** |  | **2015** |  | **2015** |  | **2015** |  | **2015** |  | **2015** |
| AGNC portfolio | | 9% |  | 8% |  | 9% |  | 12% |  | 11% |  | 12% |  | 13% |  | 13% |  | 11% |  | 11% |  | 9% |  | 9% |



\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. 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.

43

**FINANCIAL CONDITION**

As of December 31, 2015 and 2014, our investment portfolio consisted of $52.5 billion and $56.7 billion of MBS, respectively, and a $7.4 billion and $14.8 billion net long TBA position, at fair value, respectively. The following table is a summary of our investment portfolio as of December 31, 2015 and 2014 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **December 31, 2015** | | | |  |  |  |  |  |  | **December 31, 2014** | | | |  |  |
| **MBS and TBA Securities** |  |  | **Amortized** | |  | **Fair Value** |  | **Average** | | **%** |  |  | **Amortized** | |  | **Fair Value** |  | **Average** | | **%** |  |
|  | **Cost** |  |  | **Coupon** |  |  |  | **Cost** |  |  | **Coupon** |  |  |
| Fixed rate agency securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 15-year | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 15-year | | $ | 16,725 |  | $ | 16,865 |  | 3.25% |  | 28% |  | $ | 22,694 |  | $ | 23,021 |  | 3.20% |  | 32% |  |
| 15-year TBA securities | |  | 295 |  |  | 293 |  | 3.38% |  | 1% |  |  | 3,348 |  |  | 3,360 |  | 2.78% |  | 5% |  |
| Total ≤ 15-year | |  | 17,020 |  |  | 17,158 |  | 3.25% |  | 29% |  |  | 26,042 |  |  | 26,381 |  | 3.15% |  | 37% |  |
| 20-year | |  | 1,061 |  |  | 1,088 |  | 3.48% |  | 2% |  |  | 1,232 |  |  | 1,272 |  | 3.49% |  | 2% |  |
| 30-year | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 30-year | |  | 32,790 |  |  | 32,570 |  | 3.70% |  | 54% |  |  | 30,019 |  |  | 30,180 |  | 3.82% |  | 42% |  |
| 30-year TBA securities | |  | 7,135 |  |  | 7,150 |  | 3.34% |  | 12% |  |  | 11,228 |  |  | 11,408 |  | 3.17% |  | 16% |  |
| Total 30-year | |  | 39,925 |  |  | 39,720 |  | 3.63% |  | 66% |  |  | 41,247 |  |  | 41,588 |  | 3.63% |  | 58% |  |
| Total fixed rate agency securities | |  | 58,006 |  |  | 57,966 |  | 3.52% |  | 97% |  |  | 68,521 |  |  | 69,241 |  | 3.45% |  | 97% |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Adjustable rate agency securities | |  | 484 |  |  | 495 |  | 3.05% |  | 1% |  |  | 659 |  |  | 678 |  | 3.29% |  | 1% |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AAA non-agency securities | |  | 114 |  |  | 113 |  | 3.50% |  | —% | |  | — | |  | — | | —% | | —% |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| CMO agency securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| CMO | |  | 973 |  |  | 990 |  | 3.40% |  | 2% |  |  | 1,172 |  |  | 1,195 |  | 3.37% |  | 2% |  |
| Interest-only strips | |  | 152 |  |  | 179 |  | 5.28% |  | —% | |  | 179 |  |  | 203 |  | 5.46% |  | —% |  |
| Principal-only strips | |  | 165 |  |  | 174 |  | —% | | —% | |  | 193 |  |  | 199 |  | —% | | —% |  |
| Total CMO agency securities | |  | 1,290 |  |  | 1,343 |  | 3.97% |  | 2% |  |  | 1,544 |  |  | 1,597 |  | 4.02% |  | 2% |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total MBS and TBA securities | | $ | 59,894 |  | $ | 59,917 |  | 3.53% |  | 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 December 31, 2015 and 2014, our TBA position had a net carrying value of $14 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.

44

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  | **December 31, 2015** | | |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  | **Includes Net TBA Position** | | | | |  |  |  |  | **Excludes Net TBA Position** | | | | | |  |  |
|  |  |  |  |  |  |  |  |  |  |  | **% Lower** |  |  |  |  |  | **Weighted Average** | | | | **Projected** |  |
|  |  |  |  |  |  | **Amortized** | |  |  |  | **Loan Balance** |  | **Amortized** | |  |  |  |  |  |  | **Life** |  |
| **Fixed Rate Agency Securities** |  |  | **Par Value** |  |  | **Fair Value** | |  |  | **WAC 3** |  | **Yield 4** |  | **Age (Months)** |  |  |
|  |  | **Cost** |  | **& HARP 1,2** |  | **Cost Basis** |  | **CPR 4** |  |
| **Fixed rate** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 15-year | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 2.5% | | $ | 4,162 |  | $ | 4,238 |  | $ | 4,221 |  | 47% | 101.8% | |  | 2.97% |  | 2.04% |  | 38 |  | 8% |  |
| 3.0% |  |  | 4,178 |  |  | 4,307 |  |  | 4,319 |  | 73% | 103.1% | |  | 3.50% |  | 2.22% |  | 43 |  | 9% |  |
| 3.5% |  |  | 4,332 |  |  | 4,489 |  |  | 4,557 |  | 88% | 103.6% | |  | 3.95% |  | 2.53% |  | 51 |  | 10% |  |
| 4.0% |  |  | 3,439 |  |  | 3,591 |  |  | 3,662 |  | 89% | 104.4% | |  | 4.40% |  | 2.71% |  | 60 |  | 11% |  |
| 4.5% |  |  | 372 |  |  | 390 |  |  | 394 |  | 98% | 104.9% | |  | 4.87% |  | 3.04% |  | 64 |  | 12% |  |
| ≥ 5.0% | |  | 5 |  |  | 5 |  |  | 5 |  | 28% |  | 103.8% |  | 6.51% |  | 4.54% |  | 97 |  | 13% |  |
| Total ≤ 15-year | |  | 16,488 |  |  | 17,020 |  |  | 17,158 |  | 75% | 103.2% | |  | 3.71% |  | 2.38% |  | 48 |  | 10% |  |
| 20-year | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 3.0% | |  | 287 |  |  | 285 |  |  | 294 |  | 28% | 99.3% | |  | 3.55% |  | 3.11% |  | 31 |  | 8% |  |
| 3.5% |  |  | 600 |  |  | 613 |  |  | 628 |  | 64% | 102.2% | |  | 4.05% |  | 3.04% |  | 33 |  | 10% |  |
| 4.0% |  |  | 66 |  |  | 69 |  |  | 70 |  | 48% | 104.5% | |  | 4.54% |  | 2.97% |  | 52 |  | 11% |  |
| 4.5% |  |  | 84 |  |  | 90 |  |  | 92 |  | 99% | 106.7% | |  | 4.90% |  | 3.03% |  | 61 |  | 10% |  |
| ≥ 5.0% | |  | 4 |  |  | 4 |  |  | 4 |  | —% |  | 106.1% |  | 5.92% |  | 3.35% |  | 92 |  | 18% |  |
| Total 20-year: | |  | 1,041 |  |  | 1,061 |  |  | 1,088 |  | 56% | 101.9% | |  | 4.03% |  | 3.06% |  | 37 |  | 9% |  |
| 30-year: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 3.0% | |  | 6,837 |  |  | 6,852 |  |  | 6,845 |  | 2% | 100.6% | |  | 3.59% |  | 2.92% |  | 31 |  | 6% |  |
| 3.5% |  |  | 16,627 |  |  | 17,383 |  |  | 17,188 |  | 51% | 104.7% | |  | 4.09% |  | 2.84% |  | 26 |  | 7% |  |
| 4.0% |  |  | 12,888 |  |  | 13,733 |  |  | 13,687 |  | 57% | 106.7% | |  | 4.54% |  | 2.99% |  | 29 |  | 8% |  |
| 4.5% |  |  | 1,524 |  |  | 1,629 |  |  | 1,664 |  | 87% | 106.8% | |  | 4.96% |  | 3.39% |  | 55 |  | 9% |  |
| 5.0% |  |  | 148 |  |  | 158 |  |  | 163 |  | 66% | 106.4% | |  | 5.45% |  | 3.74% |  | 92 |  | 11% |  |
| ≥ 5.5% | |  | 155 |  |  | 170 |  |  | 173 |  | 38% |  | 109.5% |  | 6.20% |  | 3.40% |  | 109 |  | 16% |  |
| Total 30-year | |  | 38,179 |  |  | 39,925 |  |  | 39,720 |  | 46% |  | 105.2% |  | 4.27% |  | 2.93% |  | 30 |  | 8% |  |
| **Total fixed rate** | | $ | 55,708 |  | $ | 58,006 |  | $ | 57,966 |  | 55% | 104.5% | |  | 4.08% |  | 2.75% |  | 36 |  | 8% |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. 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 $98,000 for 15-year and 30-year securities, respectively, as of December 31, 2015.
2. 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 127% for 15-year and 30-year securities, respectively, as of December 31, 2015. Includes $0.9 billion and $4.0 billion of 15-year and 30-year securities, respectively, with >105 LTV pools which are not deliverable into TBA securities.
3. WAC represents the weighted average coupon of the underlying collateral.
4. Portfolio yield incorporates a projected life CPR assumption based on forward rate assumptions as of December 31, 2015.

45

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  | **December 31, 2014** | | |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  | **Includes Net TBA Position** | | | | |  |  |  |  | **Excludes Net TBA Position** | | | | | |  |  |
|  |  |  |  |  |  |  |  |  |  |  | **% Lower** |  |  |  |  |  | **Weighted Average** | | | | **Projected** |  |
|  |  |  |  |  |  | **Amortized** | |  |  |  | **Loan Balance** |  | **Amortized** | |  |  |  |  |  |  | **Life** |  |
| **Agency Fixed Rate Securities** |  |  | **Par Value** |  |  | **Fair Value** | |  |  | **WAC 3** |  | **Yield 4** |  | **Age (Months)** |  |  |
|  |  | **Cost** |  | **& HARP 1,2** |  | **Cost Basis** |  | **CPR 4** |  |
| **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% |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. 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.
2. 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 $0.9 billion and $3.1 billion of 15-year and 30-year securities, respectively, with >105 LTV pools which are not deliverable into TBA securities.
3. WAC represents the weighted average coupon of the underlying collateral.
4. Portfolio yield incorporates a projected life CPR assumption based on forward rate assumptions as of December 31, 2014.

As of December 31, 2015 and 2014, the combined weighted average yield of our MBS portfolio, inclusive of interest and principal-only securities and AAA non-agency securities, was 2.78% and 2.74%, respectively.

Our pass-through agency MBS collateralized by adjustable rate mortgage loans, or ARMs, have coupons linked to various indices. As of December 31, 2015 and 2014, our ARM securities had a weighted average next reset date of 46 months and 51 months, respectively.

**SUMMARY OF CRITICAL ACCOUNTING ESTIMATES**

Our critical accounting estimates relate to the recognition of interest income and the fair value of our investments and derivatives. Certain of these items involve estimates that require management to make judgments that are subjective in nature. We rely on our Manager's experience and analysis of historical and current market data in order to arrive at what we believe to be reasonable estimates. Under different conditions, we could report materially different amounts based on such estimates. The remainder of our significant accounting policies are described in Note 2 to the Consolidated Financial Statements included under Item 8 of this Annual Report on Form 10-K.

46

***Interest Income***

The effective yield on our investment securities is highly impacted by our estimate of future prepayments. We accrue interest income based on the outstanding principal amount of our investment securities and their contractual terms and we amortize or accrete premiums and discounts associated with the purchase of investment securities into interest income over the projected lives of our securities, including contractual payments and estimated prepayments, using the interest method. The weighted average cost basis of our securities as of December 31, 2015 was 104.6% of par value; therefore, faster actual or projected prepayments can have a meaningful negative impact, while slower actual or projected prepayments can have a meaningful positive impact, on our asset yields.

Future prepayment rates are difficult to predict and we rely on a third-party service provider and our Manager's experience and analysis of historical and current market data in order to arrive at what we believe to be reasonable estimates. We use a third-party service to provide estimates for 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, interest rate 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 and, based on our Manager's judgment, we may make adjustments to their estimates.

We review our actual and anticipated prepayment experience on at least a quarterly basis and effective yields are recalculated when differences arise between (i) our previously estimated future prepayments and (ii) actual prepayments to date plus current 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.

The most significant factor impacting prepayment rates on our securities is changes to long-term interest rates. Prepayment rates generally increase when interest rates fall and decrease when interest rates rise. However, there are a variety of other factors that may impact the rate of prepayments on our securities. Prepayments can also occur when borrowers sell the property and use the sale proceeds to prepay the mortgage. In addition, changes to underwriting standards, changes in house prices, further modifications to existing U.S. Government sponsored programs such as HARP, or the implementation of new programs can have a significant impact on the rate of prepayments. Further, GSE buyouts of loans that have defaulted, loans in imminent risk of default or loans that have been modified will generally be reflected as prepayments on agency securities and also increase the uncertainty around our estimates. Consequently, under different conditions, we could report materially different amounts. Item 7A. *Quantitative and Qualitative* *Disclosures About Market Risk* in this Annual Report on Form 10-K includes the estimated change in our net interest income should interest rates go up ordown by 50 and 100 basis points, assuming the yield curves of the rate shocks will be parallel to each other and the current yield curve.

***Fair Value of Investment Securities***

We estimate the fair value of our mortgage securities based on a market approach using "Level 2" inputs from third-party pricing services and non-binding dealer quotes derived from common market pricing methods. Such methods incorporate, but are not limited to, reported trades and executable bid and ask 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 generally obtain 3 to 6 quotes or prices (referred to as "marks") per security. We attempt to validate marks obtained from pricing services and broker dealers by comparing them to our recent completed transactions involving the same or similar securities on or near the reporting date. Changes in the market environment and other events that may occur over the life of our investments may cause the gains or losses ultimately realized on these investments to be different from the valuations currently estimated.

We also evaluate our 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.

If either of the first two conditions exists as of the financial reporting date, the entire amount of the impairment loss, if any, is recognized in earnings as a realized loss and the cost basis of the security is adjusted to its fair value. However, with respect to the first condition, since the liquidity of the agency securities market, and to a somewhat lesser extent the AAA non-agency

47

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, we generally do not make decisions to sell specific securities until shortly prior to initiating a sell order. In some instances, we may sell specific agency securities by delivering the 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 before the 48-hour deadline.

If the third condition exists, the OTTI is separated into (i) the amount relating to credit loss (the "credit component") and (ii) the amount relating to all other factors (the "non-credit components"). Only the credit component is recognized in earnings, with the non-credit components recognized in OCI. However, in evaluating if the third condition exists, our investments in agency securities typically would not have a credit component since the principal and interest are guaranteed by a GSE and, therefore, any unrealized loss is not the result of a credit loss. In addition, since we designate our mortgage securities as available-for-sale securities with unrealized gains and losses recognized in OCI, any impairment loss for non-credit components is already recognized in OCI.

***Derivative Financial Instruments/Hedging Activity***

We maintain a risk management strategy, under which we may use a variety of derivative instruments to economically hedge some of our exposure to market risks, including interest rate, prepayment and extension risks. Our risk management objective is to reduce fluctuations in net book value over a range of interest rate scenarios. The principal instruments that we use are interest rate swaps and swaptions. We also utilize TBA contracts for the forward purchase or sale of agency MBS securities on a generic pool basis and we utilize 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 and other types of derivatives, such as principal or interest-only securities.

We recognize all derivatives as either assets or liabilities on the balance sheet, measured at fair value. During the third quarter of 2011, we elected to discontinue hedge accounting for our interest rate swaps. Accordingly, subsequent to the third quarter of 2011, all changes in the fair value of our derivative instruments are reported in earnings in our consolidated statement of comprehensive income in gain (loss) on derivatives and other securities, net during the period in which they occur.

The use of derivatives 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.

We estimate the fair value of our centrally cleared interest rate swaps using the daily settlement price determined by the respective clearing 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" swaps using a combination of inputs from counterparty and third-party pricing models to estimate the net present value of the future cash flows using the forward interest rate yield curve in effect as of the end of the measurement period, adjusted for non-performance risk, if any.

We estimate the fair value of interest rate swaptions using a combination of inputs from counterparty and third-party pricing models based on 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.

In considering the effect of nonperformance risk, we consider the impact of netting and credit enhancements, such as collateral postings and guarantees, and have concluded that neither our own nor our counterparty risk is significant to the overall valuation of these agreements.

48

**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,

1. 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.

**FISCAL YEAR 2015 COMPARED TO FISCAL YEAR 2014**

***Interest Income and Asset Yield***

The following table summarizes our interest income for fiscal years 2015 and 2014 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year 2015** | | |  |  | **Fiscal Year 2014** | | |
|  |  | **Amount** | | **Yield** | |  | **Amount** | | **Yield** |
| Cash/coupon interest income | $ | 1,874 |  | 3.62 % |  | $ | 1,945 |  | 3.63 % |
| Net premium amortization |  | (408) |  | (0.91)% |  |  | (473) |  | (1.00)% |
| Interest income | $ | 1,466 |  | 2.71 % |  | $ | 1,472 |  | 2.63 % |
|  |  |  |  |  |  |  |  |  |  |
| Actual portfolio CPR |  | 10% |  |  |  |  | 9% |  |  |
| Projected life CPR as of period end |  | 8% |  |  |  |  | 9% |  |  |
| Average 30-year fixed rate mortgage rate as of period end 1 |  | 4.01% |  |  |  |  | 3.87% |  |  |
| 10-year U.S. Treasury rate as of period end |  | 2.27% |  |  |  |  | 2.17% |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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

The principal elements impacting our interest income are the size of our average investment portfolio and the yield on our investments. The following is a summary of the estimated impact of each of these elements on the decrease in interest income from fiscal year 2014 to 2015 (in millions):

**Impact of Changes in the Principal Elements Impacting Interest Income**



**Fiscal Year 2015 vs. 2014**



|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Due to Change in Average** | | |  |
|  |  | **Total Increase /** | |  | **Portfolio** | |  | **Asset** |
|  |  | **(Decrease)** | |  | **Size** | |  | **Yield** |
| Interest Income | $ | (6) |  | $ | (53) |  | $ | 47 |

The size of our average investment portfolio decreased in par value by 3% during fiscal year 2015, reflective of lower "at risk" leverage, partially offset by a relative shift from TBA dollar roll funded assets to repo funded assets. In accordance with

49

GAAP, we report TBA dollar roll income in gain/loss on derivative instruments and other securities, net in our accompanying consolidated financial statements and, therefore, our reported interest income excludes such amounts.

Our average asset yield increased by 8 bps during fiscal year 2015, primarily due to fluctuations in "catch-up" premium amortization cost recognized due to changes in our projected life CPR forecasts. We recognized "catch-up" premium amortization cost of $1 million for fiscal year 2015, compared to $53 million for fiscal year 2014. Excluding "catch-up" premium amortization adjustments, our average asset yield was 2.72% for fiscal year 2015, unchanged from fiscal year 2014.

***Leverage***

Our leverage was 5.8x and 5.3x our stockholders' equity as of December 31, 2015 and 2014, respectively, measured as the sum of our agency repurchase agreements ("agency repo"), FHLB advances and debt of consolidated VIEs (collectively referred to as "mortgage 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 ("U.S. Treasury repo") due to the temporary and highly liquid nature of these investments.

Inclusive of our net TBA position, our total "at risk" leverage was 6.8x and 6.9x our stockholders' equity as of December 31, 2015 and 2014, respectively. Since we recognize our TBA commitments as derivatives under GAAP, they are not included in our repurchase agreement 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 funding liabilities. Similarly, a short TBA position has substantially the same effect as selling the underlying MBS assets and reducing our on-balance sheet funding commitments. (Refer to *Liquidity and Capital Resources* for further discussion of TBA dollar roll positions). Therefore, we refer to our leverage adjusted for TBA positions as our "at risk" leverage.

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  | **Net TBA Position** | | | |  |  |  | **Average Total** | |  |  | **"At Risk"** |  |
|  |  |  |  | **Mortgage Borrowings 1** | | | | | |  |  |  | **Long / (Short) 2** | | | |  | **Average** | | **"At Risk"** | | **Leverage** | | **Leverage** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Leverage** | | **Leverage** | | **as of** | | **as of** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Quarter Ended** |  | **Average Daily** | |  |  |  | **Maximum** | |  | **Ending** | | **Average Daily** | | |  | **Ending** |  | **during the** | | **during the** | | **Period End** | | **Period End** |  |
|  | **Amount** |  |  | **Daily Amount** | |  |  | **Amount** |  |  | **Amount** |  |  | **Amount** |  | **Period 1,3** |  | **Period 1,4** |  | **1,5** |  | **1,6** |  |
| December 31, 2015 | | $ | 47,018 | $ | | | 50,078 |  | $ | 46,077 |  | $ | 7,796 |  | $ | 7,430 | 5.8:1 | |  | 6.8:1 |  | 5.8:1 |  | 6.8:1 |  |
| September 30, 2015 | | $ | 43,308 | $ | | | 46,049 |  | $ | 44,683 |  | $ | 9,434 |  | $ | 7,265 | 5.1:1 | |  | 6.2:1 |  | 5.9:1 |  | 6.8:1 |  |
| 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 |  |
| September 30, 2014 | | $ | 46,694 | $ | | | 50,989 |  | $ | 44,368 |  | $ | 15,680 |  | $ | 17,769 | 5.0:1 | |  | 6.7:1 |  | 4.8:1 |  | 6.7:1 |  |
| 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 |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Mortgage borrowings includes agency repo, FHLB advances and debt of consolidated VIEs. Amounts exclude U.S. Treasury repo agreements.
2. Daily average and ending net TBA position outstanding measured at cost.
3. Average leverage during the period was calculated by dividing the sum of our daily weighted average mortgage 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.
5. Leverage as of period end was calculated by dividing the sum of the amount of mortgage borrowings outstanding and net payables and receivables for unsettled agency 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 mortgage borrowings and the reclassification of accumulated OCI into interest expense related to previously de-designated interest rate swaps. Our mortgage borrowings primarily consist of agency repurchase agreements and FHLB advances. Upon our election to discontinue hedge accounting under GAAP as of

50

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 mortgage borrowings outstanding, includes periodic interest costs on our interest rate swaps reported in gain/loss on derivative instruments 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 mortgage 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 fiscal years 2015 and 2014 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Fiscal Year 2015** | | | |  | **Fiscal Year 2014** | | |
| **Adjusted Net Interest Expense and Cost of Funds** |  | **Amount** | |  | **% 1** |  | **Amount** | |  | **% 1** |
| **Interest expense:** | |  |  |  |  |  |  |  |  |  |
| Interest expense on mortgage borrowings | | $ | 229 |  | 0.47% |  | $ | 216 |  | 0.43% |
| Periodic interest costs of interest rate swaps | |  |  |  |  |  |  |  |  |  |
| previously designated as hedges under GAAP, | |  |  |  |  |  |  |  |  |  |
| net | |  | 101 |  | 0.21% |  |  | 156 |  | 0.31% |
| **Total interest expense** | |  | 330 |  | 0.68% |  |  | 372 |  | 0.74% |
| Other periodic interest costs of interest rate swaps, | |  |  |  |  |  |  |  |  |  |
| net | |  | 393 |  | 0.81% |  |  | 330 |  | 0.66% |
| **Total adjusted net interest expense and cost of funds** | | $ | 723 |  | 1.49% |  | $ | 702 |  | 1.40% |
|  |  |  |  |  |  |  |  |  |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Percent of our average mortgage borrowings outstanding for the period annualized.

The principal elements impacting our adjusted net interest expense are the size of our average mortgage borrowings and the size of our average interest rate swap balance outstanding during the period (excluding forward starting swaps), and the average interest rate on our borrowings and the average net pay rate on our interest rates swaps. The 9 bps increase in our average cost of funds during fiscal year 2015 was largely due to higher interest rates on our borrowings and a higher ratio of interest rate swaps outstanding to our average mortgage borrowings. The following is a summary of the estimated impact of these elements on changes in our adjusted net interest expense from fiscal year 2014 to 2015 (in millions):

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



**Fiscal Year 2015 vs. 2014**



|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Due to Change in Average** | | |  |  |
|  | **Total Increase** |  |  |  | **Borrowing / Swap** | | **Borrowing / Swap** | |  |
|  |  |  |  | **Balance** | | **Rate** |  |  |
| Interest expense on mortgage borrowings | $ | 13 |  | $ | (6) |  | $ | 19 |  |
| Periodic interest rate swap costs 1 |  | 8 |  |  | 18 |  |  | (10) |  |
| Total change in adjusted net interest expense | $ | 21 |  | $ | 12 |  | $ | 9 |  |
|  |  |  |  |  |  |  |  |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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.

51

The table below presents a summary of our average mortgage borrowings outstanding and our average interest rates swaps outstanding, excluding forward starting swaps, for fiscal years 2015 and 2014 (dollars in millions):

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Fiscal Year** | | |  |  |
| **Average Ratio of Interest Rate Swaps Outstanding (Excluding Forward Starting Swaps) to Mortgage Borrowings** | |  | **2015** |  |  | **2014** |  |
| **Outstanding** |  |  |  |  |  |
| Average mortgage borrowings | | $ | 48,641 |  | $ | 50,015 |  |
| Average notional amount of interest rate swaps (excluding forward starting swaps) | | $ | 35,220 |  | $ | 33,988 |  |
| Average ratio of interest rate swaps to mortgage borrowings | |  | 72% |  |  | 68% |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Weighted average pay rate on interest rate swaps | |  | 1.68% |  |  | 1.64% |  |
| Weighted average receive rate on interest rate swaps | |  | 0.28% |  |  | 0.21% |  |
| Weighted average net pay rate on interest rate swaps | |  | 1.40% |  |  | 1.43% |  |
|  |  |  |  |  |  |  |  |

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.

Including forward starting swaps and our net TBA position, our average ratio of interest rate swaps outstanding to our average mortgage borrowings and net TBA position (at cost) was 81% for fiscal year 2015, compared to 58% for fiscal year 2014.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Fiscal Year** | | |  |  |
| **Average Ratio of Interest Rate Swaps Outstanding (Including Forward Starting Swaps) to Mortgage Borrowings** | |  | **2015** |  |  | **2014** |  |
| **and Net TBA Position** |  |  |  |  |  |
| Average mortgage borrowings | | $ | 48,641 |  | $ | 50,015 |  |
| Average net TBA position - at cost | |  | 7,547 |  |  | 13,212 |  |
| Total average mortgage borrowings and net TBA position | | $ | 56,188 |  | $ | 63,227 |  |
| Average notional amount of interest rate swaps (including of forward starting swaps) | | $ | 45,446 |  | $ | 36,408 |  |
| Average ratio of interest rate swaps to mortgage borrowings and net TBA position | |  | 81% |  |  | 58% |  |
|  |  |  |  |  |  |  |  |

52

***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 fiscal years 2015 and 2014 (dollars in millions):

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year** | | | |  |
|  |  | **2015** |  |  | **2014** |  |
| Net interest income | $ | 1,136 |  | $ | 1,100 |  |
| Other periodic interest costs of interest rate swaps, net 1 |  | (393) |  |  | (330) |  |
| Dividend from REIT equity securities 1 |  | 6 |  |  | 20 |  |
| TBA dollar roll income 1 |  | 237 |  |  | 505 |  |
| Adjusted net interest income |  | 986 |  |  | 1,295 |  |
| Operating expenses |  | 139 |  |  | 141 |  |
| Net spread and dollar roll income |  | 847 |  |  | 1,154 |  |
| Dividend on preferred stock |  | 28 |  |  | 23 |  |
| Net spread and dollar roll income available to common stockholders |  | 819 |  |  | 1,131 |  |
| Estimated "catch-up" premium amortization cost due to change in CPR forecast |  | 1 |  |  | 53 |  |
| Net spread and dollar roll income, excluding "catch-up" premium amortization, available to | $ | 820 |  | $ | 1,184 |  |
| common stockholders |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
| Weighted average number of common shares outstanding - basic and diluted |  | 348.6 |  |  | 353.3 |  |
|  |  |  |  |  |  |  |
| Net spread and dollar roll income per common share - basic and diluted | $ | 2.35 |  | $ | 3.20 |  |
| Net spread and dollar roll income, excluding "catch-up" premium amortization, per common share - | $ | 2.35 |  | $ | 3.35 |  |
| basic and diluted |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_



1. Reported in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income

Net spread and dollar roll income, excluding "catch-up" premium amortization adjustments, for fiscal year 2015 decreased to $2.35 per common share from $3.35 per common share for fiscal year 2014, due to the combination of lower "at risk" leverage, a decline in TBA dollar roll income and a higher cost of funds. The decline in dollar roll income was a function of a smaller average net TBA dollar roll position, as well as an increase in implied TBA 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 1.48% for fiscal year 2015, compared to 1.83% for fiscal year 2014. Including catch-up premium amortization adjustments, our net interest rate spread and dollar roll income was 1.48% for fiscal year 2015, compared to 1.75% for fiscal year 2014.

***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 fiscal years 2015 and 2014 (in millions):

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year** | | |  |
|  |  | **2015** |  |  | **2014** |
| Agency MBS sold, at cost | $ | (27,578) |  | $ | (30,123) |
| Proceeds from agency MBS sold 1 |  | 27,555 |  |  | 30,174 |
| Net gain (loss) on sale of agency MBS | $ | (23) |  | $ | 51 |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
| Gross gain on sale of agency MBS | $ | 98 |  | $ | 172 |
| Gross loss on sale of agency MBS |  | (121) |  |  | (121) |
| Net gain (loss) on sale of agency MBS | $ | (23) |  | $ | 51 |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_



1. 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 leverage adjustments and portfolio repositioning. We did not have any sales of non-agency securities during either of the periods presented.

53

***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 fiscal years 2015 and 2014 (in millions):

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year** | | |  |
|  |  | **2015** |  |  | **2014** |
| Periodic interest costs of interest rate swaps, net | $ | (393) |  | $ | (330) |
| Realized gain (loss) on derivative instruments and other securities, net: |  |  |  |  |  |
| TBA securities - dollar roll income, net |  | 237 |  |  | 505 |
| TBA securities - mark-to-market net gain |  | 246 |  |  | 416 |
| Payer swaptions |  | (77) |  |  | (171) |
| Receiver swaptions |  | 15 |  |  | (1) |
| U.S. Treasury securities - long position |  | (33) |  |  | 7 |
| U.S. Treasury securities - short position |  | (72) |  |  | (378) |
| U.S. Treasury futures - short position |  | (21) |  |  | (34) |
| Interest rate swap termination fees |  | (327) |  |  | (127) |
| REIT equity securities |  | 4 |  |  | 71 |
| Other |  | 1 |  |  | (10) |
| Total realized gain (loss) on derivative instruments and other securities, net |  | (27) |  |  | 278 |
| Unrealized gain (loss) on derivative instruments and other securities, net: |  |  |  |  |  |
| TBA securities - mark-to-market net (loss) gain |  | (178) |  |  | 196 |
| Interest rate swaps |  | (212) |  |  | (1,381) |
| Payer swaptions |  | 42 |  |  | (22) |
| Receiver swaptions |  | (11) |  |  | 12 |
| Interest and principal-only strips |  | 5 |  |  | 32 |
| U.S. Treasury securities - long position |  | (5) |  |  | 59 |
| U.S. Treasury securities - short position |  | 4 |  |  | (42) |
| U.S. Treasury futures - short position |  | 9 |  |  | (42) |
| Debt of consolidated VIEs |  | 16 |  |  | (10) |
| REIT equity securities |  | (9) |  |  | 4 |
| Other |  | — | |  | 3 |
| Total unrealized gain (loss) on derivative instruments and other securities, net |  | (339) |  |  | (1,191) |
| Total gain (loss) on derivative instruments and other securities, net | $ | (759) |  | $ | (1,243) |
|  |  |  |  |  |  |

For further details regarding our use of derivative instruments and related activity refer to Notes 2 and 5 of our Consolidated Financial Statements in this Form 10-K.

***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 $116 million and $119 million for fiscal year 2015 and 2014, respectively. The decline in our management fees was a function of our smaller capital base due to the combination of share repurchases and net losses realized on our portfolio.

General and administrative expenses were $23 million and $22 million for fiscal year 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 1.58% and 1.52% for fiscal years 2015 and 2014, respectively.

54

***Dividends and Income Taxes***

For fiscal years 2015 and 2014, we had estimated taxable income available to common stockholders of $431 million and $439 million (or $1.24 and $1.24 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

1. temporary differences related to the amortization of premiums and discounts 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 fiscal years 2015 and 2014 (dollars in millions):

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year** | | | |
|  |  | **2015** |  |  | **2014** |
| Net income (loss) | $ | 215 |  | $ | (233) |
| Estimated book to tax differences: |  |  |  |  |  |
| Premium amortization, net |  | (32) |  |  | 34 |
| Realized gain/loss, net |  | 14 |  |  | 495 |
| Net capital loss/(utilization of net capital loss carryforward) |  | (77) |  |  | (1,024) |
| Unrealized gain/loss, net |  | 339 |  |  | 1,191 |
| Other |  | — | |  | (1) |
| Total book to tax differences |  | 244 |  |  | 695 |
| Estimated REIT taxable income |  | 459 |  |  | 462 |
| Dividend on preferred stock |  | 28 |  |  | 23 |
| Estimated REIT taxable income available to common stockholders | $ | 431 |  | $ | 439 |
|  |  |  |  |  |  |
| Weighted average number of common shares outstanding - basic and diluted |  | 348.6 |  |  | 353.3 |
| Estimated REIT taxable income per common share - basic and diluted | $ | 1.24 |  | $ | 1.24 |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
| Beginning cumulative non-deductible net capital loss | $ | 761 |  | $ | 1,785 |
| Utilization of net capital loss carryforward |  | (77) |  |  | (1,024) |
| Ending cumulative non-deductible net capital loss | $ | 684 |  | $ | 761 |
| Ending cumulative non-deductible net capital loss per ending common share | $ | 2.03 |  | $ | 2.16 |
|  |  |  |  |  |  |

As of December 31, 2015, we had $684 million (or $2.03 per common share) of net capital loss carryforwards, which can be carried forward and applied against future net capital gains through fiscal year 2018.

As of December 31, 2015 and 2014, we had distributed all of our estimated taxable income for fiscal years 2015 and 2014, respectively. Accordingly, we do not expect to incur an income tax or excise tax liability on our 2015 taxable income, nor did we incur such liabilities on our 2014 taxable income.

55

The following table summarizes dividends declared on our Series A Preferred Stock, depositary shares underlying our Series B Preferred Stock and common stock during fiscal years 2015 and 2014:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Dividends Declared per Share** | | | | | |  |
|  |  |  |  |  |  |  | |  |  |
|  |  |  |  |  |  | **Series B Preferred** | |  |  |
|  |  |  | **Series A Preferred** | |  | **Stock (Per** | |  |  |
| **Quarter Ended** | |  | **Stock** | |  | **Depositary Share)** | |  | **Common Stock** |
|  |  |  |  |  |  |  |  |  |  |
| December 31, 2015 | | $ | 0.50000 |  | $ | 0.484375 |  | $ | 0.60 |
| September 30, 2015 | |  | 0.50000 |  |  | 0.484375 |  |  | 0.60 |
|  |  |  |  |  |  |  |  |  |  |
| June 30, 2015 | |  | 0.50000 |  |  | 0.484375 |  |  | 0.62 |
| March 31, 2015 | |  | 0.50000 |  |  | 0.484375 |  |  | 0.66 |
|  |  |  |  |  |  |  |  |  |  |
| Total | | $ | 2.00000 |  | $ | 1.937500 |  | $ | 2.48 |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| December 31, 2014 | | $ | 0.50000 |  | $ | 0.484375 |  | $ | 0.66 |
| September 30, 2014 | |  | 0.50000 |  |  | 0.484375 |  |  | 0.65 |
|  |  |  |  |  |  |  |  |  |  |
| June 30, 2014 | |  | 0.50000 |  |  | 0.360590 |  |  | 0.65 |
| March 31, 2014 | |  | 0.50000 |  |  | — | |  | 0.65 |
|  |  |  |  |  |  |  |  |  |  |
| Total | | $ | 2.00000 |  | $ | 1.329340 |  | $ | 2.61 |
|  |  |  |  |  |  |  |  |  |  |

***Other Comprehensive Income (Loss)***

The following table summarizes the components of our other comprehensive income (loss) for fiscal years 2015 and 2014 (in millions):

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year** | | | |
|  |  | **2015** |  |  | **2014** |
| Unrealized gain (loss) on available-for-sale securities, net: |  |  |  |  |  |
| Unrealized gain (loss), net | $ | (620) |  | $ | 1,708 |
| Reversal of prior period unrealized (gain) loss, net, upon realization |  | 23 |  |  | (51) |
| Unrealized gain (loss) on available-for-sale securities, net: |  | (597) |  |  | 1,657 |
| 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 |  | 101 |  |  | 156 |
| Total other comprehensive income (loss) | $ | (496) |  | $ | 1,813 |
|  |  |  |  |  |  |

56

**FISCAL YEAR 2014 COMPARED TO FISCAL YEAR 2013:**

***Interest Income and Asset Yield***

The following table summarizes our interest income for the fiscal years 2014 and 2013 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year 2014** | | |  |  | **Fiscal Year 2013** | | |
|  |  | **Amount** | | **Yield** | |  | **Amount** | | **Yield** |
| Cash/coupon interest income | $ | 1,945 |  | 3.63 % |  | $ | 2,710 |  | 3.59 % |
| Net premium amortization |  | (473) |  | (1.00)% |  |  | (517) |  | (0.82)% |
| Interest income | $ | 1,472 |  | 2.63 % |  | $ | 2,193 |  | 2.77 % |
|  |  |  |  |  |  |  |  |  |  |
| Actual portfolio CPR |  | 9% |  |  |  |  | 10% |  |  |
| Projected life CPR as of period end |  | 9% |  |  |  |  | 7% |  |  |
| Average 30-year fixed rate mortgage rate as of period end 1 |  | 3.87% |  |  |  |  | 4.48% |  |  |
| 10-year U.S. Treasury rate as of period end |  | 2.17% |  |  |  |  | 3.01% |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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

The following is a summary of the estimated impact of the principal elements impacting our interest income on the decline in interest income from fiscal year 2013 to 2014 (in millions):

**Impact of Changes in Principal Elements Impacting**

**Interest Income**



**Fiscal Year 2014 vs. 2013**



|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Due to Change in Average 1** | | | |
|  |  | **Net** | |  | **Portfolio** | |  | **Asset** |
|  |  | **Decrease** | |  | **Size** | |  | **Yield** |
| Interest Income | $ | (721) |  | $ | (638) |  | $ | (83) |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Variances that are the combined effect of changes in portfolio size and asset yield, but cannot be separately identified, are allocated to the portfolio size and asset yield variances based on their respective relative amounts.

The average par value of our agency MBS portfolio decreased by 29% for fiscal year 2014, reflective of a shift from agency MBS repo funded assets to TBA dollar roll funded assets and a smaller average capital base due to common stock share repurchases and realized losses on our portfolio during 2013.

Our average asset yield for fiscal year 2014 was also impacted by changes in our asset composition and 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 for fiscal year 2014 was 2.72%, compared to 2.64% for fiscal year 2013.

***Leverage***

Our leverage was 5.3x and 7.3x our stockholders' equity as of December 31, 2014 and 2013, respectively. Inclusive of our net TBA position, our total "at risk" leverage was 6.9x and 7.5x our stockholders' equity as of December 31, 2014 and 2013, respectively.

57

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Agency MBS Repurchase Agreements** | | | | | | | |  | **Net TBA Position** | | | |  |  |  | **Average Total** | |  |  | **"At Risk"** |  |
|  |  |  |  |  | **and Other Debt 1** | | |  |  |  |  | **Long / (Short) 2** | | | |  | **Average** | | **"At Risk"** | | **Leverage** | | **Leverage** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Leverage** | | **Leverage** | | **as of** | | **as of** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Quarter Ended** |  | **Average Daily** | | |  | **Maximum** | |  | **Ending** | | **Average Daily** | | |  | **Ending** |  | **during the** | | **during the** | | **Period End** | | **Period End** |  |
|  | **Amount** |  | **Daily Amount** | |  |  | **Amount** |  |  | **Amount** |  |  | **Amount** |  | **Period 1,3** |  | **Period 1,4** |  | **1,5** |  | **1,6** |  |
| 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 |  |
| September 30, 2014 | | $ | 46,694 |  | $ | 50,989 |  | $ | 44,368 |  | $ | 15,680 |  | $ | 17,769 | 5.0:1 | |  | 6.7:1 |  | 4.8:1 |  | 6.7:1 |  |
| 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 |  |
| December 31, 2013 | | $ | 71,260 |  | $ | 80,706 |  | $ | 62,124 |  | $ | (486) |  | $ | 2,276 | 7.6:1 | |  | 7.5:1 |  | 7.3:1 |  | 7.5:1 |  |
| September 30, 2013 | | $ | 78,845 |  | $ | 83,859 |  | $ | 79,117 |  | $ | 131 |  | $ | (7,060) | 7.8:1 | |  | 7.8:1 |  | 7.9:1 |  | 7.2:1 |  |
| June 30, 2013 | | $ | 66,060 |  | $ | 71,102 |  | $ | 71,102 |  | $ | 28,904 |  | $ | 15,285 | 5.9:1 | |  | 8.4:1 |  | 7.0:1 |  | 8.5:1 |  |
| March 31, 2013 | | $ | 70,591 |  | $ | 75,580 |  | $ | 67,122 |  | $ | 17,892 |  | $ | 27,294 | 6.5:1 | |  | 8.2:1 |  | 5.7:1 |  | 8.1:1 |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Excludes U.S. Treasury repo agreements.
2. Daily average and ending net TBA position outstanding measured at cost.
3. Average leverage during the period was calculated by dividing the sum of our daily weighted average agency repurchase agreements and debt of consolidated VIEs outstanding for the period 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.
5. Leverage as of period end was calculated by dividing the sum of the amount outstanding under our agency MBS repurchase agreements, net payables and receivables for unsettled agency MBS securities and debt of consolidated VIEs 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***

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 fiscal years 2014 and 2013 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Fiscal Year 2014** | | | |  | **Fiscal Year 2013** | | |
| **Adjusted Net Interest Expense and Cost of Funds** |  | **Amount** | |  | **% 1** |  | **Amount** | |  | **% 1** |
| **Interest expense:** | |  |  |  |  |  |  |  |  |  |
| Repurchase agreement and other debt interest | |  |  |  |  |  |  |  |  |  |
| expense | | $ | 216 |  | 0.43% |  | $ | 347 |  | 0.48% |
| Periodic interest costs of interest rate swaps | |  |  |  |  |  |  |  |  |  |
| previously designated as hedges under GAAP, | |  |  |  |  |  |  |  |  |  |
| net | |  | 156 |  | 0.31% |  |  | 189 |  | 0.26% |
| **Total interest expense** | |  | 372 |  | 0.74% |  |  | 536 |  | 0.74% |
| Other periodic interest costs of interest rate swaps, net | |  | 330 |  | 0.66% |  |  | 424 |  | 0.60% |
| **Total adjusted net interest expense and cost of funds** | | $ | 702 |  | 1.40% |  | $ | 960 |  | 1.34% |
|  |  |  |  |  |  |  |  |  |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Percent of our average repurchase agreements and other debt outstanding for the period annualized.

58

The following is a summary of the estimated impact of the principal elements impacting our adjusted net interest expense on changes in our adjusted net interest expense for from fiscal year 2013 to 2014 (in millions):

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



**Fiscal Year 2014 vs. 2013**



|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Due to Change in Average 1** | | | |
|  | **Decrease** |  |  | **Repo / Swap Balance** | | |  | **Repo / Swap Rate** |
| Repurchase agreements and other debt expense | $ | (131) |  | $ | (105) |  | $ | (26) |
| Periodic interest rate swap costs 2 |  | (127) |  |  | (170) |  |  | 43 |
| Total change in adjusted net interest expense | $ | (258) |  | $ | (275) |  | $ | 17 |
|  |  |  |  |  |  |  |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Variances that are the combined effect of changes in our repurchase agreement/interest rate swap balance and changes in repurchase agreement/swap interest rates, but cannot be separately identified, are allocated to each variance based on their respective relative amounts.
2. Includes amounts recognized in interest expense and in gain (loss) on derivative instruments 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 decline in our adjusted net interest expense was primarily a function of a smaller average swap portfolio in effect during 2014, due to a larger number of forward starting swaps held during the year, and a function of a decline in our average repo and other debt outstanding, due to a smaller agency MBS portfolio and shift towards TBA dollar roll funded assets during the year. Our cost of funds also benefited from a decline in our average repo rate of 5 bps during the year, which was more than offset by an increase in the average fixed rate we pay on our interest rate swaps. The table below presents a summary of our average repo outstanding and interest rates swaps in effect for fiscal years 2014 and 2013 (dollars in millions):

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Fiscal Year** | | |  |
| **Average Debt and Current Pay Interest Rate Swaps Outstanding 1** |  |  | **2014** |  |  | **2013** |
| Average repurchase agreements and other debt | | $ | 50,015 |  | $ | 71,753 |
| Average notional amount of current pay interest rate swaps | | $ | 33,988 |  | $ | 47,007 |
| Average ratio of current pay interest rate swaps to repurchase agreements and other debt outstanding | |  | 68% |  |  | 66% |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
| Weighted average pay rate on current pay interest rate swaps | |  | 1.64% |  |  | 1.55% |
| Weighted average receive rate on current pay interest rate swaps | |  | 0.21% |  |  | 0.25% |
| Weighted average net pay rate on current pay interest rate swaps | |  | 1.43% |  |  | 1.30% |
|  |  |  |  |  |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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. As of December 31, 2014, we had $12.4 billion of forward starting interest rate swaps outstanding with a weighted average forward start date of 1.1 years through April 2019 and a weighted average fixed pay rate of 3.01%. As of December 31, 2013, we had $4.0 billion of forward starting interest rate swaps outstanding with a weighted average forward start date of 1.9 years through November 2016 and a weighted average fixed pay rate of 2.94%.

59

***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(non-GAAP financial measures) for the fiscal years 2014 and 2013 (dollars in millions):

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year** | | | |  |
|  |  | **2014** |  |  | **2013** |  |
| Net interest income | $ | 1,100 |  | $ | 1,657 |  |
| Other periodic interest costs of interest rate swaps, net 1 |  | (330) |  |  | (424) |  |
| Dividend from REIT equity securities |  | 20 |  |  | 5 |  |
| TBA dollar roll income 1 |  | 505 |  |  | 320 |  |
| Adjusted net interest income |  | 1,295 |  |  | 1,558 |  |
| Operating expenses |  | 141 |  |  | 168 |  |
| Net spread and dollar roll income |  | 1,154 |  |  | 1,390 |  |
| Dividend on preferred stock |  | 23 |  |  | 14 |  |
| Net spread and dollar roll income available to common shareholders |  | 1,131 |  |  | 1,376 |  |
| Estimated "catch-up" premium amortization cost (benefit) due to change in CPR forecast |  | 53 |  |  | (103) |  |
| Net spread and dollar roll income, excluding "catch-up" premium amortization, available to common | $ | 1,184 |  | $ | 1,273 |  |
| shareholders |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
| Weighted average number of common shares outstanding - basic and diluted |  | 353.3 |  |  | 379.1 |  |
|  |  |  |  |  |  |  |
| Net spread and dollar roll income per common share - basic and diluted | $ | 3.20 |  | $ | 3.63 |  |
| Net spread and dollar roll income, excluding "catch-up" premium amortization, per common share - | $ | 3.35 |  | $ | 3.36 |  |
| basic and diluted |  |  |
|  |  |  |  |  |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Reported in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income

Net spread and dollar roll income, excluding "catch-up" premium amortization cost (benefit), for fiscal year 2014 was largely unchanged at $3.35 per common share, compared to $3.36 per common share for fiscal year 2013, despite a 12.5% decline in our average "at risk" leverage. Our smaller investment portfolio was largely offset by improved financing in the TBA dollar roll market, our relative shift from repo funded assets towards dollar roll funded assets and lower swap costs. Our average net interest rate spread and dollar roll income (the difference between the average yield on our assets and our average cost of funds), excluding catch-up amortization, was approximately 1.83% for fiscal year 2014, compared to 1.51% for fiscal year 2013. Including catch-up amortization, our net interest rate spread and dollar roll income was 1.75% for fiscal year 2014, compared to 1.63% for fiscal year 2013.

***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 fiscal years 2014 and 2013 (in millions):

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year** | | |  |
|  |  | **2014** |  |  | **2013** |
| Agency MBS sold, at cost | $ | (30,123) |  | $ | (81,516) |
| Proceeds from agency MBS sold 1 |  | 30,174 |  |  | 80,108 |
| Net gain (loss) on sale of agency MBS | $ | 51 |  | $ | (1,408) |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
| Gross gain on sale of agency MBS | $ | 172 |  | $ | 217 |
| Gross loss on sale of agency MBS |  | (121) |  |  | (1,625) |
| Net gain (loss) on sale of agency MBS | $ | 51 |  | $ | (1,408) |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_



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

Asset sales were primarily a function of shifting our portfolio to TBA dollar roll funded assets, reducing leverage and repositioning our investment portfolio. The decline in gross loss on sale of agency MBS was a function of higher asset prices in 2014, compared to price declines experienced during 2013.

60

***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 fiscal years 2014 and 2013 (in millions):

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year** | | |  |
|  |  | **2014** |  |  | **2013** |
| Periodic interest costs of interest rate swaps, net 1 | $ | (330) |  | $ | (424) |
| Realized gain on derivative instruments and other securities, net: |  |  |  |  |  |
| TBA securities - dollar roll income, net |  | 505 |  |  | 320 |
| TBA securities - mark-to-market net gain/(loss) |  | 416 |  |  | (946) |
| Payer swaptions |  | (171) |  |  | 233 |
| Receiver swaptions |  | (1) |  |  | — |
| U.S. Treasury securities - long position |  | 7 |  |  | 13 |
| U.S. Treasury securities - short position |  | (378) |  |  | 412 |
| U.S. Treasury futures - short position |  | (34) |  |  | 9 |
| Interest rate swap termination fees |  | (127) |  |  | 29 |
| REIT equity securities |  | 71 |  |  | 5 |
| Other |  | (10) |  |  | (6) |
| Total realized gain on derivative instruments and other securities, net |  | 278 |  |  | 69 |
| Unrealized (loss) gain on derivative instruments and other securities, net: 2 |  |  |  |  |  |
| TBA securities - mark-to-market net gain/(loss) |  | 196 |  |  | (100) |
| Interest rate swaps |  | (1,381) |  |  | 1,540 |
| Payer swaptions |  | (22) |  |  | 25 |
| Receiver swaptions |  | 12 |  |  | — |
| Interest and principal-only strips |  | 32 |  |  | — |
| U.S. Treasury securities - long position |  | 59 |  |  | (55) |
| U.S. Treasury securities - short position |  | (42) |  |  | 60 |
| U.S. Treasury futures - short position |  | (42) |  |  | 40 |
| Debt of consolidated VIEs |  | (10) |  |  | 39 |
| REIT equity securities |  | 4 |  |  | (3) |
| Other |  | 3 |  |  | — |
| Total unrealized (loss) gain on derivative instruments and other securities, net |  | (1,191) |  |  | 1,546 |
| Total (loss) gain on derivative instruments and other securities, net | $ | (1,243) |  | $ | 1,191 |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_



1. Please refer to *Interest Expense and Cost of Funds* discussion above for additional information regarding other periodic interest costs of interest rate swaps, net.
2. 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 2 and 5 of our Consolidated Financial Statements in this Annual Report on Form 10-K.

***Management Fees and General and Administrative Expenses***

We incurred management fees of $119 million and $136 million for fiscal years 2014 and 2013, respectively. The decline in our management fees was a function of our smaller capital base due to the combination of share repurchases and net realized losses on our portfolio during the second half of fiscal year 2013.

General and administrative expenses were $22 million and $32 million for fiscal years 2014 and 2013, respectively. Our general and administrative expenses for such periods primarily consisted of prime broker fees, information technology costs, accounting fees, legal fees, Board of Director fees, insurance expense and general overhead expense. The decline in our general and administrative expenses was largely due to a smaller average portfolio size.

Our total operating expense as a percentage of our average stockholders' equity was 1.52% and 1.61% as of December 31, 2014 and 2013, respectively.

61

***Dividends and Income Taxes***

For fiscal years 2014 and 2013, we had estimated taxable income available to common shareholders of $439 million and $940 million (or $1.24 and $2.48 per common share), respectively.

The following is a reconciliation of our GAAP net income to our estimated taxable income for fiscal years 2014 and 2013 (dollars in millions):

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year** | | |  |
|  |  | **2014** |  |  | **2013** |
| Net (loss) income | $ | (233) |  | $ | 1,259 |
| Estimated book to tax differences: |  |  |  |  |  |
| Premium amortization, net |  | 34 |  |  | (137) |
| Realized losses (gains), net |  | 495 |  |  | (414) |
| Capital loss (carryforward) / in excess of capital gain |  | (1,024) |  |  | 1,785 |
| Unrealized losses (gains), net |  | 1,191 |  |  | (1,546) |
| Other |  | (1) |  |  | 7 |
| Total book to tax differences |  | 695 |  |  | (305) |
| Estimated REIT taxable income |  | 462 |  |  | 954 |
| Dividend on preferred stock |  | 23 |  |  | 14 |
| Estimated REIT taxable income available to common shareholders | $ | 439 |  | $ | 940 |
|  |  |  |  |  |  |
| Weighted average number of common shares outstanding - basic and diluted |  | 353.3 |  |  | 379.1 |
| Estimated REIT taxable income per common share - basic and diluted | $ | 1.24 |  | $ | 2.48 |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
| Beginning cumulative non-deductible capital losses | $ | 1,785 |  | $ | — |
| Non-deductible capital losses in excess of capital gains |  | — | |  | 1,785 |
| Utilization of capital loss carryforward |  | (1,024) |  |  | — |
| Ending cumulative non-deductible capital losses | $ | 761 |  | $ | 1,785 |
| Ending cumulative non-deductible capital losses per common share | $ | 2.16 |  | $ | 5.01 |
|  |  |  |  |  |  |

Taxable income for fiscal year 2014 excludes $1.0 billion of estimated net capital gains, which were applied against our prior year net capital loss carryforward. Taxable income for fiscal year 2013 excludes $1.8 billion of non-deductible net capital losses. Net capital losses can be carried forward and applied against future net capital gains for up to five years.

For fiscal years 2014 and 2013, we distributed all of our taxable income within the limits prescribed by the Internal Revenue Code. Accordingly, we did not incur an income tax liability on our 2014 and 2013 taxable income. However, we did not distribute the required minimum amount of taxable income during fiscal year 2013 pursuant to federal excise tax requirements and we recognized an excise tax provision of $3 million for fiscal year 2013. Additionally, for fiscal year 2013, we recorded an income tax provision of $10 million attributable to our TRS.

62

The following table summarizes dividends declared on our Series A Preferred Stock, depositary shares underlying our Series B Preferred Stock and common stock during fiscal years 2014 and 2013:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Dividends Declared per Share** | | | | | |  |
|  |  |  |  |  |  |  | |  |  |
|  |  |  |  |  |  | **Series B Preferred** | |  |  |
|  |  |  | **Series A Preferred** | |  | **Stock (Per** | |  |  |
| **Quarter Ended** | |  | **Stock** | |  | **Depositary Share)** | |  | **Common Stock** |
|  |  |  |  |  |  |  |  |  |  |
| December 31, 2014 1 | | $ | 0.50000 |  | $ | 0.484375 |  | $ | 0.66 |
| September 30, 2014 | |  | 0.50000 |  |  | 0.484375 |  |  | 0.65 |
|  |  |  |  |  |  |  |  |  |  |
| June 30, 2014 2 | |  | 0.50000 |  |  | 0.360590 |  |  | 0.65 |
| March 31, 2014 | |  | 0.50000 |  |  | — | |  | 0.65 |
|  |  |  |  |  |  |  |  |  |  |
| Total | | $ | 2.00000 |  | $ | 1.329340 |  | $ | 2.61 |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| December 31, 2013 3 | | $ | 0.50000 |  | $ | — | | $ | 0.65 |
| September 30, 2013 | |  | 0.50000 |  |  | — | |  | 0.80 |
|  |  |  |  |  |  |  |  |  |  |
| June 30, 2013 | |  | 0.50000 |  |  | — | |  | 1.05 |
| March 31, 2013 | |  | 0.50000 |  |  | — | |  | 1.25 |
|  |  |  |  |  |  |  |  |  |  |
| Total | | $ | 2.00000 |  | $ | — | | $ | 3.75 |
|  |  |  |  |  |  |  |  |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. The Series A and Series B Preferred Stock dividend held a record date of January 1, 2015 and is included in fiscal year 2015 for federal income tax purposes.
2. Series B Preferred Stock depositary share dividend amount includes dividends payable for a partial dividend period.
3. The Series A Preferred Stock dividend held a record date of January 1, 2014 and is included in fiscal year 2014 for federal income tax purposes.

***Other Comprehensive Income (Loss)***

The following table summarizes the components of our other comprehensive income (loss) for fiscal years 2014 and 2013 (in millions):

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Fiscal Year** | | |  |
|  |  | **2014** |  |  | **2013** |
| Unrealized gain (loss) on AFS securities, net: |  |  |  |  |  |
| Unrealized gain (loss), net | $ | 1,708 |  | $ | (4,535) |
| Reversal of prior period unrealized (gain) loss, net, upon realization |  | (51) |  |  | 1,408 |
| Unrealized gain (loss) on AFS securities, net: |  | 1,657 |  |  | (3,127) |
| 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 |  | 156 |  |  | 189 |
| Total other comprehensive income (loss) | $ | 1,813 |  | $ | (2,938) |
|  |  |  |  |  |  |

**LIQUIDITY AND CAPITAL RESOURCES**

Our primary sources of funds are borrowings under master repurchase agreements, asset sales, receipts of monthly principal and interest payments on our investment portfolio and equity offerings. 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. 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.

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

63

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 the majority of our borrowings under such master repurchase agreements will have maturities ranging up to one year, but we may have longer-term borrowings ranging up to five years or longer. Borrowings under our master repurchase agreements with maturities greater than 90 days will typically have floating rates of interest based on LIBOR plus or minus a fixed spread.

As of December 31, 2015, we had $41.7 billion of repurchase agreements outstanding used to fund acquisitions of agency securities and we had an additional $25 million 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. Our "at risk" leverage ratio was 6.8x as of December 31, 2015, compared to 6.9x as of December 31, 2014, measured as the sum of our mortgage borrowings (primarily consisting of our agency repurchase agreements), our net TBA position (at cost) and our net receivable / payable for unsettled mortgage 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 5.8x our stockholders' equity as of December 31, 2015, compared to 5.3x as of December 31, 2014.

As of December 31, 2015, our agency repurchase agreements had a weighted average cost of funds of 0.61% and a weighted average remaining days-to-maturity of 173 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 December 31, 2015, we had master repurchase agreements with 36 financial institutions located throughout North America, Europe and Asia. As of December 31, 2015, less than 5% of our stockholders' equity was at risk with any one repo counterparty, with the top five repo counterparties representing less than 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 December 31, 2015. For further details regarding our borrowings under repurchase agreements and concentration of credit risk as of December 31, 2015, please refer to Notes 4 and 6 to our Consolidated Financial Statements in this Annual Report on Form 10-K.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **December 31, 2015** | | |  |
|  |  | **Number of Counter-** | | **Percent of** |  |
| **Counter-Party Region** |  | **Repurchase** |  |
| **Parties** |  | **Agreement Funding** |  |
| North America | | 18 |  | 61% |  |
| Europe | | 13 |  | 25% |  |
| Asia | | 5 |  | 14% |  |
|  |  | 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 fiscal year 2015, haircuts on our pledged collateral remained stable and as of December 31, 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 securities securing our repurchase agreements and prepayments on the mortgages securing such securities. Similarly, if the estimated fair value of our investment securities increases due to changes in interest

64

rates or other factors, counterparties may release collateral back to us. Our repurchase agreements generally provide that the valuations of securities 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 their value. 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 December 31, 2015, we had met all of our margin requirements and we had unrestricted cash and cash equivalents of $1.1 billion and unpledged securities of approximately $3.0 billion, including securities pledged to us and unpledged interests in our consolidated VIEs, available to meet margin calls on our repurchase agreements and other funding liabilities, 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.

During 2015, we formed a wholly-owned captive broker-dealer subsidiary, BES. BES is currently in the regulatory application process and expects to be operational in mid-2016. BES intends to become a member of the FICC, thereby providing us with additional repurchase agreement funding and TBA trade clearing capabilities. There can be no assurances that BES will be successful in receiving the regulatory approvals required to become operational or that BES will be successful in becoming a member of the FICC.

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 2 and 5 to our Consolidated Financial Statements in this Annual Report on Form 10-K 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 our 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 December 31, 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 2 and 5 to our Consolidated Financial Statements in this Annual Report on Form 10-K).

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 December 31, 2015, we had a net long TBA position with a market value and total contract

65

price of $7.4 billion and a total net carrying value of $14 million recognized in derivative assets/(liabilities), at fair value, on our Consolidated Balance Sheets in this Annual Report on Form 10-K.

Our TBA dollar roll contracts are also subject to margin requirements governed by the MBSD of the FICC 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, OGI, was approved as a member of the FHLB of Des Moines. The FHLBs provide a variety of products and services to their members, including short and long-term secured loans, called "advances." In January 2016, the FHFA released its final rule on changes to regulations concerning FHLB membership criteria. The final rule terminates OGI's FHLB membership and requires repayment of all advances at the earlier of their contractual maturity dates or one year after the effective date of the final rule (February 2017). As of December 31, 2015, we had $3.8 billion of FHLB advances outstanding with a weighted average interest rate of 0.53% and a weighted average remaining days to maturity of 141 days up to February 2017. Termination of our FHLB membership could negatively impact our liquidity position, however, since FHLB advances do not represent our primary source of funding, we believe that we will have adequate alternative sources of funding upon such termination.

FHLB members may use a variety of real estate related assets, including agency MBS and AAA non-agency securities, as collateral for advances. The ability to borrow from the FHLB during the duration of our FHLB membership 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. In addition, membership in the FHLB obligates OGI to purchase membership and activity-based stock in the FHLB, the latter dependent upon the aggregate amount of advances obtained from the FHLB.

FHLB advances 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 over the term of the secured borrowings.

***Asset Sales and TBA Eligible Securities***

We maintain a portfolio of highly liquid mortgage-backed securities. We may sell our agency securities through the TBA market by delivering them into TBA contracts, subject to "good delivery" provisions promulgated by SIFMA. We may alternatively sell agency 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 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 December 31, 2015, approximately 90% 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, 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 funding liabilities 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. Furthermore, when the trading price of our common stock is significantly less than our estimate of our current net asset value per common share, among other conditions, we may repurchase shares of our common stock.

66

*Common Stock Repurchase Program*

Our Board of Directors adopted a program that authorizes repurchases of our common stock up to $2 billion. In October 2015, our Board of Directors extended its authorization through December 31, 2016. 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 fiscal year 2015, we repurchased 15.3 million shares of our common stock at an average repurchase price of $18.58 per share, including expenses, totaling $285 million. As of December 31, 2015, the total remaining amount authorized for repurchases of our common stock was $707 million.

**OFF-BALANCE SHEET ARRANGEMENTS**

As of December 31, 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 December 31, 2015, we had not guaranteed any obligations of unconsolidated entities or entered into any commitment or intent to provide funding to any such entities.

**AGGREGATE CONTRACTUAL OBLIGATIONS**

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for repurchase agreements, FHLB advances and related interest expense (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  | **Fiscal Year** | | |  |  |  |  |  |  |  |  |
|  |  |  | **2016** |  |  | **2017** |  |  | **2018** |  |  | **2019** |  |  | **2020** |  |  | **Total** |
| Repurchase agreements and FHLB advances | | $ | 39,464 |  | $ | 2,593 |  | $ | 650 |  | $ | 1,300 |  | $ | 1,500 |  | $ | 45,507 |
| Interest expense1 | |  | 80 |  |  | 35 |  |  | 25 |  |  | 16 |  |  | 1 |  |  | 157 |
| Total | | $ | 39,544 |  | $ | 2,628 |  | $ | 675 |  | $ | 1,316 |  | $ | 1,501 |  | $ | 45,664 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Interest expense is calculated based on the weighted average interest rates on our repurchase agreements and FHLB advances as of December 31, 2015.

**FORWARD-LOOKING STATEMENTS**

*All statements contained herein that are not historical facts including, but not limited to, statements regarding anticipated activity are forward looking in nature and involve a number of risks and uncertainties. Actual results may differ materially. Among the factors that could cause actual results to differ materially are the following: (i) changes in the market value of our assets; (ii) changes in net interest rate spreads; (iii) changes in prepayment rates of the mortgage loans underlying our agency securities; (iv) risks associated with our hedging activities; (v) availability and terms of financing arrangements; (vi) further actions by the U.S. government to stabilize the economy; (vii) changes in our business or investment strategy; (viii) legislative and regulatory changes (including changes to laws governing the taxation of REITs); (ix) our ability to meet the requirements of a REIT (including income and asset requirements); and (x) our ability to remain exempt from registration under the Investment Company Act of 1940. For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, please see the information under the caption "Risk Factors" described in this Annual Report on Form 10-K. We caution readers not to place undue reliance on any such forward-looking statements, which statements are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made.*

67

**Item 7A. *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 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 mortgage 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 invest in mortgage and other types of derivative instruments, such as interest and principal-only securities. 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. Duration measures 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. 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); the fair value of our investment portfolio (including derivatives and other securities used for hedging purposes); and our net asset value as of December 31, 2015 and 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 December 31, 2015 and 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. 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.

68

**Interest Rate Sensitivity 1**



|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Percentage Change in Projected** | | | | |  |
|  |  |  |  | **Portfolio** | |  |  |
| **Change in Interest Rate** |  | **Net Interest** | | **Market** | | **Net Asset Value** |  |
| **Income 2** |  | **Value 3,4** |  | **3,5** |  |
| **As of December 31, 2015** | |  |  |  |  |  |  |
| -100 Basis Points | | -17.3% |  | -0.4% |  | -2.8% |  |
| -50 Basis Points | | -4.2% |  | +0.1% |  | +0.6% |  |
| +50 Basis Points | | +2.0% |  | -0.5% |  | -3.7% |  |
| +100 Basis Points | | +2.5% |  | -1.2% |  | -9.4% |  |
|  |  |  |  |  |  |  |  |
| **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% |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. 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.
2. 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 interest rate swaps, but excludes costs associated with our forward starting swaps and other supplemental hedges, such as swaptions and U.S. Treasury securities. Amounts also exclude costs associated with our TBA position and TBA dollar roll income/loss, which are accounted for as derivative instruments in accordance with GAAP. Base case scenario assumes interest rates and forecasted CPR of 8% and 9% as of December 31, 2015 and 2014, respectively. As of December 31, 2015, rate shock scenarios assume a forecasted CPR of 12%, 10%, 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 residential mortgage-backed securities 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 mortgage securities 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 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 investment securities and benchmark interest rates, our net book value could decline if the value of our investment 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

69

anticipated monetary policy actions by the Federal Reserve, 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 December 31, 2015 and 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 as of December 31, 2015 and 2014, respectively, based on interest rates and MBS prices as of such dates. 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 1**



|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Percentage Change in Projected** | | |  |
|  |  | **Portfolio** | | **Net Asset** |  |
| **Change in MBS Spread** |  | **Market** | |  |
| **Value 2,3** |  | **Value 2,4** |  |
| **As of December 31, 2015** | |  |  |  |  |
| -25 Basis Points | | +1.3% |  | +10.2% |  |
| -10 Basis Points | | +0.5% |  | +4.1% |  |
| +10 Basis Points | | -0.5% |  | -4.1% |  |
| +25 Basis Points | | -1.3% |  | -10.2% |  |
|  |  |  |  |  |  |
| **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% |  |



\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. 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, FHLB advances and other short-term funding agreements. As of December 31, 2015, we had unrestricted cash and cash equivalents of $1.1 billion and unpledged securities of approximately $3.0 billion, including securities pledged to us and unpledged interests in our consolidated VIEs, available to meet margin calls on our funding liabilities 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 funding liabilities and derivative agreements could increase, causing an adverse change in our liquidity position. Furthermore, there is no assurance that we will always be able to renew (or roll) our short-term funding liabilities. In addition, our counterparties have the option to increase our haircuts (margin requirements) on the assets we pledge against our funding liabilities, thereby reducing the amount that can be borrowed against an asset even if they agree to renew or roll such funding liabilities. 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

70

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 funding liabilities.

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 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.

***Credit Risk***

We are exposed to credit risk relating to potential losses that could be recognized on our non-agency securities due to delinquency, foreclosure and related losses on the underlying mortgage loans, and to counterparty credit risk relating to potential losses on our repurchase agreements, other debt and derivative contracts in the event that the counterparties 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. We seek to manage credit risk related to investments in non-agency securities through prudent asset selection, pre-acquisition due diligence, post-acquisition performance monitoring, sale of assets where we have identified negative credit trends and the use of various types of credit enhancements. Our overall management of credit exposure may also include the use of credit default swaps or other financial derivatives that we believe are appropriate. Additionally, we intend to limit our non-agency mortgage investments to investment grade, AAA rated securities and to up to 10% of our portfolio. However, there is no guarantee our efforts to manage credit risk will be successful and we could suffer significant losses if unsuccessful.

71

**Item 8. *Financial Statements and Supplementary Data***

Our management is responsible for the preparation, integrity and objectivity of the accompanying consolidated financial statements and the related financial information. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States and necessarily include certain amounts that are based on estimates and informed judgments. Our management also prepared the related financial information included in this Annual Report on Form 10-K and is responsible for its accuracy and consistency with the consolidated financial statements.

The consolidated financial statements have been audited by Ernst & Young LLP, an independent registered public accounting firm, who conducted their audit in accordance with the standards of the Public Company Accounting Oversight Board (United States) as of December 31, 2015 and 2014 and fiscal years 2015, 2014 and 2013. The independent registered public accounting firm's responsibility is to express an opinion as to the fairness with which such consolidated financial statements present our financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States.

**Management's Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of our management and Board of Directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the consolidated financial statements.

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

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2015, utilizing the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its Internal Control-Integrated Framework (2013 framework). Based on this assessment and those criteria, management determined that our internal control over financial reporting was effective as of December 31, 2015. The effectiveness of our internal control over financial reporting as of December 31, 2015 has been audited by Ernst & Young LLP, our independent registered public accounting firm, as stated in their attestation report included in this Annual Report on Form 10-K.

72

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders of American Capital Agency Corp.

We have audited American Capital Agency Corp.’s internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). American Capital Agency Corp.’s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company’s assets that could have a material effect on the financial statements.

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

In our opinion, American Capital Agency Corp. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of American Capital Agency Corp. as of December 31, 2015 and 2014, and the related consolidated statements of comprehensive income, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2015 of American Capital Agency Corp., and our report dated February 23, 2016 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

McLean, Virginia

February 23, 2016

73

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders of American Capital Agency Corp.

We have audited the accompanying consolidated balance sheets of American Capital Agency Corp. as of December 31, 2015 and 2014, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2015. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of American Capital Agency Corp. at December 31, 2015 and 2014, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), American Capital Agency Corp.'s internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 23, 2016 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

McLean, Virginia

February 23, 2016

74

**AMERICAN CAPITAL AGENCY CORP.**

**CONSOLIDATED BALANCE SHEETS**

**(in millions, except per share data)**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **December 31,** | | |  |
|  | **2015** |  |  |  | **2014** |
| **Assets:** |  |  |  |  |  |
|  |  |  |  |  |  |
| Agency securities, at fair value (including pledged securities of $48,380 and $51,629, respectively) | $ | 51,331 |  | $ | 55,482 |
| Agency securities transferred to consolidated variable interest entities, at fair value (pledged securities) |  | 1,029 |  |  | 1,266 |
|  |  |  |  |  |  |
| Non-agency securities, at fair value (including pledged securities of $113 and $0, respectively) |  | 113 |  |  | — |
| U.S. Treasury securities, at fair value (including pledged securities of $25 and $2,375, respectively) |  | 25 |  |  | 2,427 |
|  |  |  |  |  |  |
| REIT equity securities, at fair value |  | 33 |  |  | 68 |
| Cash and cash equivalents |  | 1,110 |  |  | 1,720 |
|  |  |  |  |  |  |
| Restricted cash and cash equivalents |  | 1,281 |  |  | 713 |
| Derivative assets, at fair value |  | 81 |  |  | 408 |
|  |  |  |  |  |  |
| Receivable for securities sold (including pledged securities of $0 and $79, respectively) |  | — | |  | 239 |
| Receivable under reverse repurchase agreements |  | 1,713 |  |  | 5,218 |
|  |  |  |  |  |  |
| Other assets |  | 305 |  |  | 225 |
| Total assets | $ | 57,021 |  | $ | 67,766 |
| **Liabilities:** |  |  |  |  |  |
| Repurchase agreements | $ | 41,754 |  | $ | 50,296 |
|  |  |  |  |  |  |
| Federal Home Loan Bank advances |  | 3,753 |  |  | — |
| Debt of consolidated variable interest entities, at fair value |  | 595 |  |  | 761 |
|  |  |  |  |  |  |
| Payable for securities purchased |  | 182 |  |  | 843 |
| Derivative liabilities, at fair value |  | 935 |  |  | 890 |
|  |  |  |  |  |  |
| Dividends payable |  | 74 |  |  | 85 |
| Obligation to return securities borrowed under reverse repurchase agreements, at |  |  |  |  |  |
| fair value |  | 1,696 |  |  | 5,363 |
|  |  |  |  |  |  |
| Accounts payable and other accrued liabilities |  | 61 |  |  | 100 |
| Total liabilities |  | 49,050 |  |  | 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; |  |  |  |  |  |
|  |  |  |  |  |  |
| 337.5 and 352.8 shares issued and outstanding, respectively |  | 3 |  |  | 4 |
| Additional paid-in capital |  | 10,048 |  |  | 10,332 |
|  |  |  |  |  |  |
| Retained deficit |  | (2,350) |  |  | (1,674) |
| Accumulated other comprehensive (loss) income |  | (66) |  |  | 430 |
|  |  |  |  |  |  |
| Total stockholders' equity |  | 7,971 |  |  | 9,428 |
| Total liabilities and stockholders' equity | $ | 57,021 |  | $ | 67,766 |
|  |  |  |  |  |  |

See accompanying notes to consolidated financial statements.

75

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

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **For the year ended December 31,** | | | | | | |
|  |  |  |  |  |  |  |  |  |
|  |  | **2015** |  |  | **2014** |  |  | **2013** |
|  |  |  |  |  |  |  |  |  |
| **Interest income:** |  |  |  |  |  |  |  |  |
| Interest income | $ | 1,466 |  | $ | 1,472 |  | $ | 2,193 |
|  |  |  |  |  |  |  |  |  |
| Interest expense |  | 330 |  |  | 372 |  |  | 536 |
| Net interest income |  | 1,136 |  |  | 1,100 |  |  | 1,657 |
|  |  |  |  |  |  |  |  |  |
| **Other gain (loss), net:** |  |  |  |  |  |  |  |  |
| Gain (loss) on sale of agency securities, net |  | (23) |  |  | 51 |  |  | (1,408) |
|  |  |  |  |  |  |  |  |  |
| Gain (loss) on derivative instruments and other securities, net |  | (759) |  |  | (1,243) |  |  | 1,191 |
| Total other loss, net |  | (782) |  |  | (1,192) |  |  | (217) |
|  |  |  |  |  |  |  |  |  |
| **Expenses:** |  |  |  |  |  |  |  |  |
| Management fees |  | 116 |  |  | 119 |  |  | 136 |
|  |  |  |  |  |  |  |  |  |
| General and administrative expenses |  | 23 |  |  | 22 |  |  | 32 |
| Total expenses |  | 139 |  |  | 141 |  |  | 168 |
|  |  |  |  |  |  |  |  |  |
| **Income (loss) before income tax** |  | 215 |  |  | (233) |  |  | 1,272 |
| Provision for income tax, net |  | — | |  | — | |  | 13 |
|  |  |  |  |  |  |  |  |  |
| **Net income (loss)** |  | 215 |  |  | (233) |  |  | 1,259 |
| Dividend on preferred stock |  | 28 |  |  | 23 |  |  | 14 |
|  |  |  |  |  |  |  |  |  |
| **Net income (loss) available (attributable) to common stockholders** | $ | 187 |  | $ | (256) |  | $ | 1,245 |
|  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| **Net income (loss)** | $ | 215 |  | $ | (233) |  | $ | 1,259 |
| **Other comprehensive income (loss):** |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Unrealized gain (loss) on available-for-sale securities, net |  | (597) |  |  | 1,657 |  |  | (3,127) |
| Unrealized gain on derivative instruments, net |  | 101 |  |  | 156 |  |  | 189 |
|  |  |  |  |  |  |  |  |  |
| Other comprehensive income (loss) |  | (496) |  |  | 1,813 |  |  | (2,938) |
| **Comprehensive income (loss)** |  | (281) |  |  | 1,580 |  |  | (1,679) |
|  |  |  |  |  |  |  |  |  |
| Dividend on preferred stock |  | 28 |  |  | 23 |  |  | 14 |
| **Comprehensive income (loss) available (attributable) to common stockholders** | $ | (309) |  | $ | 1,557 |  | $ | (1,693) |
|  |  |  |  |  |  |  |  |  |
| **Weighted average number of common shares outstanding - basic and diluted** |  | 348.6 |  |  | 353.3 |  |  | 379.1 |
| **Net income (loss) per common share - basic and diluted** | $ | 0.54 |  | $ | (0.72) |  | $ | 3.28 |
|  |  |  |  |  |  |  |  |  |

See accompanying notes to consolidated financial statements.

76

**AMERICAN CAPITAL AGENCY CORP.**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**

**(in millions)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Preferred Stock** | | | |  | **Common Stock** | | |  |  |  | **Additional** | |  |  |  |  | **Accumulated** | |  |  |  |
|  |  |  |  |  |  |  |  | **Other** | |  |  |  |
|  | **Shares** | | **Amount** | | | **Shares** | | **Amount** | | |  | **Paid-in** | |  | **Retained** | |  | **Comprehensive** | |  | **Total** |  |
|  |  | **Capital** | |  | **Deficit** | |  | **Income (Loss)** | |  |  |
| **Balance, December 31 2012** | 6.9 |  | $ | 167 |  | 338.9 |  | $ | 3 |  | $ | 9,460 |  | $ | (289) |  | $ | 1,555 |  | $ | 10,896 |  |
| Net income | — | |  | — | | — | |  | — | |  | — | |  | 1,259 |  |  | — | |  | 1,259 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Other comprehensive income (loss): |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Unrealized loss on available-for-sale |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| securities, net | — | |  | — | | — | |  | — | |  | — | |  | — | |  | (3,127) |  |  | (3,127) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Unrealized gain on derivative instruments, |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| net | — | |  | — | | — | |  | — | |  | — | |  | — | |  | 189 |  |  | 189 |  |
| Issuance of common stock | — | |  | — | | 57.5 |  |  | 1 |  |  | 1,802 |  |  | — | |  | — | |  | 1,803 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Repurchase of common stock | — | |  | — | | (40.2) |  |  | — | |  | (856) |  |  | — | |  | — | |  | (856) |  |
| Preferred dividends declared | — | |  | — | | — | |  | — | |  | — | |  | (14) |  |  | — | |  | (14) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Common dividends declared | — | |  | — | | — | |  | — | |  | — | |  | (1,453) |  |  | — | |  | (1,453) |  |
| **Balance, December 31, 2013** | 6.9 |  |  | 167 |  | 356.2 |  |  | 4 |  |  | 10,406 |  |  | (497) |  |  | (1,383) |  |  | 8,697 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net loss | — | |  | — | | — | |  | — | |  | — | |  | (233) |  |  | — | |  | (233) |  |
| Other comprehensive income: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Unrealized gain on available-for-sale |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| securities, net | — | |  | — | | — | |  | — | |  | — | |  | — | |  | 1,657 |  |  | 1,657 |  |
| Unrealized gain on derivative instruments, |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| net | — | |  | — | | — | |  | — | |  | — | |  | — | |  | 156 |  |  | 156 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Issuance of preferred stock | — | |  | 169 |  | — | |  | — | |  | — | |  | — | |  | — | |  | 169 |  |
| Repurchase of common stock | — | |  | — | | (3.4) |  |  | — | |  | (74) |  |  | — | |  | — | |  | (74) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Preferred dividends declared | — | |  | — | | — | |  | — | |  | — | |  | (23) |  |  | — | |  | (23) |  |
| Common dividends declared | — | |  | — | | — | |  | — | |  | — | |  | (921) |  |  | — | |  | (921) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Balance, December 31, 2014** | 6.9 |  |  | 336 |  | 352.8 |  |  | 4 |  |  | 10,332 |  |  | (1,674) |  |  | 430 |  |  | 9,428 |  |
| Net income | — | |  | — | | — | |  | — | |  | — | |  | 215 |  |  | — | |  | 215 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Other comprehensive income (loss): |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Unrealized loss on available-for-sale |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| securities, net | — | |  | — | | — | |  | — | |  | — | |  | — | |  | (597) |  |  | (597) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Unrealized gain on derivative instruments, |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| net | — | |  | — | | — | |  | — | |  | — | |  | — | |  | 101 |  |  | 101 |  |
| Repurchase of common stock | — | |  | — | | (15.3) |  |  | (1) |  |  | (284) |  |  | — | |  | — | |  | (285) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Preferred dividends declared | — | |  | — | | — | |  | — | |  | — | |  | (28) |  |  | — | |  | (28) |  |
| Common dividends declared | — | |  | — | | — | |  | — | |  | — | |  | (863) |  |  | — | |  | (863) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Balance, December 31, 2015** | 6.9 |  | $ | 336 |  | 337.5 |  | $ | 3 |  | $ | 10,048 |  | $ | (2,350) |  | $ | (66) |  | $ | 7,971 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

See accompanying notes to consolidated financial statements.

77

**AMERICAN CAPITAL AGENCY CORP.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(in millions)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **For the year ended December 31,** | | | | | |  |
|  |  |  |  |  |  |  |  |  |
|  |  | **2015** |  |  | **2014** |  |  | **2013** |
|  |  |  |  |  |  |  |  |  |
| **Operating activities:** |  |  |  |  |  |  |  |  |
| Net income (loss) | $ | 215 |  | $ | (233) |  | $ | 1,259 |
|  |  |  |  |  |  |  |  |  |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |  |  |  |  |  |  |  |  |
| Amortization of premiums and discounts on securities, net |  | 408 |  |  | 472 |  |  | 517 |
|  |  |  |  |  |  |  |  |  |
| Amortization of accumulated other comprehensive loss on interest rate swaps de-designated as qualifying |  |  |  |  |  |  |  |  |
| hedges |  | 101 |  |  | 156 |  |  | 189 |
| (Gain) loss on sale of agency securities, net |  | 23 |  |  | (51) |  |  | 1,408 |
|  |  |  |  |  |  |  |  |  |
| (Gain) loss on derivative instruments and other securities, net |  | 759 |  |  | 1,243 |  |  | (1,191) |
| (Increase) decrease in other assets |  | (83) |  |  | 55 |  |  | (24) |
|  |  |  |  |  |  |  |  |  |
| Increase (decrease) in accounts payable and other accrued liabilities |  | 1 |  |  | (18) |  |  | 325 |
| Accretion of discounts on debt of consolidated variable interest entities |  | 4 |  |  | (2) |  |  | 18 |
|  |  |  |  |  |  |  |  |  |
| Net cash provided by operating activities |  | 1,428 |  |  | 1,622 |  |  | 2,501 |
| **Investing activities:** |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Purchases of agency securities |  | (32,770) |  |  | (26,349) |  |  | (76,892) |
| Purchases of non-agency securities |  | (116) |  |  | — | |  | — |
|  |  |  |  |  |  |  |  |  |
| Proceeds from sale of agency securities |  | 27,794 |  |  | 30,587 |  |  | 79,456 |
| Principal collections on securities |  | 7,922 |  |  | 7,358 |  |  | 10,589 |
|  |  |  |  |  |  |  |  |  |
| Purchases of U.S. Treasury securities |  | (49,724) |  |  | (51,511) |  |  | (68,261) |
| Proceeds from sale of U.S. Treasury securities |  | 48,354 |  |  | 56,068 |  |  | 54,952 |
|  |  |  |  |  |  |  |  |  |
| Net proceeds from (payments on) reverse repurchase agreements |  | 3,505 |  |  | (3,337) |  |  | 9,937 |
| Net proceeds from (payments on) other derivative instruments |  | (300) |  |  | 313 |  |  | (1,007) |
|  |  |  |  |  |  |  |  |  |
| Purchases of REIT equity securities |  | (11) |  |  | (234) |  |  | (197) |
| Proceeds from sale of REIT equity securities |  | 35 |  |  | 416 |  |  | — |
|  |  |  |  |  |  |  |  |  |
| (Increase) decrease in restricted cash and cash equivalents |  | (568) |  |  | (612) |  |  | 298 |
| Other investing cash flows, net |  | (28) |  |  | (350) |  |  | — |
|  |  |  |  |  |  |  |  |  |
| Net cash provided by investing activities |  | 4,093 |  |  | 12,349 |  |  | 8,875 |
| **Financing activities:** |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Proceeds from repurchase arrangements |  | 380,580 |  |  | 291,736 |  |  | 564,971 |
| Repayments on repurchase agreements |  | (389,122) |  |  | (304,973) |  |  | (575,916) |
|  |  |  |  |  |  |  |  |  |
| Proceeds from Federal Home Loan Bank advances |  | 12,957 |  |  | — | |  | — |
| Repayments on Federal Home Loan Bank advances |  | (9,204) |  |  | — | |  | — |
|  |  |  |  |  |  |  |  |  |
| Proceeds from debt of consolidated variable interest entities |  | — | |  | — | |  | 203 |
| Repayments on debt of consolidated variable interest entities |  | (155) |  |  | (158) |  |  | (209) |
|  |  |  |  |  |  |  |  |  |
| Net proceeds from preferred stock issuance |  | — | |  | 169 |  |  | — |
| Net proceeds from common stock issuance |  | — | |  | — | |  | 1,803 |
|  |  |  |  |  |  |  |  |  |
| Payments for common stock repurchases |  | (285) |  |  | (74) |  |  | (856) |
| Cash dividends paid |  | (902) |  |  | (1,094) |  |  | (1,659) |
|  |  |  |  |  |  |  |  |  |
| Net cash used in financing activities |  | (6,131) |  |  | (14,394) |  |  | (11,663) |
| Net change in cash and cash equivalents |  | (610) |  |  | (423) |  |  | (287) |
|  |  |  |  |  |  |  |  |  |
| Cash and cash equivalents at beginning of period |  | 1,720 |  |  | 2,143 |  |  | 2,430 |
| Cash and cash equivalents at end of period | $ | 1,110 |  | $ | 1,720 |  | $ | 2,143 |
|  |  |  |  |  |  |  |  |  |
| **Supplemental disclosure to cash flow information:** |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Interest paid | $ | 215 |  | $ | 217 |  | $ | 347 |
|  |  |  |  |  |  |  |  |  |
| Taxes paid | $ | 1 |  | $ | 3 |  | $ | 25 |
|  |  |  |  |  |  |  |  |  |

See accompanying notes to consolidated financial statements.

78

**AMERICAN CAPITAL AGENCY CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. 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 other assets reasonably related to agency securities and up to 10% of our assets in AAA non-agency and commercial mortgage-backed securities (collectively referred to as "AAA non-agency MBS").

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 2. Summary of Significant Accounting Policies**

***Basis of Presentation and Consolidation***

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). Our consolidated financial statements include the accounts of all subsidiaries and variable interest entities for which we are the primary beneficiary. Significant intercompany accounts and transactions have been eliminated.

***Use of Estimates***

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, disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the period reported. Actual results could differ from those estimates.

***Earnings per Share***

Basic earnings per share ("EPS") is computed by dividing net income (loss) available (attributable) to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS assumes the conversion, exercise or issuance of all potential common stock equivalents unless the effect is to reduce a loss or increase the income per share.

***Accumulated Other Comprehensive Income (Loss)***

Accounting Standards Codification ("ASC") Topic 220, *Comprehensive Income* ("ASC 220"), divides comprehensive income into net income and other comprehensive income (loss) ("OCI"), which includes unrealized gains and losses on securities classified as available-for-sale and unrealized gains and losses on derivative financial instruments that are designated and qualify for cash flow hedge accounting under ASC Topic 815, *Derivatives and Hedging* ("ASC 815"). During fiscal year 2011, we discontinued designating our derivative financial instruments, principally interest rate swaps, as cash flow hedges. For further information regarding our discontinuation of cash flow hedge accounting, see *Derivatives Instruments* below and Note 5.

79

***Cash and Cash Equivalents***

Cash and cash equivalents consist of unrestricted demand deposits and highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at cost, which approximates fair value.

***Restricted Cash and Cash Equivalents***

Restricted cash and cash equivalents includes cash and cash equivalents pledged as collateral for clearing and executing trades, repurchase agreements and other borrowings, and interest rate swaps and other derivative instruments. Restricted cash and cash equivalents are carried at cost, which approximates fair value.

***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 mortgage investment securities as part of our overall management of our investment portfolio. Accordingly, we typically designate our agency and non-agency securities (collectively referred to as "mortgage securities" or "investment 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 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.

Non-agency securities in which we may invest consist of investment grade, AAA rated MBS backed by residential or commercial mortgages, for which the payment of principal and interest is not guaranteed by a GSE or government agency. Instead, a private institution such as a commercial bank will package residential or commercial mortgage loans and securitize them through the issuance of MBS. Investment grade, AAA rated non-agency MBS benefit from credit enhancements derived from structural elements, such as subordination, overcollateralization or insurance, but nonetheless carry a higher level of credit exposure than agency MBS.

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 mortgage securities based on a market approach using "Level 2" inputs from third-party pricing services and non-binding dealer quotes derived from common market pricing methods. 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 on a market approach using "Level 1" inputs based on quoted market prices. Refer to Note 7 for further discussion of fair value measurements.

We evaluate our mortgage 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.

If either of the first two conditions exists as of the financial reporting date, the entire amount of the impairment loss, if any, is recognized in earnings as a realized loss and the cost basis of the security is adjusted to its fair value. However, with respect to the first condition, since the liquidity of the agency and AAA non-agency securities market allows us to obtain competitive bids

80

and execute on a sale transaction typically within a day of making the decision to sell a security, we generally do not make decisions to sell specific mortgage securities until shortly prior to initiating a sell order. In some instances, we may sell specific agency securities by delivering the 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 before the 48-hour deadline.

If the third condition exists, the OTTI is separated into (i) the amount relating to credit loss (the "credit component") and (ii) the amount relating to all other factors (the "non-credit components"). Only the credit component is recognized in earnings, with the non-credit components recognized in OCI. However, in evaluating if the third condition exists, our investments in agency securities typically would not have a credit component since the principal and interest are guaranteed by a GSE and, therefore, any unrealized loss is not the result of a credit loss. In addition, since we designate our mortgage securities as available-for-sale securities with unrealized gains and losses recognized in OCI, any impairment loss for non-credit components is already recognized in OCI.

We did not recognize any OTTI charges on our investment securities for fiscal years 2015, 2014 or 2013.

***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 mortgage 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, interest rate 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 and, based on our Manager's judgment, we may make adjustments to its estimates. 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.

***Repurchase Agreements***

We finance the acquisition of securities for our investment portfolio through repurchase transactions under master repurchase agreements. Pursuant to ASC Topic 860, *Transfers and Servicing* ("ASC 860"), we account for repurchase transactions as collateralized financing transactions, which are carried at their contractual amounts (cost), plus accrued interest, as specified in the respective transactions. Our repurchase agreements typically have maturities of less than one year, but may extend up to five years or more. Interest rates under our repurchase agreements generally correspond to one, three or six month LIBOR plus or minus a fixed spread. The fair value of our repurchase agreements is assumed to equal cost as the interest rates are considered to be at market.

***Federal Home Loan Bank Advances***

Federal Home Loan Bank ("FHLB") advances are secured loans from the FHLB of Des Moines used to finance the acquisitions of investment securities. We account for FHLB advances as collateralized financing transactions, which are carried at their contractual amounts (cost), plus accrued interest, as specified in the respective transactions. In April 2015, our wholly-owned captive insurance subsidiary, Old Georgetown Insurance Co., LLC ("OGI"), was approved as a member of the FHLB of Des Moines. The FHLBs provide a variety of products and services to their members, including short and long-term secured loans. In January 2016, the Federal Housing Finance Agency released its final rule on changes to regulations concerning FHLB membership criteria. The final rule terminates OGI's FHLB membership and requires repayment of all advances at the earlier of their contractual maturity dates or one year after the effective date of the final rule (February 2017). Interest rates under our FHLB advances generally correspond to the FHLB's Member Option Variable Rate or to one or three month LIBOR plus or minus a fixed spread. The fair value of our FHLB advances is assumed to equal cost as the interest rates are considered to be at market.

81

***Reverse Repurchase Agreements and Obligation to Return Securities Borrowed under Reverse Repurchase Agreements***

We from time to time borrow securities to cover short sales of U.S. Treasury securities through reverse repurchase transactions under our master repurchase agreements (see *Derivatives Instruments* below). 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. Our reverse repurchase agreements generally mature daily. The fair value of our reverse repurchase agreements is assumed to equal cost as the interest rates are generally reset daily.

***Derivative Instruments***

We use a variety of derivative instruments to hedge a portion of our exposure to market risks, including interest rate, prepayment and extension risks. 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 on a generic pool basis in the TBA market and we utilize 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 invest in mortgage and other types of derivatives, such as interest and principal-only securities.

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 fiscal year 2011, we entered into interest rate swap agreements typically with the intention of qualifying for hedge accounting under ASC 815. However, during fiscal year 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.

82

*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" swaps using a combination of inputs from counterparty and third-party pricing models to estimate the net present value of the future cash flows using the forward interest rate yield curve in effect as of the end of the measurement period. We also incorporate both our own and our counterparties' nonperformance risk in estimating the fair value of our interest rate swaps. In considering the effect of nonperformance risk, we consider the impact of netting and credit enhancements, such as collateral postings and guarantees, and have concluded that our own and our counterparty risk is not significant to the overall valuation of these agreements.

*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 interest rate swaptions using a combination of inputs from counterparty and third-party pricing models based on 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 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

83

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.

***Variable Interest Entities***

ASC Topic 810, *Consolidation* ("ASC 810"), requires an enterprise to consolidate a variable interest entity ("VIE") if it is deemed the primary beneficiary of the VIE. Further, ASC 810 requires a qualitative assessment to determine the primary beneficiary of a VIE and ongoing assessments of whether an enterprise is the primary beneficiary of a VIE as well as additional disclosures for entities that have variable interests in VIEs.

We have entered into transactions involving CMO trusts, which are VIEs. We will consolidate a CMO trust if we are the CMO trust's primary beneficiary; that is, if we have a variable interest that provides us with a controlling financial interest in the CMO trust. An entity is deemed to have a controlling financial interest if the entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and the obligation to absorb losses of or right to receive benefits from the VIE that could potentially be significant to the VIE. As part of the qualitative assessment in determining if we have a controlling financial interest, we evaluate whether we control the selection of financial assets transferred to the CMO trust. For each of our consolidated CMO trusts we controlled the selection of the agency MBS transferred from our investment portfolio to an investment bank in exchange for cash proceeds and at the same time entered into a commitment with the investment bank to purchase to-be-issued securities collateralized by the agency MBS transferred, which resulted in our consolidation of the CMO trusts.

Agency MBS transferred to consolidated VIEs are reported on our consolidated balance sheets in agency securities transferred to consolidated VIEs, at fair value and can only be used to settle the obligations of each respective VIE. We elected the option to account for the consolidated debt 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 assets and consolidated debt are presented in a consistent manner 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 measured on a market approach using "Level 2" inputs from third-party pricing services and dealer quotes. The fair value of the agency MBS transferred to the consolidated VIEs and the fair value of our retained interests are based on more observable inputs than inputs used to independently determine the value of our consolidated debt.

***Manager Compensation***

Our management agreement provides for the payment to our Manager of a management fee and reimbursement of certain operating expenses, which are accrued and expensed during the period for which they are earned or incurred. Refer to Note 8 for the terms of our management agreement and the administrative services agreement between American Capital and our Manager.

***Income Taxes***

We elected to be taxed as a REIT under the provisions of the Internal Revenue Code and the corresponding provisions of state law, commencing with our initial tax year ended December 31, 2008. In order to continue to qualify as a REIT, we must annually distribute, in a timely manner to our stockholders, at least 90% of our taxable ordinary income, amongst other conditions. A REIT is not subject to tax on its earnings to the extent that it distributes its annual taxable income to its stockholders and as long as certain asset, income and stock ownership tests are met. We operate in a manner that will allow us to be taxed as a REIT. As permitted by the Internal Revenue Code, a REIT can designate dividends paid in the subsequent year as dividends of the current year if those dividends are both declared by the extended due date of the REIT's federal income tax return and paid to stockholders by the last day of the subsequent year.

As a REIT, if we fail to distribute in any calendar year at least the sum of (i) 85% of our ordinary income for such year, (ii) 95% of our capital gain net income for such year and (iii) any undistributed taxable income from the prior year, we are subject to a non-deductible 4% excise tax on the excess of such required distribution over the sum of (a) the amounts actually distributed and, if applicable, (b) the amounts of income we retained and on which we have paid corporate income tax. Dividends declared by December 31 and paid by January 31 are treated as having been a distribution of our taxable income for the prior tax year.

We and our wholly-owned subsidiary, American Capital Agency TRS, LLC ("AGNC TRS"), have made a joint election to treat AGNC TRS as a taxable REIT subsidiary. As such, AGNC TRS is subject to federal and state income tax. All other subsidiaries

84

are disregarded entities for federal income tax purposes. As such, their assets, liabilities and income would generally be treated as our assets, liabilities and income for purposes of federal and state income taxes.

We evaluate uncertain income tax positions, if any, in accordance with ASC Topic 740, *Income Taxes* ("ASC 740"). To the extent we incur interest and/or penalties in connection with our tax obligations, such amounts shall be classified as income tax expense on our consolidated statements of operations.

**Note 3. Investment Securities**

As of December 31, 2015 and 2014, our investment portfolio consisted of $52.5 billion and $56.7 billion of MBS, respectively, and a $7.4 billion and $14.8 billion net long TBA position, at fair value, respectively.

Our TBA position is reported at its net carrying value of $14 million and $192 million as of December 31, 2015 and 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 5 for further details of our net TBA position as of December 31, 2015 and 2014.)

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

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **December 31, 2015** | | | | | |  |  |  |
|  |  |  | **Amortized** | | **Gross** |  |  |  | **Gross** | |  |  |  |
| **Investments in Mortgage-Backed Securities** |  |  | **Unrealized** |  |  |  | **Unrealized** | |  | **Fair Value** |  |
|  | **Cost** |  | **Gain** |  |  |  | **Loss** |  |  |  |
| Agency MBS: | |  |  |  |  |  |  |  |  |  |  |  |  |
| Fixed rate | | $ | 50,576 |  | $ | 339 |  | $ | (393) |  | $ | 50,522 |  |
| Adjustable rate | |  | 484 |  |  | 11 |  |  | — | |  | 495 |  |
| CMO | |  | 973 |  |  | 18 |  |  | (1) |  |  | 990 |  |
| Interest-only and principal-only strips | |  | 317 |  |  | 39 |  |  | (3) |  |  | 353 |  |
| Total agency MBS | |  | 52,350 |  |  | 407 |  |  | (397) |  |  | 52,360 |  |
| Non-agency MBS: | |  |  |  |  |  |  |  |  |  |  |  |  |
| AAA non-agency | |  | 114 |  |  | — | |  | (1) |  |  | 113 |  |
| Total MBS | | $ | 52,464 |  | $ | 407 |  | $ | (398) |  | $ | 52,473 |  |
|  |  |  |  |  |  | |  |  | |  |  |  |  |
|  |  |  |  |  | **December 31, 2014** | | | | | |  |  |  |
|  |  |  | **Amortized** | | **Gross** |  |  |  | **Gross** | |  |  |  |
| **Investments in Mortgage-Backed Securities** |  |  | **Unrealized** |  |  |  | **Unrealized** | |  | **Fair Value** |  |
|  | **Cost** |  | **Gain** |  |  |  | **Loss** |  |  |  |
| 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 MBS | | $ | 56,148 |  | $ | 791 |  | $ | (191) |  | $ | 56,748 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |

85

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  | **December 31, 2015** | | |  |  |  |  |  |
| **Investments in Mortgage-Backed Securities** |  |  | **Fannie Mae** |  |  | **Freddie Mac** |  |  | **Ginnie Mae** |  |  | **Non-Agency** |  |  | **Total** |
| Available-for-sale MBS: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| MBS, par value | | $ | 39,205 |  | $ | 10,575 |  | $ | 62 |  | $ | 113 |  | $ | 49,955 |
| Unamortized discount | |  | (32) |  |  | (4) |  |  | — | |  | — | |  | (36) |
| Unamortized premium | |  | 1,707 |  |  | 519 |  |  | 1 |  |  | 1 |  |  | 2,228 |
| Amortized cost | |  | 40,880 |  |  | 11,090 |  |  | 63 |  |  | 114 |  |  | 52,147 |
| Gross unrealized gains | |  | 286 |  |  | 80 |  |  | 2 |  |  | — | |  | 368 |
| Gross unrealized losses | |  | (283) |  |  | (111) |  |  | — | |  | (1) |  |  | (395) |
| Total available-for-sale MBS, at fair value | |  | 40,883 |  |  | 11,059 |  |  | 65 |  |  | 113 |  |  | 52,120 |
| MBS remeasured at fair value through earnings: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest-only and principal-only strips, amortized cost 1 | |  | 298 |  |  | 19 |  |  | — | |  | — | |  | 317 |
| Gross unrealized gains | |  | 35 |  |  | 4 |  |  | — | |  | — | |  | 39 |
| Gross unrealized losses | |  | (2) |  |  | (1) |  |  | — |  |  | — |  |  | (3) |
| Total MBS remeasured at fair value through earnings | |  | 331 |  |  | 22 |  |  | — | |  | — | |  | 353 |
| Total MBS, at fair value | | $ | 41,214 |  | $ | 11,081 |  | $ | 65 |  | $ | 113 |  | $ | 52,473 |
| Weighted average coupon as of December 31, 2015 2 | |  | 3.62% |  |  | 3.69% |  |  | 3.18% |  |  | 3.50% |  |  | 3.63% |
| Weighted average yield as of December 31, 2015 3 | |  | 2.79% |  |  | 2.77% |  |  | 1.97% |  |  | 3.33% |  |  | 2.78% |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. The underlying unamortized principal balance ("UPB" or "par value") of our interest-only securities was $1.0 billion and the weighted average contractual interest we are entitled to receive was 5.28% of this amount as of December 31, 2015. The par value of our principal-only securities was $207 million as of December 31, 2015.
2. The weighted average coupon includes the interest cash flows from our interest-only securities and is stated as a percentage of par value (excluding the UPB of our interest-only securities) as of December 31, 2015.
3. Incorporates a weighted average future constant prepayment rate assumption of 8% based on forward rates as of December 31, 2015.

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **December 31, 2014** | | | | |  |  |
| **Investments in Mortgage-Backed Securities** |  |  | **Fannie Mae** |  |  | **Freddie Mac** |  |  | **Ginnie Mae** |  |  | **Total** |
| Available-for-sale MBS: | |  |  |  |  |  |  |  |  |  |  |  |
| MBS, par value | | $ | 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 MBS, at fair value | |  | 45,075 |  |  | 11,159 |  |  | 112 |  |  | 56,346 |
| MBS measured at fair value through earnings: | |  |  |  |  |  |  |  |  |  |  |  |
| Interest-only and principal-only strips, amortized cost 1 | |  | 348 |  |  | 24 |  |  | — | |  | 372 |
| Gross unrealized gains | |  | 30 |  |  | 3 |  |  | — | |  | 33 |
| Gross unrealized losses | |  | (2) |  |  | (1) |  |  | — |  |  | (3) |
| Total MBS measured at fair value through earnings | |  | 376 |  |  | 26 |  |  | — | |  | 402 |
| Total MBS, at fair value | | $ | 45,451 |  | $ | 11,185 |  | $ | 112 |  | $ | 56,748 |
| Weighted average coupon as of December 31, 2014 2 | |  | 3.63% |  |  | 3.70% |  |  | 3.52% |  |  | 3.65% |
| Weighted average yield as of December 31, 2014 3 | |  | 2.75% |  |  | 2.73% |  |  | 1.87% |  |  | 2.74% |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |

1. The underlying UPB of our interest-only securities 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 securities was $242 million as of December 31, 2014.
2. The weighted average coupon includes the interest cash flows from our interest-only securities and is stated as a percentage of par value (excluding the UPB of our interest-only securities) as of December 31, 2014.
3. 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 investment securities are generally shorter than their stated contractual maturities. Actual maturities are affected by the contractual lives of the underlying mortgages, periodic contractual principal payments and principal

86

prepayments. As of December 31, 2015 and 2014, our weighted average expected constant prepayment rate ("CPR") over the remaining life of our aggregate investment 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 investments classified as available-for-sale as of December 31, 2015 and 2014 according to their estimated weighted average life classification (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **December 31, 2015** | | | |  |  |  |  |  |  | **December 31, 2014** | | | |  |  |
| **Estimated Weighted Average Life of** | |  |  |  |  | **Amortized** | | **Weighted** | | **Weighted** | |  |  |  |  | **Amortized** | | **Weighted** | | **Weighted** |  |
|  | **Fair Value** |  |  | **Average** | | **Average** | |  | **Fair Value** |  |  | **Average** | | **Average** |  |
| **Securities Classified as Available-for-Sale 1** |  |  |  | **Cost** |  | **Coupon** |  | **Yield** |  |  |  | **Cost** |  | **Coupon** |  | **Yield** |  |
| ≥ 1 year and ≤ 3 years | | $ | 167 |  | $ | 163 |  | 4.02% |  | 2.66% |  | $ | 289 |  | $ | 280 |  | 4.08% |  | 2.62% |  |
| > 3 years and ≤ 5 years | |  | 17,497 |  |  | 17,343 |  | 3.27% |  | 2.40% |  |  | 22,153 |  |  | 21,820 |  | 3.26% |  | 2.40% |  |
| > 5 years and ≤10 years | |  | 34,206 |  |  | 34,391 |  | 3.67% |  | 2.93% |  |  | 33,271 |  |  | 33,055 |  | 3.73% |  | 2.92% |  |
| > 10 years | |  | 250 |  |  | 250 |  | 3.56% |  | 3.08% |  |  | 633 |  |  | 621 |  | 3.28% |  | 3.15% |  |
| Total | | $ | 52,120 |  | $ | 52,147 |  | 3.54% |  | 2.75% |  | $ | 56,346 |  | $ | 55,776 |  | 3.54% |  | 2.72% |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Excludes interest and principal-only strips.

The weighted average life of our interest-only securities was 6.1 and 6.0 years as of December 31, 2015 and 2014, respectively. The weighted average life of our principal-only securities was 8.0 and 8.1 years as of December 31, 2015 and 2014, respectively.

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 10 for a summary of changes in accumulated OCI for our available-for-sale securities for fiscal years 2015 and 2014.

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  | **Unrealized Loss Position For** | | | | |  |  |  |  |  |  |  |
|  |  |  | **Less than 12 Months** | | | |  |  | **12 Months or More** | | | |  |  |  | **Total** | | |  |  |
| **Securities Classified as Available-for-Sale** |  |  | **Estimated Fair** | |  | **Unrealized** | |  | **Estimated** | |  | **Unrealized** | | **Estimated Fair** | |  |  |  | **Unrealized** |  |
|  | **Value** |  |  | **Loss** |  |  | **Fair Value** |  |  | **Loss** |  |  | **Value** |  |  |  | **Loss** |  |
| December 31, 2015 | | $ | 24,035 |  | $ | (200) |  | $ | 6,793 |  | $ | (195) |  | $ | 30,828 | $ | | | (395) |  |
| December 31, 2014 | | $ | 778 |  | $ | (2) |  | $ | 11,679 |  | $ | (186) |  | $ | 12,457 | $ | | | (188) |  |

We did not recognize any OTTI charges on our investment securities for fiscal years 2015, 2014 and 2013. As of the end of each respective reporting period, a decision had not been made to sell any of our securities in an unrealized loss position and we did not believe it was more likely than not that we would be required to sell such securities before recovery of their amortized cost basis. The unrealized losses on our securities were not due to credit losses given the GSE guarantees and credit enhancements on our AAA non-agency securities, but rather were due to changes in interest rates and prepayment expectations. However, as we continue to actively manage our portfolio, we may recognize additional realized losses on our investment securities upon selecting specific securities to sell.

87

***Gains and Losses***

The following table is a summary of our net gain (loss) from the sale of securities classified as available-for-sale for fiscal years 2015, 2014 and 2013 (in millions):

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **Fiscal Year** | |  |  |
| **Securities Classified as Available-for-Sale** |  |  | **2015** |  |  | **2014** |  |  | **2013** |
| MBS sold, at cost | | $ | (27,578) |  | $ | (30,123) |  | $ | (81,516) |
| Proceeds from agency MBS sold 1 | |  | 27,555 |  |  | 30,174 |  |  | 80,108 |
| Net gain (loss) on sale of MBS | | $ | (23) |  | $ | 51 |  | $ | (1,408) |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| Gross gain on sale of MBS | | $ | 98 |  | $ | 172 |  | $ | 217 |
| Gross loss on sale of MBS | |  | (121) |  |  | (121) |  |  | (1,625) |
| Net gain (loss) on sale of MBS | | $ | (23) |  | $ | 51 |  | $ | (1,408) |
|  |  |  |  |  |  |  |  |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Proceeds include cash received during the period, plus receivable for MBS sold during the period as of period end.

For fiscal years 2015 and 2014, we recognized a net unrealized gain of $5 million and $32 million, respectively, for the change in value of investments in interest and principal-only securities in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. For fiscal year 2013, we did not recognize a net unrealized gain or loss on our interest and principal-only securities. 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 December 31, 2015 and 2014, we held investments in CMO trusts, which are 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 $1.0 billion and $1.3 billion as of December 31, 2015 and 2014, respectively, and debt, at fair value, of $595 million and $761 million, respectively, in our accompanying consolidated balance sheets. As of December 31, 2015 and 2014, the agency securities had an aggregate unpaid principal balance of $1.0 billion and $1.2 billion, respectively, and the debt had an aggregate unpaid principal balance of $587 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 fiscal years 2015 and 2014, we recorded a gain of $16 million and a loss of $10 million, respectively, associated with our consolidated debt. 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 December 31, 2015 and 2014, the fair value of our CMO securities and interest and principal-only securities was $1.3 billion and $1.6 billion, respectively, excluding the consolidated CMO trusts discussed above, or $1.8 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 $238 million and $274 million as of December 31, 2015 and 2014, respectively.

**Note 4. Repurchase Agreements and Other Secured Borrowings**

We pledge certain of our securities as collateral under our repurchase agreements with financial institutions and under our secured borrowing facility with the FHLB of Des Moines. Interest rates on our 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 December 31, 2015 and 2014, we had met all margin call requirements. For additional information regarding our pledged assets, please refer to Note 6.

88

***Repurchase Agreements***

As of December 31, 2015 and 2014, we had $41.8 billion and $50.3 billion, respectively, of repurchase agreements outstanding. The terms and conditions of our repurchase agreements are typically negotiated on a transaction-by-transaction basis. Our repurchase agreements with original maturities > 90 days have floating interest rates based on an index plus or minus a fixed spread. As of December 31, 2015 and 2014, $41.7 billion and $48.4 billion, respectively, of our repurchase agreements were used to fund purchases of agency securities ("agency repo"), with an average borrowing rate of 0.61% and 0.41%, respectively, and a weighted average remaining term to maturity of 173 and 143 days, respectively. The remainder, or $25 million and $1.9 billion, of our repurchase agreements as of December 31, 2015 and 2014, respectively, were used to fund temporary holdings of U.S. Treasury securities ("U.S. Treasury repo").

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **December 31, 2015** | |  |  |  |  |  | **December 31, 2014** | |  |  |
|  |  |  |  |  | **Weighted** | | **Weighted** | |  |  |  | **Weighted** | | **Weighted** |  |
|  |  |  | **Repurchase** | | **Average** | |  | **Repurchase** | | **Average** | |  |
| **Remaining Maturity** |  |  | **Interest** | | **Average Days** | |  | **Interest** | | **Average Days** |  |
|  | **Agreements** |  | **Rate** |  | **to Maturity** |  |  | **Agreements** |  | **Rate** |  | **to Maturity** |  |
| Agency repo: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 1 month | | $ | 17,579 |  | 0.54% |  | 14 |  | $ | 14,157 |  | 0.37% |  | 15 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 1 to ≤ 3 months | |  | 14,283 |  | 0.64% |  | 58 |  |  | 20,223 |  | 0.38% |  | 61 |  |
| > 3 to ≤ 6 months | |  | 3,154 |  | 0.61% |  | 121 |  |  | 6,654 |  | 0.42% |  | 120 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 6 to ≤ 9 months | |  | 589 |  | 0.65% |  | 199 |  |  | 1,575 |  | 0.50% |  | 225 |  |
| > 9 to ≤ 12 months | |  | 1,201 |  | 0.65% |  | 307 |  |  | 2,678 |  | 0.54% |  | 313 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 12 to ≤ 24 months | |  | 1,473 |  | 0.73% |  | 600 |  |  | 600 |  | 0.57% |  | 551 |  |
| > 24 to ≤ 36 months | |  | 650 |  | 0.81% |  | 901 |  |  | 952 |  | 0.60% |  | 999 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 36 to ≤ 48 months | |  | 1,300 |  | 0.86% |  | 1,231 |  |  | 650 |  | 0.64% |  | 1,266 |  |
| > 48 to < 60 months | |  | 1,500 |  | 0.76% |  | 1,477 |  |  | 900 |  | 0.68% |  | 1,542 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total agency repo | |  | 41,729 |  | 0.61% |  | 173 |  |  | 48,389 |  | 0.41% |  | 143 |  |
| U.S. Treasury repo: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 1 day | |  | 25 |  | —% | | 1 |  |  | 1,907 |  | 0.09% |  | 1 |  |
| Total | | $ | 41,754 |  | 0.61% |  | 173 |  | $ | 50,296 |  | 0.40% |  | 138 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

***Federal Home Loan Bank Advances***

As of December 31, 2015, we had $3.8 billion of outstanding secured FHLB advances, with a weighted average borrowing rate of 0.53% and a weighted average remaining term to maturity of 141 days through February 2017 (the termination date of our FHLB membership), consisting of 30 day and longer-term floating rate advances:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **December 31, 2015** | |  |  |
| **Remaining Maturity** |  |  | **FHLB Advances** |  | **Weighted Average** | | **Weighted Average** |  |
|  | **Interest Rate** |  | **Days to Maturity** |  |
| ≤ 1 month | | $ | 1,952 |  | 0.47% |  | 14 |  |
| > 1 to ≤ 3 months | |  | 681 |  | 0.60% |  | 84 |  |
|  |  |  |  |  |  |  |  |  |
| 13 months 1 | |  | 1,120 |  | 0.58% |  | 397 |  |
| Total FHLB advances | | $ | 3,753 |  | 0.53% |  | 141 |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |

1. The maturity date of our FHLB advances as of December 31, 2015 has been adjusted to reflect the termination of our FHLB membership in February 2017 (see Note 2 for further information).

89

***Debt of Consolidated Variable Interest Entities***

As of December 31, 2015 and 2014, debt of consolidated VIEs, at fair value, was $595 million and $761 million, respectively, and had a weighted average interest rate of LIBOR plus 34 and 43 basis points, respectively, and a principal balance of $587 million and $742 million, respectively. The actual maturities of our debt of consolidated VIEs are generally shorter than the stated contractual maturities. The actual maturities are affected by the contractual lives of the underlying agency MBS securitizing the debt of our consolidated VIEs and periodic principal prepayments of such underlying securities. The estimated weighted average life of the debt of our consolidated VIEs as of December 31, 2015 and 2014 was 4.9 and 5.8 years, respectively.

***TBA Dollar Roll Financing Transactions***

As of December 31, 2015 and 2014, we had outstanding forward commitments to purchase and sell agency securities through the TBA market at a cost of $7.4 billion and $14.6 billion, respectively (see Notes 2 and 5). 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. We account for such transactions as one or more series of derivative transactions and report our outstanding TBA commitments at their net carrying value of $14 million and $192 million as of December 31, 2015 and 2014, respectively, in derivative assets/(liabilities) on our accompanying consolidated balance sheets.

**Note 5. 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 invest in mortgage and other types of derivative instruments, such as interest and principal-only securities. Our risk management strategy attempts to manage the overall risk of the portfolio, reduce fluctuations in our net 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 2.

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 fiscal years 2015, 2014 and 2013, we reclassified $101 million, $156 million and $189 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 for those periods were $494 million, $486 million and $613 million, 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 gain (loss) on derivative instruments and other securities, net in our accompanying consolidated statements of comprehensive income (totaling $393 million, $330 million and $424 million for fiscal years 2015, 2014 and 2013, respectively). As of December 31, 2015, the remaining net deferred loss in accumulated OCI related to de-designated interest rate swaps was $39 million and will be reclassified from OCI into interest expense over a remaining weighted average period of 0.6 years.

90

***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 December 31, 2015 and 2014 (in millions):

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **December 31,** | | |  |
| **Derivative and Other Hedging Instruments** |  | **Balance Sheet Location** |  |  | **2015** |  |  | **2014** |
| Interest rate swaps | | Derivative assets, at fair value | | $ | 31 |  | $ | 136 |
| Swaptions | | Derivative assets, at fair value | |  | 17 |  |  | 75 |
|  |  |  |  |  |  |  |  |  |
| TBA securities | | Derivative assets, at fair value | |  | 29 |  |  | 197 |
| U.S. Treasury futures - short | | Derivative assets, at fair value | |  | 4 |  |  | — |
|  |  |  |  |  |  |  |  |  |
| Total derivative assets, at fair value | |  |  | $ | 81 |  | $ | 408 |
|  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Interest rate swaps | | Derivative liabilities, at fair value | | $ | (920) |  | $ | (880) |
| TBA securities | | Derivative liabilities, at fair value | |  | (15) |  |  | (5) |
|  |  |  |  |  |  |  |  |  |
| U.S. Treasury futures - short | | Derivative liabilities, at fair value | |  | — | |  | (5) |
| Total derivative liabilities, at fair value | |  |  | $ | (935) |  | $ | (890) |
|  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities - long | | U.S. Treasury securities, at fair value | | $ | 25 |  | $ | 2,427 |
|  |  |  |  |  |  |  |  |  |
|  |  | Obligation to return securities borrowed under reverse | |  |  |  |  |  |
| U.S. Treasury securities - short | | repurchase agreements, at fair value | |  | (1,696) |  |  | (5,363) |
| Total - U.S. Treasury securities, net at fair value | |  |  | $ | (1,671) |  | $ | (2,936) |
|  |  |  |  |  |  |  |  |  |

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **December 31, 2015** | | |  |  |  |  |  |
|  |  |  | **Notional** | | **Average** |  | **Average** | |  | **Net** | | **Average** |  |
| **Payer Interest Rate Swaps** |  |  | **Fixed** |  | **Receive** | |  | **Estimated** | | **Maturity** |  |
|  | **Amount 1** |  | **Pay Rate 2** |  | **Rate 3** |  |  | **Fair Value** |  | **(Years)** |  |
| ≤ 3 years | | $ | 14,775 |  | 1.06% | 0.40% | |  | $ | (23) |  | 1.6 |  |
| > 3 to ≤ 5 years | |  | 9,950 |  | 2.03% | 0.40% | |  |  | (203) |  | 4.0 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 5 to ≤ 7 years | |  | 7,175 |  | 2.47% | 0.44% | |  |  | (230) |  | 6.1 |  |
| > 7 to ≤ 10 years | |  | 7,450 |  | 2.57% | 0.39% | |  |  | (342) |  | 8.3 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 10 years | |  | 1,175 |  | 3.20% | 0.39% | |  |  | (91) |  | 14.7 |  |
| Total payer interest rate swaps | | $ | 40,525 |  | 1.89% |  | 0.40% |  | $ | (889) |  | 4.6 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Notional amount includes forward starting swaps of $4.5 billion with an average forward start date of 0.7 years and an average maturity of 5.5 years from December 31, 2015.
2. Average fixed pay rate includes forward starting swaps. Excluding forward starting swaps, the average fixed pay rate was 1.75% as of December 31, 2015.
3. Average receive rate excludes forward starting swaps.

91

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **December 31, 2014** | | | |  |  |  |  |  |
|  |  |  | **Notional** | | **Average** |  |  | **Average** | |  | **Net** | | **Average** |  |
| **Payer Interest Rate Swaps** |  |  | **Fixed** |  |  | **Receive** | |  | **Estimated** | | **Maturity** |  |
|  | **Amount 1** |  | **Pay Rate 2** |  |  | **Rate 3** |  |  | **Fair Value** |  | **(Years)** |  |
| ≤ 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 December 31, 2015 and 2014 (dollars in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Payer Swaptions** |  |  |  |  |  | **Option** | |  |  |  |  |  | **Underlying Payer Swap** | | | |  |  |
|  |  |  |  |  |  |  |  | **Average** | |  |  |  | **Average Fixed** | | **Average** | | **Average** |  |
|  |  |  |  |  |  | **Fair** | |  | **Notional** | | **Receive** | |  |
| **Years to Expiration** |  |  | **Cost** |  |  | **Months to** | |  | **Pay** | | **Rate** | | **Term** |  |
|  |  | **Value** |  | **Expiration** |  |  | **Amount** |  | **Rate** |  | **(LIBOR)** |  | **(Years)** |  |
| **December 31, 2015** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total ≤ 1 year | | $ | 74 |  | $ | 17 |  | 4 |  | $ | 2,150 |  | 3.51% |  | 3M | | 7.0 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **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 | | $ | 145 |  | $ | 46 |  | 8 |  | $ | 6,800 |  | 3.28% |  | 3M | | 6.2 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

The following table summarizes our interest rate receiver swaption agreements outstanding as of 2014 (dollars in millions). We did not have any interest rate receiver swaptions outstanding as of December 31, 2015.

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

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **December 31, 2015** | | |  |  |  |  |  | **December 31, 2014** | | | |  |  |  |
| **Maturity** |  | **Face Amount Net** | | |  | **Cost Basis** |  |  | **Market Value** |  |  | **Face Amount Net** |  |  | **Cost Basis** |  |  | **Market Value** |  |
|  | **Long / (Short)** |  |  |  |  | **Long / (Short)** |  |  |  |  |
| 5 years | | $ | (250) |  | $ | (249) |  | $ | (249) |  | $ | (4,674) | $ | | (4,650) |  | $ | (4,645) |  |
| 7 years | |  | (354) |  |  | (353) |  |  | (352) |  |  | (717) |  |  | (717) |  |  | (718) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 10 years | |  | (1,085) |  |  | (1,078) |  |  | (1,070) |  |  | 2,410 |  |  | 2,422 |  |  | 2,427 |  |
| Total U.S. Treasury securities, net | | $ | (1,689) |  | $ | (1,680) |  | $ | (1,671) |  | $ | (2,981) |  | $ | (2,945) |  | $ | (2,936) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

92

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **December 31, 2015** | | | | |  |  |  |  |  |  |  | **December 31, 2014** | | | | |  |  |  |
|  |  |  | **Notional** | |  |  |  |  |  |  |  |  |  |  | **Notional** | |  |  |  |  |  |  |  |  |  |
|  |  |  | **Amount - Long** | |  | **Cost** | |  | **Market** | |  | **Net Carrying** | |  | **Amount - Long** | |  | **Cost** | |  | **Market** | | **Net Carrying** | |  |
| **Maturity** |  |  | **(Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Value 4** |  |  | **(Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Value 4** |  |
| 5 years | | $ | (730) |  | $ | (866) |  | $ | (864) |  | $ | 2 |  | $ | — | | $ | — | | $ | — | | $ | — |  |
| 10 years | |  | (1,130) |  |  | (1,424) |  |  | (1,422) |  |  | 2 |  |  | (730) |  |  | (920) |  |  | (925) |  |  | (5) |  |
| Total U.S. Treasury futures | | $ | (1,860) |  | $ | (2,290) |  | $ | (2,286) |  | $ | 4 |  | $ | (730) |  | $ | (920) |  | $ | (925) |  | $ | (5) |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Notional amount represents the par value (or principal balance) of the underlying U.S. Treasury security.
2. Cost basis represents the forward price to be paid / (received) for the underlying U.S. Treasury security.
3. Market value represents the current market value of U.S. Treasury futures as of period-end.
4. Net carrying value represents the difference between the market value and the cost basis of U.S. Treasury futures as of period-end and is reported in derivative assets / (liabilities), at fair value in our consolidated balance sheets.

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **December 31, 2015** | | | | |  |  |  |  |  |  |  | **December 31, 2014** | | | | |  |  |
|  |  |  | **Notional** | |  |  |  |  |  |  |  |  |  |  | **Notional** | |  |  |  |  |  |  |  |  |
|  |  |  | **Amount - Long** | |  | **Cost** | |  | **Market** | | **Net Carrying** | | |  | **Amount - Long** | |  | **Cost** | |  | **Market** | |  | **Net Carrying** |
| **TBA Securities by Coupon** |  |  | **(Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Value 4** |  |  | **(Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Value 4** |
| 15-Year TBA securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2.5% |  | $ | (80) |  | $ | (81) |  | $ | (80) |  | $ | 1 |  | $ | 962 |  | $ | 968 |  | $ | 980 |  | $ | 12 |
| 3.0% |  |  | 225 |  |  | 233 |  |  | 232 |  |  | (1) |  |  | 2,779 |  |  | 2,889 |  |  | 2,888 |  |  | (1) |
| 3.5% |  |  | 136 |  |  | 143 |  |  | 142 |  |  | (1) |  |  | (468) |  |  | (495) |  |  | (494) |  |  | 1 |
| 4.0% |  |  | — | |  | — | |  | — | |  | — | |  | (13) |  |  | (14) |  |  | (14) |  |  | — |
| Total 15-Year TBAs | |  | 281 |  |  | 295 |  |  | 294 |  |  | (1) |  |  | 3,260 |  |  | 3,348 |  |  | 3,360 |  |  | 12 |
| 30-Year TBA securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 3.0% |  |  | 3,914 |  |  | 3,911 |  |  | 3,916 |  |  | 5 |  |  | 5,254 |  |  | 5,259 |  |  | 5,313 |  |  | 54 |
| 3.5% |  |  | 1,497 |  |  | 1,536 |  |  | 1,539 |  |  | 3 |  |  | 7,902 |  |  | 8,151 |  |  | 8,232 |  |  | 81 |
| 4.0% |  |  | 1,575 |  |  | 1,658 |  |  | 1,665 |  |  | 7 |  |  | (1,853) |  |  | (2,019) |  |  | (1,974) |  |  | 45 |
| 4.5% |  |  | 28 |  |  | 30 |  |  | 30 |  |  | — | |  | (151) |  |  | (163) |  |  | (163) |  |  | — |
| Total 30-Year TBAs | |  | 7,014 |  |  | 7,135 |  |  | 7,150 |  |  | 15 |  |  | 11,152 |  |  | 11,228 |  |  | 11,408 |  |  | 180 |
| Total net TBA securities | | $ | 7,295 |  | $ | 7,430 |  | $ | 7,444 |  | $ | 14 |  | $ | 14,412 |  | $ | 14,576 |  | $ | 14,768 |  | $ | 192 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **December 31, 2015** | | | | |  |  |  |  |  |  |  | **December 31, 2014** | | | | |  |  |  |
|  |  |  | **Notional** | |  |  |  |  |  |  |  |  |  |  | **Notional** | |  |  |  |  |  |  |  |  |  |
|  |  |  | **Amount - Long** | |  | **Cost** | |  | **Market** | | **Net Carrying** | | |  | **Amount - Long** | |  | **Cost** | |  | **Market** | |  | **Net Carrying** |  |
| **TBA Securities by Issuer** |  |  | **(Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Value 4** |  |  | **(Short) 1** |  |  | **Basis 2** |  |  | **Value 3** |  |  | **Value 4** |  |
| Fannie Mae | | $ | 6,033 |  | $ | 6,145 |  | $ | 6,159 |  | $ | 14 |  | $ | 15,127 |  | $ | 15,316 |  | $ | 15,509 |  | $ | 193 |  |
| Freddie Mac | |  | 689 |  |  | 703 |  |  | 703 |  |  | — | |  | (715) |  |  | (740) |  |  | (741) |  |  | (1) |  |
| Ginnie Mae | |  | 573 |  |  | 582 |  |  | 582 |  |  | — | |  | — | |  | — | |  | — | |  | — |  |
| TBA securities, net | | $ | 7,295 |  | $ | 7,430 |  | $ | 7,444 |  | $ | 14 |  | $ | 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.

93

***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 fiscal years 2015, 2014 and 2013 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **Fiscal year 2015** | |  |  |  |  |  |  |  |
|  |  | **Notional Amount** | | |  |  | **Settlement,** | |  |  |  |  |  | **Amount of** |  |
|  |  |  |  | **Notional Amount** | | | |  | **Gain/(Loss)** |  |
|  |  |  | **Long/(Short)** | |  |  | **Termination,** | |  | **Recognized in** |  |
| **Derivative and Other Hedging Instruments** |  |  | **December 31,** | | **Additions** |  | **Expiration or** | |  | **Long/(Short)** | | |  | **Income on** |  |
|  | **2014** |  | **Exercise** |  | **December 31, 2015** | |  |  |  | **Derivatives 1** |  |
| TBA securities, net | | $ | 14,412 |  | 119,922 |  | (127,039) |  | $ | 7,295 |  |  | $ | 305 |  |
| Interest rate swaps | | $ | (43,700) |  | (4,950) |  | 8,125 |  | $ | (40,525) |  |  |  | (932) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Payer swaptions | | $ | (6,800) |  | (1,500) |  | 6,150 |  | $ | (2,150) |  |  |  | (35) |  |
| Receiver swaptions | | $ | 4,250 |  | — | | (4,250) |  | $ | — | |  |  | 4 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities - short position | | $ | (5,392) |  | (12,503) |  | 16,181 |  | $ | (1,714) |  |  |  | (68) |  |
| U.S. Treasury securities - long position | | $ | 2,411 |  | 33,525 |  | (35,911) |  | $ | 25 |  |  |  | (38) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury futures contracts - short position | | $ | (730) |  | (4,480) |  | 3,350 |  | $ | (1,860) |  |  |  | (12) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  | $ | (776) |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Excludes a net gain of $16 million from debt of consolidated VIEs, a net gain of $5 million from interest and principal-only securities and other miscellaneous net losses of $4 million recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **Fiscal year 2014** | |  |  |  |  |  |  |  |
|  |  | **Notional Amount** | | |  |  | **Settlement,** | |  |  |  |  |  | **Amount of** |  |
|  |  |  |  | **Notional Amount** | | | |  | **Gain/(Loss)** |  |
|  |  |  | **Long/(Short)** | |  |  | **Termination,** | |  | **Recognized in** |  |
| **Derivative and Other Hedging Instruments** |  |  | **December 31,** | | **Additions** |  | **Expiration or** | |  | **Long/(Short)** | | |  | **Income on** |  |
|  | **2013** |  | **Exercise** |  | **December 31, 2014** | |  |  |  | **Derivatives 1** |  |
| TBA securities, net | | $ | 2,119 |  | 213,627 |  | (201,334) |  | $ | 14,412 |  |  | $ | 1,117 |  |
| Interest rate swaps | | $ | (43,250) |  | (20,550) |  | 20,100 |  | $ | (43,700) |  |  |  | (1,838) |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Payer swaptions | | $ | (14,250) |  | (5,250) |  | 12,700 |  | $ | (6,800) |  |  |  | (193) |  |
| Receiver swaptions | | $ | — | | 5,500 |  | (1,250) |  | $ | 4,250 |  |  |  | 11 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities - short position | | $ | (2,007) |  | (36,489) |  | 33,104 |  | $ | (5,392) |  |  |  | (420) |  |
| U.S. Treasury securities - long position | | $ | 3,927 |  | 18,549 |  | (20,065) |  | $ | 2,411 |  |  |  | 66 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury futures contracts - short position | | $ | (1,730) |  | (2,920) |  | 3,920 |  | $ | (730) |  |  |  | (76) |  |
| TBA put option | | $ | — | | (150) |  | 150 |  | $ | — | |  |  | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  | $ | (1,333) |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Excludes a net gain of $75 million from investments in REIT equity securities, a net loss of $10 million from debt of consolidated VIEs, a net gain of $32 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.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **Fiscal year 2013** | |  |  |  |  |  |  |  |
|  |  | **Notional Amount** | | |  |  | **Settlement,** | |  |  |  |  |  | **Amount of** |  |
|  |  |  |  | **Notional Amount** | | | |  | **Gain/(Loss)** |  |
|  |  |  | **Long/(Short)** | |  |  | **Termination,** | |  | **Recognized in** |  |
| **Derivative and Other Hedging Instruments** |  |  | **December 31,** | | **Additions** |  | **Expiration or** | |  | **Long/(Short)** | | |  | **Income on** |  |
|  | **2012** |  | **Exercise** |  | **December 31, 2013** | |  |  |  | **Derivatives 1** |  |
| TBA securities, net | | $ | 12,477 |  | 42,707 |  | (53,065) |  | $ | 2,119 |  |  | $ | (726) |  |
| Interest rate swaps | | $ | (46,850) |  | (20,750) |  | 24,350 |  | $ | (43,250) |  |  |  | 1,145 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Payer swaptions | | $ | (14,450) |  | (23,800) |  | 24,000 |  | $ | (14,250) |  |  |  | 258 |  |
| U.S. Treasury securities - short position | | $ | (11,835) |  | (31,941) |  | 41,769 |  | $ | (2,007) |  |  |  | 472 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities - long position | | $ | — | | 27,805 |  | (23,878) |  | $ | 3,927 |  |  |  | (42) |  |
| U.S. Treasury futures contracts - short position | | $ | — | | (9,239) |  | 7,509 |  | $ | (1,730) |  |  |  | 49 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| TBA put option | | $ | — | | (50) |  | 50 |  | $ | — | |  |  | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  | $ | 1,156 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

94

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Excludes a net gain of $2 million from investments in REIT equity securities, a net gain of $39 million from debt of consolidated VIEs and other miscellaneous net losses of $6 million recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

**Note 6. Pledged Assets**

Our funding agreements 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. Our derivative contracts similarly require us to fully collateralize our obligations under such agreements, which will vary over time based on similar factors as well as our counterparties' determination of the value of the derivative contract. We are typically required to post initial collateral upon execution of derivative transactions, such as interest rate swap agreements and TBA contracts. If we breach our collateral requirements, 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. Additionally, the FHLB of Des Moines may adjust the haircut on our outstanding FHLB advances at any time prior to maturity. As a condition of our membership in the FHLB of Des Moines, we are also obligated to purchase membership and activity-based stock in the FHLB based upon the aggregate amount of advances obtained from the FHLB.

Consequently, our funding agreements and derivative contracts expose 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 U.S. government agencies 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 certain thresholds causes an event of default under the ISDA Master 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 December 31, 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 December 31, 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.

95

***Assets Pledged to Counterparties***

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **December 31, 2015** | | | | |  |  |  |  |  |  |
| **Assets Pledged to Counterparties** |  | **Repurchase Agreements** | | | **Debt of Consolidated** | | |  | **Derivative** | |  | **Prime Broker** | |  | **Total** |  |
|  | **and FHLB Advances 1** |  |  | **VIEs** |  |  | **Agreements** |  |  | **Agreements** |  |  |  |
| Agency MBS - fair value | | $ | 47,992 |  | $ | 1,029 |  | $ | 148 |  | $ | 485 |  | $ | 49,654 |  |
| AAA non-agency MBS - fair value | |  | 113 |  |  | — | |  | — | |  | — | |  | 113 |  |
| U.S. Treasury securities - fair value | |  | 25 |  |  | — | |  | — | |  | — | |  | 25 |  |
| Accrued interest on pledged securities | |  | 135 |  |  | 3 |  |  | — | |  | 2 |  |  | 140 |  |
| Restricted cash and cash equivalents | |  | 23 |  |  | — | |  | 1,226 |  |  | 32 |  |  | 1,281 |  |
| Total | | $ | 48,288 |  | $ | 1,032 |  | $ | 1,374 |  | $ | 519 |  | $ | 51,213 |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Includes $245 million of retained interests in our consolidated VIEs pledged as collateral under repurchase agreements.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **December 31, 2014** | | | | |  |  |  |  |  |  |
| **Assets Pledged to Counterparties** |  | **Repurchase Agreements** | | | **Debt of Consolidated** | | |  | **Derivative** | |  | **Prime Broker** | |  | **Total** |  |
|  | **1** |  |  | **VIEs** |  |  | **Agreements** |  |  | **Agreements** |  |  |  |
| Agency MBS - fair value | | $ | 51,037 |  | $ | 1,266 |  | $ | 69 |  | $ | 702 |  | $ | 53,074 |  |
| U.S. Treasury securities - fair value | |  | 1,904 |  |  | — | |  | 550 |  |  | — | |  | 2,454 |  |
| Accrued interest on pledged securities | |  | 147 |  |  | 4 |  |  | 2 |  |  | — | |  | 153 |  |
| Restricted cash and cash equivalents | |  | 6 |  |  | — | |  | 698 |  |  | 9 |  |  | 713 |  |
| Total | | $ | 53,094 |  | $ | 1,270 |  | $ | 1,319 |  | $ | 711 |  | $ | 56,394 |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Includes $179 million of retained interests in our consolidated VIEs pledged as collateral under repurchase agreements.

As of December 31, 2015, we held $150 million of membership and activity-based stock in the FHLB of Des Moines. FHLB stock is reported at cost, which equals par value, in other assets on our accompanying consolidated balance sheets. FHLB stock can only be redeemed or sold at its par value, and only to the FHLB of Des Moines.

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

The following table summarizes our securities pledged as collateral under our repurchase agreements and FHLB advances by the remaining maturity of our borrowings, including securities pledged related to sold but not yet settled securities, as of December 31, 2015 and 2014 (in millions). For the corresponding borrowings associated with the following amounts and the interest rates thereon, refer to Note 4*.*

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **December 31, 2015** | | | |  |  |  |  |  | **December 31, 2014** | | | | |  |  |  |
|  |  |  |  |  |  | **Amortized** | |  | **Accrued** | |  |  |  |  |  | **Amortized** | |  | **Accrued** |  |
| **Securities Pledged by Remaining Maturity of Repurchase** | |  | **Fair Value of** |  |  |  | **Interest on** | |  | **Fair Value of** |  |  |  |  | **Interest on** |  |
|  |  | **Cost of Pledged** | | |  | **Pledged** | |  |  |  | **Cost of Pledged** | | |  | **Pledged** |  |
| **Agreements and FHLB Advances** |  | **Pledged Securities** | |  |  | **Securities** |  |  | **Securities** |  | **Pledged Securities** | |  |  |  | **Securities** |  |  | **Securities** |  |
| MBS:1 | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| ≤ 30 days | | $ | 20,053 | $ | | 20,075 |  | $ | 57 |  | $ | 14,659 | $ | | | 14,509 |  | $ | 41 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 30 and ≤ 60 days | |  | 8,311 |  |  | 8,340 |  |  | 23 |  |  | 10,906 |  |  |  | 10,784 |  |  | 30 |  |
| > 60 and ≤ 90 days | |  | 7,534 |  |  | 7,525 |  |  | 21 |  |  | 10,205 |  |  |  | 10,109 |  |  | 28 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| > 90 days | |  | 12,207 |  |  | 12,187 |  |  | 34 |  |  | 15,267 |  |  |  | 15,096 |  |  | 43 |  |
| Total MBS | |  | 48,105 |  |  | 48,127 |  |  | 135 |  |  | 51,037 |  |  |  | 50,498 |  |  | 142 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 1 day | |  | 25 |  |  | 25 |  |  | — | |  | 1,904 |  |  |  | 1,899 |  |  | 5 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total | | $ | 48,130 | $ | | 48,152 |  | $ | 135 |  | $ | 52,941 | $ | | | 52,397 |  | $ | 147 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

96

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Includes $245 million and $179 million of retained interests in our consolidated VIEs pledged as collateral under repurchase agreements, as of December 31, 2015 and 2014, respectively.

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

The table above excludes agency securities transferred to our consolidated VIEs. Securities transferred to our consolidated VIEs can only be used to settle the obligations of each respective VIE. However, we may pledge our retained interests in our consolidated VIEs as collateral under our repurchase agreements and derivative contracts. Please refer to Notes 3 and 4 for additional information regarding our consolidated VIEs.

***Assets Pledged from Counterparties***

As of December 31, 2015 and 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).

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **December 31, 2015** | | |  |  |  |  |  | **December 31, 2014** | | | |  |  |  |
|  |  |  | **Reverse** | |  | **Derivative** | |  |  |  |  | **Reverse** |  |  | **Derivative** | |  |  |  |
| **Assets Pledged to AGNC** |  |  | **Repurchase** | |  |  | **Total** |  |  | **Repurchase** |  |  |  | **Total** |  |
|  | **Agreements** |  |  | **Agreements** |  |  |  | **Agreements** |  |  | **Agreements** | |  |  |
| Agency MBS - fair value | | $ | — | | $ | — | | $ | — | | $ | — | $ | | 43 |  | $ | 43 |  |
| U.S. Treasury securities - fair value | |  | 1,702 |  |  | — | |  | 1,702 |  |  | 5,363 |  |  | 47 |  |  | 5,410 |  |
| Cash | |  | — |  |  | — |  |  | — |  |  | — |  |  | 28 |  |  | 28 |  |
| Total | | $ | 1,702 |  | $ | — | | $ | 1,702 |  | $ | 5,363 | $ | | 118 |  | $ | 5,481 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

U.S Treasury securities received as collateral under our reverse repurchase agreements that are used to cover short sales of the same securities are accounted for as securities borrowing transactions. 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.

97

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 December 31, 2015 and 2014 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  | **Offsetting of Financial and Derivative Assets** | | | | | | | | | | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Net Amounts of** | | |  | **Gross Amounts Not Offset** | | | | |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **in the** | | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  | **Gross Amounts** |  |  |  |  | **Assets Presented** | | |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Consolidated Balance Sheets** | | | |  |  |  |  |
|  |  |  |  | **Gross Amounts** | | |  |  |  | **Offset in the** |  |  |  |  |  | **in the** | |  |  |  |  |
|  |  |  |  |  | **of Recognized** | |  |  |  | **Consolidated** |  |  |  |  |  | **Consolidated** | |  | **Financial** | |  | **Collateral** | |  | **Net Amount** |  |
|  |  |  |  |  | **Assets** | |  |  |  | **Balance Sheets** |  |  |  |  |  | **Balance Sheets** | |  | **Instruments** | |  | **Received 2** | |  |  |
| **December 31, 2015** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest rate swap and swaption agreements, at fair value 1 | | $ | | | 48 |  |  |  | $ | — | $ | | | | | 48 |  | $ | (31) |  | $ | — | | $ | 17 |  |
| Receivable under reverse repurchase agreements | |  |  |  | 1,713 |  |  |  |  | — |  |  |  |  |  | 1,713 |  |  | (1,356) |  |  | (357) |  |  | — |  |
| Total | | $ | | | 1,761 |  |  |  | $ | — | $ | | | | | 1,761 |  | $ | (1,387) |  | $ | (357) |  | $ | 17 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **December 31, 2014** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest rate swap and swaption agreements, at fair value 1 | | $ | | | 211 |  |  |  | $ | — | $ | | | | | 211 |  | $ | (94) |  | $ | (83) |  | $ | 34 |  |
| Receivable under reverse repurchase agreements | |  |  |  | 5,218 |  |  |  |  | — |  |  |  |  |  | 5,218 |  |  | (4,690) |  |  | (528) |  |  | — |  |
| Total | |  | | $ | 5,429 |  |  |  | $ | — |  |  | | $ | | 5,429 |  | $ | (4,784) |  | $ | (611) |  | $ | 34 |  |
|  |  |  |  |  |  |  |  |  |  |  | |  |  |  |  | |  |  | |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  | **Offsetting of Financial and Derivative Liabilities** | | | | | | | | | | | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Net Amounts of** | | |  | **Gross Amounts Not Offset** | | | | |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **in the** | | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  | **Gross Amounts** | |  |  |  |  |  | **Liabilities** | |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Consolidated Balance Sheets** | | | |  |  |  |  |
|  |  |  | **Gross Amounts** | | | |  |  |  | **Offset in the** |  |  |  |  | **Presented in the** | | |  |  |  |  |
|  |  |  | **of Recognized** | | | |  |  |  | **Consolidated** |  |  |  |  |  | **Consolidated** | |  | **Financial** | |  | **Collateral** | |  | **Net Amount** |  |
|  |  |  |  |  | **Liabilities** |  |  |  | **Balance Sheets** | |  |  |  |  |  | **Balance Sheets** |  |  | **Instruments** |  |  | **Pledged 2** |  |  |  |
| **December 31, 2015** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest rate swap agreements, at fair value 1 | | $ | |  | 920 |  | $ | |  | — | $ | | | | | 920 |  | $ | (31) |  | $ | (889) |  | $ | — |  |
| Repurchase agreements and FHLB advances | |  |  |  | 45,507 |  |  |  |  | — |  |  |  |  |  | 45,507 |  |  | (1,356) |  |  | (44,151) |  |  | — |  |
| Total | | $ | |  | 46,427 |  | $ | |  | — | $ | | | | | 46,427 |  | $ | (1,387) |  | $ | (45,040) |  | $ | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **December 31, 2014** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest rate swap agreements, at fair value 1 | | $ | |  | 880 |  | $ | |  | — | $ | | | | | 880 |  | $ | (94) |  | $ | (782) |  | $ | 4 |  |
| Repurchase agreements | |  |  |  | 50,296 |  |  |  |  | — |  |  |  |  |  | 50,296 |  |  | (4,690) |  |  | (45,606) |  |  | — |  |
| Total | | $ | |  | 51,176 |  | $ | |  | — | $ | | | | | 51,176 |  | $ | (4,784) |  | $ | (46,388) |  | $ | 4 |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Reported under derivative assets / liabilities, at fair value in the accompanying consolidated balance sheets. Refer to Note 5 for a reconciliation of derivative assets / liabilities, at fair value to their sub-components.
2. Includes cash and securities pledged / received 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.

98

**Note 7. Fair Value Measurements**

We determine the fair value of our investment 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 2.

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 fiscal years December 31, 2015 and 2014. 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.

99

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **December 31, 2015** | | | |  |  |  |  |  | **December 31, 2014** | | | |  |  |  |
|  |  | **Level 1** |  |  | **Level 2** | |  | **Level 3** | |  | **Level 1** |  |  | **Level 2** | |  | **Level 3** |  |
| Assets: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Agency securities | $ | — | $ | | 51,331 |  | $ | — | | $ | — | $ | | 55,482 |  | $ | — |  |
| Agency securities transferred to consolidated VIEs |  | — |  |  | 1,029 |  |  | — | |  | — |  |  | 1,266 |  |  | — |  |
| Non-agency securities |  | — |  |  | 113 |  |  | — | |  | — |  |  | — | |  | — |  |
| U.S. Treasury securities |  | 25 |  |  | — | |  | — | |  | 2,427 |  |  | — | |  | — |  |
| Interest rate swaps |  | — |  |  | 31 |  |  | — | |  | — |  |  | 136 |  |  | — |  |
| Swaptions |  | — |  |  | 17 |  |  | — | |  | — |  |  | 75 |  |  | — |  |
| REIT equity securities |  | 33 |  |  | — | |  | — | |  | 68 |  |  | — | |  | — |  |
| TBA securities |  | — |  |  | 29 |  |  | — | |  | — |  |  | 197 |  |  | — |  |
| U.S. Treasury futures |  | 4 |  |  | — |  |  | — |  |  | — |  |  | — |  |  | — |  |
| Total | $ | 62 | $ | | 52,550 |  | $ | — | | $ | 2,495 | $ | | 57,156 |  | $ | — |  |
| Liabilities: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Debt of consolidated VIEs | $ | — | $ | | 595 |  | $ | — | | $ | — | $ | | 761 |  | $ | — |  |
| Obligation to return U.S. Treasury securities borrowed under reverse |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| repurchase agreements |  | 1,696 |  |  | — | |  | — | |  | 5,363 |  |  | — | |  | — |  |
| Interest rate swaps |  | — |  |  | 920 |  |  | — | |  | — |  |  | 880 |  |  | — |  |
| TBA securities |  | — |  |  | 15 |  |  | — | |  | — |  |  | 5 |  |  | — |  |
| U.S. Treasury futures |  | — |  |  | — |  |  | — |  |  | 5 |  |  | — |  |  | — |  |
| Total | $ | 1,696 | $ | | 1,530 |  | $ | — | | $ | 5,368 | $ | | 1,646 |  | $ | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

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 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 and cash equivalents, receivables, payables and borrowings under repurchase agreements and FHLB advances, which are presented in our consolidated financial statements at cost. The cost basis of these instruments is determined to approximate fair value due to their short duration or, in the case of longer-term repo and FHLB advances, due to floating rates of interest based on an index plus or minus a fixed spread which is consistent with fixed spreads demanded in the market. We estimate the fair value of these instruments using "Level 2" inputs.

**Note 8. Management Agreement and Related Party Transactions**

We are externally managed and advised by our Manager pursuant to the terms of a management agreement. The management agreement has been renewed through May 20, 2016 and provides for automatic one-year extension options thereafter. The management agreement may only be terminated by us or our Manager without cause, as defined in the management agreement, after the completion of the current renewal term, or the expiration of each subsequent automatic annual renewal term, provided that either party provide 180-days prior written notice of non-renewal of the management agreement. If we were to not renew the management agreement without cause, we must pay a termination fee on the last day of the applicable term, equal to three times the average annual management fee earned by our Manager during the prior 24-month period immediately preceding the most recently completed month prior to the effective date of termination. We may only not renew the management agreement with or without cause with the consent of the majority of our independent directors. We pay our Manager a management fee payable monthly in arrears in 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 OCI, each as computed in accordance with GAAP.

100

There is no incentive compensation payable to our Manager pursuant to the management agreement. For fiscal years 2015, 2014 and 2013, we recorded an expense for management fees of $116 million, $119 million and $136 million, respectively.

We are obligated to reimburse our Manager for its expenses incurred directly related to our operations, excluding employment-related expenses of our Manager's officers and employees and any American Capital employees who provide services to us pursuant to the management agreement. Our Manager has entered into an administrative services agreement with American Capital, pursuant to which American Capital will provide personnel, services and resources necessary for our Manager to perform its obligations under the management agreement. For fiscal years 2015, 2014 and 2013, we recorded expense reimbursements to our Manager of $8 million, $8 million and $10 million, respectively, primarily consisting of costs related to information technology systems. As of December 31, 2015 and 2014, $9 million and $10 million was payable to our Manager, respectively.

**Note 9. Income Taxes**

The following table summarizes dividends for federal income tax purposes declared for fiscal tax years 2015, 2014 and 2013 and their related tax characterization (in millions, except per share amounts):

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **Tax Characterization** | | |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Dividends** |  |  |  | **Ordinary** |  |  |  | **Long-Term** |
|  | **Declared Per** | |  | **Dividends** |  | **Income Per** |  | **Qualified** | **Capital Gains** | |
| **Fiscal Tax Year** |  | **Share** |  | **Declared** |  | **Share** |  | **Dividends** |  | **Per Share** |
|  |  |  |  |  |  |  |  |  |  |  |
| ***8.000 % Series A Cumulative Redeemable Preferred Stock*** |  |  |  |  |  |  |  |  |  |  |
| Fiscal year 2015 | $ | 2.000000 | $ | 14 | $ | 2.000000 | $ | — | $ | — |
|  |  |  |  |  |  |  |  |  |  |  |
| Fiscal year 2014 | $ | 2.000000 | $ | 14 | $ | 2.000000 | $ | — | $ | — |
| Fiscal year 2013 | $ | 2.000000 | $ | 14 | $ | 2.000000 | $ | 0.015980 | $ | — |
|  |  |  |  |  |  |  |  |  |  |  |
| ***7.750% Series B Cumulative Redeemable Preferred Stock (Per Depositary*** |  |  |  |  |  |  |  |  |  |  |
| ***Share)*** |  |  |  |  |  |  |  |  |  |  |
| Fiscal year 2015 | $ | 1.937500 | $ | 14 | $ | 1.937500 | $ | — | $ | — |
|  |  |  |  |  |  |  |  |  |  |  |
| Fiscal year 2014 | $ | 0.844965 | $ | 6 | $ | 0.844965 | $ | — | $ | — |
| ***Common Stock*** |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| Fiscal year 2015 | $ | 2.480000 | $ | 863 | $ | 2.480000 | $ | — | $ | — |
| Fiscal year 2014 | $ | 2.610000 | $ | 921 | $ | 2.610000 | $ | — | $ | — |
|  |  |  |  |  |  |  |  |  |  |  |
| Fiscal year 2013 | $ | 3.750000 | $ | 1,453 | $ | 3.750000 | $ | 0.029963 | $ | — |
|  |  |  |  |  |  |  |  |  |  |  |

As of December 31, 2015, we had distributed all of our estimated taxable income for fiscal year 2015. Accordingly, we do not expect to incur an income tax liability on our 2015 taxable income. For fiscal years 2014 and 2013, we distributed all of our taxable income within the limits prescribed by the Internal Revenue Code. Accordingly, we did not incur an income tax liability on our taxable income for such periods.

For fiscal year 2013, we did not distribute the required minimum amount of taxable income pursuant to federal excise tax requirements, as described in Note 2, and consequently we accrued an excise tax of $3 million, which is included in our net income tax provision on our accompanying consolidated statements of operations and comprehensive income. Additionally, for fiscal year 2013, we recorded an income tax provision of $10 million, attributable to our TRS, which is included in our net income tax provision on our accompanying consolidated statements of comprehensive income. The statutory combined federal and state corporate tax rate for our TRS was 39.5% for fiscal year 2013. For fiscal years 2015 and 2014, we did not record an income tax provision attributable to our TRS.

Based on our analysis of any potential uncertain income tax positions, we concluded that we do not have any uncertain tax positions that meet the recognition or measurement criteria of ASC 740 as of December 31, 2015, 2014 and 2013. Our tax returns for tax years 2012 and forward are open to examination by the IRS. In the event that we incur income tax related interest and penalties, our policy is to classify them as a component of provision for income taxes.

101

**Note 10. 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 December 31, 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 depository 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 depository 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 December 31, 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 up to $2 billion. In October 2015, our Board of Directors extended its authorization through December 31, 2016. 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 fiscal years 2015, 2014 and 2013, we repurchased approximately 15.3 million, 3.4 million and 40.2 million shares, of our common stock, respectively, at an average repurchase price of $18.58, $22.10 and $21.25 per share, respectively, including expenses, totaling $285 million, $74 million and $856 million, respectively. As of December 31, 2015, the total remaining amount authorized for repurchases of our common stock was $707 million.

***Follow-On Equity Offerings***

During fiscal year 2013, we completed a follow-on public offering of 57.5 million at an average price of $31.34 per share, for total proceeds of $1,803 million, net of offering costs. During fiscal years 2015 and 2014, we did not complete any follow-on public offerings of shares of our common stock.

***At-the-Market Offering Program***

We have entered into sales agreements with sales agents to publicly offer and sell shares of our common stock in privately negotiated and/or at-the-market transactions from time to time. During fiscal years 2015, 2014 and 2013, there were no shares issued under this program. As of December 31, 2015, 16.7 million shares remain available for issuance under this program.

102

***Dividend Reinvestment and Direct Stock Purchase Plan***

We sponsor a dividend reinvestment and direct stock purchase plan through which stockholders may purchase additional shares of our common stock by reinvesting some or all of the cash dividends received on shares of our common stock. Stockholders may also make optional cash purchases of shares of our common stock subject to certain limitations detailed in the plan prospectus. During fiscal years 2015, 2014 and 2013, there were no shares issued under the plan. As of December 31, 2015, 21.7 million shares remain available for issuance under the plan.

***Accumulated Other Comprehensive Income (Loss)***

The following table summarizes changes to accumulated OCI for fiscal years 2015, 2014 and 2013 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Net Unrealized Gain** | |  | **Net Unrealized** | | **Total Accumulated** | |  |
| **Accumulated Other Comprehensive Income (Loss)** |  |  | **(Loss) on Available-** | |  | **Gain (Loss) on** | |  | **OCI** |  |
|  | **for-Sale MBS** |  |  | **Swaps** |  |  | **Balance** |  |
| **Fiscal Year 2015** | |  |  |  |  |  |  |  |  |  |
| Balance as of December 31, 2014 | | $ | 570 |  | $ | (140) |  | $ | 430 |  |
|  |  |  |  |  |  |  |  |  |  |  |
| OCI before reclassifications | |  | (620) |  |  | — | |  | (620) |  |
| Amounts reclassified from accumulated OCI | |  | 23 |  |  | 101 |  |  | 124 |  |
|  |  |  |  |  |  |  |  |  |  |  |
| Balance as of December 31, 2015 | | $ | (27) |  | $ | (39) |  | $ | (66) |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| **Fiscal Year 2014** | |  |  |  |  |  |  |  |  |  |
| Balance as of December 31, 2013 | | $ | (1,087) |  | $ | (296) |  | $ | (1,383) |  |
|  |  |  |  |  |  |  |  |  |  |  |
| OCI before reclassifications | |  | 1,708 |  |  | — | |  | 1,708 |  |
| Amounts reclassified from accumulated OCI | |  | (51) |  |  | 156 |  |  | 105 |  |
|  |  |  |  |  |  |  |  |  |  |  |
| Balance as of December 31, 2014 | | $ | 570 |  | $ | (140) |  | $ | 430 |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| **Fiscal Year 2013** | |  |  |  |  |  |  |  |  |  |
| Balance as of December 31, 2012 | | $ | 2,040 |  | $ | (485) |  | $ | 1,555 |  |
|  |  |  |  |  |  |  |  |  |  |  |
| OCI before reclassifications | |  | (4,535) |  |  | — | |  | (4,535) |  |
| Amounts reclassified from accumulated OCI | |  | 1,408 |  |  | 189 |  |  | 1,597 |  |
|  |  |  |  |  |  |  |  |  |  |  |
| Balance as of December 31, 2013 | | $ | (1,087) |  | $ | (296) |  | $ | (1,383) |  |
|  |  |  |  |  |  |  |  |  |  |  |

The following table summarizes reclassifications out of accumulated OCI for fiscal years 2015, 2014 and 2013 (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Fiscal Year** | | |  |  |  | **Line Item in the Consolidated** |  |
|  |  |  |  |  |  |  |  |  |  |  | **Statements of Comprehensive Income** |  |
| **Amounts Reclassified from Accumulated OCI** |  |  | **2015** |  |  | **2014** |  |  | **2013** |  |  |
|  |  |  |  |  |  | **Where Net Income is Presented** |  |
| (Gain) loss amounts reclassified from accumulated OCI for available- | |  |  |  |  |  |  |  |  |  |  |  |
| for-sale MBS upon realization | | $ | 23 |  | $ | (51) |  | $ | 1,408 |  | Gain (loss) on sale of agency securities, net |  |
| Periodic interest costs of interest rate swaps previously designated as | |  |  |  |  |  |  |  |  |  |  |  |
| hedges under GAAP, net | |  | 101 |  |  | 156 |  |  | 189 |  | Interest expense |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total reclassifications | | $ | 124 |  | $ | 105 |  | $ | 1,597 |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |

***Long-Term Incentive Plan***

We sponsor an equity incentive plan to provide for the issuance of equity-based awards, including stock options, restricted stock, restricted stock units and unrestricted stock awards to our independent directors. During fiscal years 2015 and 2014, we granted restricted stock unit ("RSU") awards under the plan totaling $625,000 and $375,000, respectively. The awards represent the right to receive an equivalent number of shares of common stock as measured by the closing price of our common stock on the grant date, plus any equivalent shares for dividends declared on our common stock, and vest over a 13 month period, subject to the terms and conditions of the plan. During fiscal year 2013, we granted restricted common stock awards under the plan totaling $468,000. The restricted stock awards had a grant date fair value equal to the closing price of our common stock on such date and vest annually over three years. The following table summarizes restricted stock and RSU transactions for fiscal years 2015, 2014 and 2013:

103

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Shares of Restricted** | | **Restricted Stock** | |  | **Weighted Average** | |  | **Weighted Average** |  |
|  |  |  | **Grant Date Fair** | | **Vest Date Fair Value** | |  |
|  |  | **Stock** |  | **Units** |  |  | **Value 1** |  |  | **2** |  |
| **Fiscal Year 2015** | |  |  |  |  |  |  |  |  |  |  |
| Unvested balance as of December 31, 2014 | | 14,000 |  | 18,239 |  | $ | 25.11 |  | $ | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Granted | | — | | 28,880 |  | $ | 21.64 |  | $ | — |  |
| Accrued RSU dividend equivalents | | — | | 3,319 |  | $ | — | | $ | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Vested | | 9,000 |  | 19,007 |  | $ | 23.17 |  | $ | 21.03 |  |
| Unvested balance as of December 31, 2015 | | 5,000 |  | 31,431 |  | $ | 21.44 |  | $ | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Fiscal Year 2014** | |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Unvested balance as of December 31, 2013 | | 27,000 |  | — | | $ | 30.37 |  | $ | — |  |
| Granted | | — | | 16,770 |  | $ | 22.36 |  | $ | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Accrued RSU dividend equivalents | | — | | 1,469 |  | $ | — | | $ | — |  |
| Vested | | 13,000 |  | — | | $ | 30.01 |  | $ | 22.01 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Unvested balance as of December 31, 2014 | | 14,000 |  | 18,239 |  | $ | 25.11 |  | $ | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Fiscal Year 2013** | |  |  |  |  |  |  |  |  |  |  |
| Unvested balance as of December 31, 2012 | | 21,500 |  | — | | $ | 29.06 |  | $ | — |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Granted | | 15,000 |  | — | | $ | 31.20 |  | $ | — |  |
| Vested | | 9,500 |  | — | | $ | 28.71 |  | $ | 30.56 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Unvested balance as of December 31, 2013 | | 27,000 |  | — | | $ | 30.37 |  | $ | — |  |
| \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |

1. Accrued RSU dividend equivalents have a weighted average grant date fair value of $0.
2. Weighted average vest date fair value is based on the closing price of our common stock on the vest date.

During fiscal years 2015, 2014 and 2013, we recognized $704,000, $540,000 and $383,000 of compensation expense under the plan, respectively. As of December 31, 2015, we had unrecognized compensation costs related to awards granted under the plan of approximately $238,000. As of December 31, 2015, 1,850 shares of common stock remained available for future issuance under the plan, net of unissued shares reserved for unvested RSU awards outstanding as of December 31, 2015.

**Note 11. Quarterly Results (Unaudited)**

The following is a presentation of the quarterly results of operations and comprehensive income for fiscal years 2015 and 2014 (in millions, except per share data).

104

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Quarter Ended** | | | | |  |  |  |
|  |  | **March 31,** | |  | **June 30,** | |  | **September 30,** | |  | **December 31,** |  |
|  |  | **2015** |  |  | **2015** |  |  | **2015** |  |  | **2015** |  |
| **Interest income:** |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest income | $ | 383 |  | $ | 414 |  | $ | 295 |  | $ | 374 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest expense |  | 86 |  |  | 81 |  |  | 77 |  |  | 86 |  |
| Net interest income |  | 297 |  |  | 333 |  |  | 218 |  |  | 288 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Other gain (loss):** |  |  |  |  |  |  |  |  |  |  |  |  |
| Gain (loss) on sale of agency securities, net |  | 36 |  |  | (22) |  |  | (39) |  |  | 2 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Gain (loss) on derivative instruments and other securities, net |  | (549) |  |  | 237 |  |  | (778) |  |  | 331 |  |
| Total other gain (loss), net |  | (513) |  |  | 215 |  |  | (817) |  |  | 333 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Expenses:** |  |  |  |  |  |  |  |  |  |  |  |  |
| Management fees |  | 30 |  |  | 29 |  |  | 29 |  |  | 28 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| General and administrative expenses |  | 6 |  |  | 7 |  |  | 5 |  |  | 5 |  |
| Total expenses |  | 36 |  |  | 36 |  |  | 34 |  |  | 33 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Net income (loss)** |  | (252) |  |  | 512 |  |  | (633) |  |  | 588 |  |
| Dividend on preferred stock |  | 7 |  |  | 7 |  |  | 7 |  |  | 7 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Net income (loss) available (attributable) to common shareholders** | $ | (259) |  | $ | 505 |  | $ | (640) |  | $ | 581 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Net income (loss)** | $ | (252) |  | $ | 512 |  | $ | (633) |  | $ | 588 |  |
| **Other comprehensive income (loss):** |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Unrealized gain (loss) on available-for-sale securities, net |  | 391 |  |  | (872) |  |  | 467 |  |  | (583) |  |
| Unrealized gain on derivative instruments, net |  | 29 |  |  | 26 |  |  | 24 |  |  | 22 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Other comprehensive income (loss) |  | 420 |  |  | (846) |  |  | 491 |  |  | (561) |  |
| **Comprehensive income (loss)** |  | 168 |  |  | (334) |  |  | (142) |  |  | 27 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| Dividend on preferred stock |  | 7 |  |  | 7 |  |  | 7 |  |  | 7 |  |
| **Comprehensive income (loss) available (attributable) to common shareholders** | $ | 161 |  | $ | (341) |  | $ | (149) |  | $ | 20 |  |
| **Weighted average number of common shares outstanding-basic and diluted** |  | 352.8 |  |  | 352.1 |  |  | 347.8 |  |  | 341.6 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Net income (loss) per common share - basic and diluted** | $ | (0.73) |  | $ | 1.43 |  | $ | (1.84) |  | $ | 1.70 |  |
| **Comprehensive income (loss) per common share - basic and diluted** | $ | 0.46 |  | $ | (0.97) |  | $ | (0.43) |  | $ | 0.06 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Dividends declared per common share** | $ | 0.66 |  | $ | 0.62 |  | $ | 0.60 |  | $ | 0.60 |  |
| 105 |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Quarter Ended** | | | | |  |  |
|  |  | **March 31,** | |  | **June 30,** | |  | **September 30,** | |  | **December 31,** |
|  |  | **2014** |  |  | **2014** |  |  | **2014** |  |  | **2014** |
| **Interest income:** |  |  |  |  |  |  |  |  |  |  |  |
| Interest income | $ | 399 |  | $ | 385 |  | $ | 357 |  | $ | 331 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Interest expense |  | 108 |  |  | 95 |  |  | 88 |  |  | 81 |
| Net interest income |  | 291 |  |  | 290 |  |  | 269 |  |  | 250 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Other loss:** |  |  |  |  |  |  |  |  |  |  |  |
| Gain (loss) on sale of agency securities, net |  | (19) |  |  | 22 |  |  | 14 |  |  | 34 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Loss on derivative instruments and other securities, net |  | (378) |  |  | (244) |  |  | (51) |  |  | (572) |
| Total other loss, net |  | (397) |  |  | (222) |  |  | (37) |  |  | (538) |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Expenses:** |  |  |  |  |  |  |  |  |  |  |  |
| Management fees |  | 29 |  |  | 30 |  |  | 30 |  |  | 30 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| General and administrative expenses |  | 6 |  |  | 6 |  |  | 5 |  |  | 5 |
| Total expenses |  | 35 |  |  | 36 |  |  | 35 |  |  | 35 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Net income (loss)** |  | (141) |  |  | 32 |  |  | 197 |  |  | (323) |
| Dividend on preferred stock |  | 3 |  |  | 5 |  |  | 7 |  |  | 7 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Net income (loss) available (attributable) to common shareholders** | $ | (144) |  | $ | 27 |  | $ | 190 |  | $ | (330) |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Net income (loss)** | $ | (141) |  | $ | 32 |  | $ | 197 |  | $ | (323) |
| **Other comprehensive income (loss):** |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Unrealized gain (loss) on available-for-sale securities, net |  | 521 |  |  | 790 |  |  | (253) |  |  | 599 |
| Unrealized gain on derivative instruments, net |  | 43 |  |  | 40 |  |  | 38 |  |  | 35 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Other comprehensive income (loss) |  | 564 |  |  | 830 |  |  | (215) |  |  | 634 |
| **Comprehensive income (loss)** |  | 423 |  |  | 862 |  |  | (18) |  |  | 311 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Dividend on preferred stock |  | 3 |  |  | 5 |  |  | 7 |  |  | 7 |
| **Comprehensive income (loss) available (attributable) to common shareholders** | $ | 420 |  | $ | 857 |  | $ | (25) |  | $ | 304 |
| **Weighted average number of common shares outstanding-basic and diluted** |  | 354.8 |  |  | 352.8 |  |  | 352.8 |  |  | 352.8 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Net income (loss) per common share - basic and diluted** | $ | (0.41) |  | $ | 0.08 |  | $ | 0.54 |  | $ | (0.94) |
| **Comprehensive income (loss) per common share - basic and diluted** | $ | 1.18 |  | $ | 2.43 |  | $ | (0.07) |  | $ | 0.86 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **Dividends declared per common share** | $ | 0.65 |  | $ | 0.65 |  | $ | 0.65 |  | $ | 0.66 |
|  |  |  |  |  |  |  |  |  |  |  |  |

**Note 12. Subsequent Events**

On January 14, 2016, our Board of Directors declared a monthly dividend of $0.20 per common share, which will be paid on February 8, 2016, to common stockholders of record as of January 29, 2016. On February 11, 2016, our Board of Directors declared a monthly dividend of $0.20 per common share, which will be paid on March 8, 2016, to common stockholders of record as of February 29, 2016.

106

**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

**Item 9A. *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 December 31, 2015. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

***Management's Report on Internal Control over Financial Reporting***

Management Report on Internal Control over Financial Reporting is included in "Item 8. Financial Statements and Supplementary Data."

***Attestation Report of Registered Public Accounting Firm***

The attestation report of our registered public accounting firm is included in "Item 8. Financial Statements and Supplementary Data."

***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.

**Item 9B. *Other Information***

None.

107

**PART III.**

**Item 10. *Directors, Executive Officers and Corporate Governance***

Information in response to this Item is incorporated herein by reference to the information provided in our Proxy Statement for our 2016 Annual Meeting of Stockholders (the "2016 Proxy Statement") under the headings "PROPOSAL 1: ELECTION OF DIRECTORS", "EXECUTIVE OFFICERS", "BOARD AND GOVERNANCE MATTERS", and "SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE."

**Item 11. *Executive Compensation***

Information in response to this Item is incorporated herein by reference to the information provided in the 2016 Proxy Statement under the headings "PROPOSAL 1: ELECTION OF DIRECTORS", "EXECUTIVE COMPENSATION", "COMPENSATION DISCUSSION AND ANALYSIS", "REPORT OF THE COMPENSATION AND GOVERNANCE COMMITTEE", and "COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION."

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information in response to this Item is incorporated herein by reference to the information provided in the 2016 Proxy Statement under the heading

"SECURITY OWNERSHIP OF MANAGEMENT AND CERTAIN BENEFICIAL OWNERS."

**Item 13. *Certain Relationships and Related Transactions, and Director Independence***

Information in response to this Item is incorporated herein by reference to the information provided in the 2016 Proxy Statement under the headings "CERTAIN TRANSACTIONS WITH RELATED PERSONS" and "PROPOSAL 1: ELECTION OF DIRECTORS."

**Item 14. *Principal Accounting Fees and Services***

Information in response to this Item is incorporated herein by reference to the information provided in the 2016 Proxy Statement under the heading

"PROPOSAL 4: RATIFICATION OF APPOINTMENT OF INDEPENDENT PUBLIC ACCOUNTANT."

108

**PART IV.**

**Item 15.** ***Exhibits and Financial Statement Schedules***

1. List of documents filed as part of this report:
   1. The following financial statements are filed herewith:

Consolidated Balance Sheets as of December 31, 2015 and 2014

Consolidated Statements of Comprehensive Income for fiscal years 2015, 2014 and 2013

Consolidated Statements of Stockholders' Equity for fiscal years 2015, 2014 and 2013 Consolidated Statements of Cash Flows for fiscal years 2015, 2014 and 2013

1. The following exhibits are filed herewith or incorporated herein by reference

**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 of 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 of 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 of 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 of Form 8-K (File No. 001-34067), filed May 8, 2014.

\*10.1 Management Agreement between American Capital Agency Corp. and American Capital Agency Management, LLC, dated May 20, 2008, incorporated herein by reference to Exhibit 10.2 of Form 10-Q for the quarter ended June 30, 2008 (File No. 001-34057), filed August 14, 2008.

\*10.2 Assignment and Amendment Agreement, dated July 29, 2011, among American Capital Agency Management, LLC, American Capital AGNC Management, LLC and American Capital Agency Corp., incorporated herein by reference to Exhibit 10.1 of Form 10-Q for the quarter ended September 30, 2011 (File No. 001-34057), filed November 7, 2011.

\*10.3 Amendment and Joinder to Management Agreement, dated September 30, 2011, between American Capital Agency TRS, LLC and American Capital AGNC Management, LLC, incorporated herein by reference to Exhibit 10.2 of Form 10-Q for the quarter ended September 30, 2011 (File No. 001-34057), filed November 7, 2011.

109

†\*10.4 American Capital Agency Corp. Equity Incentive Plan for Independent Directors, incorporated herein by reference to Exhibit 10.1 of Registration Statement on Form S-8 (File No. 333-151027), filed May 20, 2008.

†\*10.5 Form of Restricted Stock Agreement for independent directors, incorporated herein by reference to Exhibit 10.1 of Form 8-K (File No. 001-34057), filed December 12, 2011.

†\*10.6 Form of Restricted Stock Unit Agreement for independent directors, incorporated herein by reference to Exhibit 10.1 of Form 10-Q for the quarter ended June 30, 2014 (File No. 001-34057), filed August 7, 2014.

12.1 Computation of ratio of earnings to fixed charges and ratio of earnings to combined fixed charges and preferred stock dividends, filed herewith.

\*14 American Capital Agency Corp. Code of Ethics and Conduct, adopted May 12, 2008, incorporated herein by reference to Exhibit 14.1 of Form 10-K for the year ended December 31, 2010 (File No. 001-34057), filed February 25, 2011.

1. Subsidiaries of the Company and jurisdiction of incorporation:
   1. American Capital Agency TRS, LLC, a Delaware limited liability company
   2. Old Georgetown Insurance Co. LLC, a Missouri limited liability company
   3. Bethesda Securities, LLC, a Delaware limited liability company
2. Consent of Ernst & Young LLP, filed herewith.
3. Powers of Attorneys of directors and officers, filed herewith.

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.

1. 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

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

\* 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
* Management contract or compensatory plan or arrangement
  1. Exhibits

See the exhibits filed herewith.

* 1. Additional financial statement schedules None.

110

**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: February 23, 2016

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

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Name** | |  | **Title** | |  | **Date** | |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  | Chair of the Board of Directors and Chief | | |  |  |  |
|  |  |  |  |  | Executive Officer (Principal Executive | | |  |  |  |
|  |  | /s/ MALON WILKUS | | | Officer) | | | February 23, 2016 | | |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Malon Wilkus** | | |  |  |  |  |  |  |
|  |  |  |  |  | Director, Chief Financial Officer and | | |  |  |  |
|  |  |  |  |  | Executive Vice President (Principal | | |  |  |  |
|  | /s/ | JOHN R. ERICKSON | | | Financial Officer) | | | February 23, 2016 | | |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **John R. Erickson** | | |  |  |  |  |  |  |
|  |  |  |  |  | Senior Vice President and Chief | | |  |  |  |
|  |  |  |  |  | Accounting Officer (Principal Accounting | | |  |  |  |
|  |  | /s/ BERNICE E. BELL | | | Officer) | | | February 23, 2016 | | |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Bernice E. Bell** | | |  |  |  |  |  |  |
|  |  | \* | |  | Director | | | February 23, 2016 | | |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Robert M. Couch** | | |  |  |  |  |  |  |
|  |  | \* | |  | Director | | | February 23, 2016 | | |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Morris A. Davis** | | |  |  |  |  |  |  |
|  |  | \* | |  | Director | | | February 23, 2016 | | |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Randolph E. Dobbs** | | |  |  |  |  |  |  |
|  |  | \* | |  | Director | | | February 23, 2016 | | |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Samuel A. Flax** | | |  |  |  |  |  |  |
|  |  | \* | |  | Director | | | February 23, 2016 | | |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Larry K. Harvey** | | |  |  |  |  |  |  |
|  |  | \* | |  | Director | | | February 23, 2016 | | |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Prue B. Larocca** | | |  |  |  |  |  |  |
|  |  | \* | |  | Director | | | February 23, 2016 | | |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Alvin N. Puryear** | | |  |  |  |  |  |  |
| \*By: | /s/ | JOHN R. ERICKSON | | |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
|  |  | **John R. Erickson** | | |  |  |  |  |  |  |
|  |  | ***Attorney-in-fact*** | | |  |  |  |  |  |  |

111

**Exhibit 12.1**

**Ratio of Earnings to Fixed Charges and Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends**

The following table sets forth the calculation of our ratio of earnings to fixed charges and our ratio of earnings to combined fixed charges and preferred stock dividends for the periods shown (in millions):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  | **Fiscal Year** | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | **2015** |  |  | **2014** |  |  | **2013** |  |  | **2012** |  |  | **2011** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Ratio of earnings to fixed charges:** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Fixed charges 1 | $ | 330 |  | $ | 372 |  | $ | 536 |  | $ | 512 |  | $ | 285 |
| Net income (loss) available (attributable) to common shareholders before |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| provision for income taxes |  | 187 |  |  | (256) |  |  | 1,258 |  |  | 1,286 |  |  | 776 |
| Earnings | $ | 517 |  | $ | 116 |  | $ | 1,794 |  | $ | 1,798 |  | $ | 1,061 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Ratio of earnings to fixed charges |  | 1.57 |  |  | 0.31 |  |  | 3.35 |  |  | 3.51 |  |  | 3.72 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Ratio of earnings to combined fixed charges and preferred stock dividends:** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Fixed charges 1 | $ | 330 |  | $ | 372 |  | $ | 536 |  | $ | 512 |  | $ | 285 |
| Preferred stock dividends 2 |  | 28 |  |  | 23 |  |  | 14 |  |  | 10 |  |  | — |
| Combined fixed charges and preferred stock dividends |  | 358 |  |  | 395 |  |  | 550 |  |  | 522 |  |  | 285 |
| Net income (loss) available (attributable) to common shareholders before |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| provision for income taxes |  | 187 |  |  | (256) |  |  | 1,258 |  |  | 1,286 |  |  | 776 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Earnings | $ | 545 |  | $ | 139 |  | $ | 1,808 |  | $ | 1,808 |  | $ | 1,061 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Ratio of earnings to combined fixed charges and preferred stock dividends |  | 1.52 |  |  | 0.35 |  |  | 3.29 |  |  | 3.46 |  |  | 3.72 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. Fixed charges consist of interest expense, as defined under U.S. generally accepted accounting principles, on all indebtedness.
2. No preferred stock was outstanding during fiscal year 2011.

**Exhibit 23**

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in the following Registration Statements:

1. Form S-8 (No. 333-151027),
2. Form S-3 (No. 333-205306), and
3. Form S-3 (No. 333-205307);

of our reports dated February 23, 2016, with respect to the consolidated financial statements of American Capital Agency Corp., and the effectiveness of internal control over financial reporting of American Capital Agency Corp., included in this Annual Report (Form 10-K) of American Capital Agency Corp. for the year ended December 31, 2015.

McLean, Virginia February 23, 2016

/s/ Ernst & Young

**Exhibit 24**

**POWER OF ATTORNEY**

KNOW ALL MEN BY THESE PRESENTS, that the undersigned directors and officers of American Capital Agency Corp., a corporation organized under the laws of the state of Delaware (the “Corporation”), hereby constitute and appoint John R. Erickson, Samuel A. Flax and Cydonii V. Fairfax and each of them (with full power to each of them to act alone), his/her true and lawful attorneys‑in‑fact and agents for him/her and on his/her behalf and in his/her name, place and stead, in all cases with full power of substitution and resubstitution, in any hand and all capacities, to sign, execute and affix his/her seal to and file with the Securities and Exchange Commission (or any other governmental or regulatory authority) the Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2015, and all amendments or supplements thereto with all exhibits and any and all documents required to be filed with respect thereto, and grants to each of them full power and authority to do and to perform each and every act and thing requisite and necessary to be done in and about the premises in order to effectuate the same as fully and to all intents and purposes as he/she might or could do if personally present, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, each of the undersigned directors and/or officers has hereunto set his hand and seal, as of the date specified.

|  |  |  |
| --- | --- | --- |
|  |  | **AMERICAN CAPITAL AGENCY CORP.** |
| Dated: January \_\_, 2016 |  | /s/ MALON WILKUS |
|  |  |  |
|  |  | Malon Wilkus |
|  |  | Chair and Chief Executive Officer |
| /s/ MALON WILKUS | Director, Chair and Chief | January \_\_, 2016 |
|  |  |  |
| Malon Wilkus | Executive Officer (Principal Executive Officer) |  |
| /s/ JOHN R. ERICKSON | Director, Executive Vice President and Chief | January \_\_, 2016 |
|  |  |  |
| John R. Erickson | Financial Officer (Principal Financial Officer) |  |
| /s/ BERNICE E. BELL | Senior Vice President and Chief Accounting | January \_\_, 2016 |
|  |  |  |
| Bernice E. Bell | Officer (Principal Accounting Officer) |  |
| /s/ ROBERT M. COUCH | Director | January \_\_, 2016 |
|  |  |  |
| Robert M. Couch |  |  |
| /s/ MORRIS A. DAVIS | Director | January \_\_, 2016 |
|  |  |  |
| Morris A. Davis |  |  |
| /s/ RANDOLPH E. DOBBS | Director | January \_\_, 2016 |
|  |  |  |
| Randolph E. Dobbs |  |  |
| /s/ SAMUEL A. FLAX | Director | January \_\_, 2016 |
|  |  |  |
| Samuel A. Flax |  |  |
| /s/ LARRY K. HARVEY | Director | January \_\_, 2016 |
|  |  |  |
| Larry K. Harvey |  |  |
| /s/ PRUE B. LAROCCA | Director | January \_\_, 2016 |
|  |  |  |
| Prue B. Larocca |  |  |
| /s/ ALVIN N. PURYEAR | Director | January \_\_, 2016 |
|  |  |  |
| Alvin N. Puryear |  |  |

**Exhibit 31.1**

**American Capital Agency Corp.**

**Certification Pursuant to Section 302(a)**

**of the Sarbanes-Oxley Act of 2002**

I, Malon Wilkus, certify that:

1. I have reviewed this Annual Report on Form 10-K of American Capital Agency Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   1. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   2. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   3. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   4. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
   1. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   2. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 23, 2016

/s/ MALON WILKUS



Malon Wilkus

Chair of the Board and Chief Executive Officer

(Principal Executive Officer)

**Exhibit 31.2**

**American Capital Agency Corp.**

**Certification Pursuant to Section 302(a)**

**of the Sarbanes-Oxley Act of 2002**

I, John R. Erickson, certify that:

1. I have reviewed this Annual Report on Form 10-K of American Capital Agency Corp;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   1. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entitles, particularly during the period in which this report is being prepared;
   2. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   3. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   4. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
   1. All significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   2. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 23, 2016

/s/ JOHN R. ERICKSON



John R. Erickson

Chief Financial Officer and Executive Vice

President (Principal Financial Officer)

**Exhibit 32**

**American Capital Agency Corp.**

**Certification of CEO and CFO Pursuant to 18 U.S.C. Section 1350,**

**as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

We, Malon Wilkus, Chief Executive Officer and Chair of the Board of Directors, and John R. Erickson, Executive Vice President and Chief Financial

Officer of American Capital Agency Corp. (the “Company”), certify pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 that:

1. The Annual Report on Form 10-K of the Company for the fiscal year ended December 31, 2015 (the “Report”) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

|  |  |  |  |
| --- | --- | --- | --- |
|  | /s/ | MALON WILKUS |  |
| Name: |  | |  |
| Malon Wilkus | |  |
| Title: | Chair of the Board | |  |
|  | and Chief Executive Officer (Principal Executive Officer) | |  |
| Date: | February 23, 2016 | |  |
|  | /s/ | JOHN R. ERICKSON |  |
| Name: |  | |  |
| John R. Erickson | |  |
| Title: | Chief Financial Officer and | |  |
|  | Executive Vice President (Principal Financial Officer) | |  |
| Date: | February 23, 2016 | |  |

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.