

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

American Capital Agency Corp  
Form 10-Q  
August 07, 2014

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

---

FORM 10-Q

---

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

For the quarterly period ended June 30, 2014

OR

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 (State or Other Jurisdiction of Incorporation or Organization) 2 Bethesda Metro Center, 14th Floor Bethesda, Maryland 20814 (Address of principal executive offices) (301) 968-9300 (Registrant's telephone number, including area code)	26-1701984 (I.R.S. Employer Identification 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 earlier period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large accelerated filer  Accelerated filer

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

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

The number of shares of the issuer's common stock, \$0.01 par value, outstanding as of July 31, 2014 was 352,788,707.

AMERICAN CAPITAL AGENCY CORP.  
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1.	Financial Statements	<u>2</u>
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	<u>27</u>
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	<u>50</u>
Item 4.	Controls and Procedures	<u>53</u>

PART II. OTHER INFORMATION

Item 1.	Legal Proceedings	<u>55</u>
Item 1A.	Risk Factors	<u>55</u>
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	<u>55</u>
Item 3.	Defaults upon Senior Securities	<u>55</u>
Item 4.	Mine Safety Disclosures	<u>55</u>
Item 5.	Other Information	<u>55</u>
Item 6.	Exhibits	<u>55</u>
	Signatures	<u>57</u>

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

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

	June 30, 2014 (Unaudited)	December 31, 2013
Assets:		
Agency securities, at fair value (including pledged securities of \$50,057 and \$62,205, respectively)	\$52,174	\$64,482
Agency securities transferred to consolidated variable interest entities, at fair value (pledged securities)	1,377	1,459
U.S. Treasury securities, at fair value (including pledged securities of \$1,247 and \$3,778, respectively)	1,247	3,822
REIT equity securities, at fair value	202	237
Cash and cash equivalents	1,747	2,143
Restricted cash	783	101
Derivative assets, at fair value	593	1,194
Receivable for securities sold (including pledged securities of \$441 and \$622, respectively)	1,872	652
Receivable under reverse repurchase agreements	6,621	1,881
Other assets	238	284
Total assets	\$66,854	\$76,255
Liabilities:		
Repurchase agreements	\$48,714	\$63,533
Debt of consolidated variable interest entities, at fair value	844	910
Payable for securities purchased	558	118
Derivative liabilities, at fair value	583	422
Dividends payable	235	235
Obligation to return securities borrowed under reverse repurchase agreements, at fair value	6,094	1,848
Accounts payable and other accrued liabilities	215	492
Total liabilities	57,243	67,558
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 and \$173, respectively)	336	167
Common stock - \$0.01 par value; 600.0 shares authorized:		
352.8 and 356.2 shares issued and outstanding, respectively	4	4
Additional paid-in capital	10,332	10,406
Retained deficit	(1,073	) (497
Accumulated other comprehensive income (loss)	12	(1,383
Total stockholders' equity	9,611	8,697
Total liabilities and stockholders' equity	\$66,854	\$76,255
See accompanying notes to consolidated financial statements.		



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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Interest income:				
Interest income	\$385	\$545	\$784	\$1,092
Interest expense	95	131	203	271
Net interest income	290	414	581	821
Other loss (income), net:				
Gain (loss) on sale of agency securities, net	22	17	3	(9 )
(Loss) gain on derivative instruments and other securities, net	(244 )	1,444	(621 )	1,346
Total other (loss) income, net	(222 )	1,461	(618 )	1,337
Expenses:				
Management fees	30	37	59	70
General and administrative expenses	6	9	12	18
Total expenses	36	46	71	88
Income (loss) before income tax	32	1,829	(108 )	2,070
Provision for income tax, net	—	—	—	10
Net income (loss)	32	1,829	(108 )	2,060
Dividend on preferred stock	5	3	9	7
Net income (loss) available (attributable) to common shareholders	\$27	\$1,826	\$(117 )	\$2,053
Net income (loss)	\$32	\$1,829	\$(108 )	\$2,060
Other comprehensive income (loss):				
Unrealized gain (loss) on available-for-sale securities, net	790	(2,813 )	1,312	(3,650 )
Unrealized gain on derivative instruments, net	40	48	83	97
Other comprehensive income (loss)	830	(2,765 )	1,395	(3,553 )
Comprehensive income (loss)	862	(936 )	1,287	(1,493 )
Dividend on preferred stock	5	3	9	7
Comprehensive income (loss) available (attributable) to common shareholders	\$857	\$(939 )	\$1,278	\$(1,500 )
Weighted average number of common shares outstanding - basic and diluted	352.8	396.4	353.8	376.4
Net income (loss) per common share - basic and diluted	\$0.08	\$4.61	\$(0.33 )	\$5.45
Comprehensive income (loss) per common share - basic and diluted	\$2.43	\$(2.37 )	\$3.61	\$(3.99 )
Dividends declared per common share	\$0.65	\$1.05	\$1.30	\$2.30
See accompanying notes to consolidated financial statements.				

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

	Preferred Stock		Common Stock		Additional Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount	Shares	Amount				
Balance, December 31, 2012	6.9	\$ 167	338.9	\$ 3	\$ 9,460	\$ (289 )	\$ 1,555	\$ 10,896
Net income	—	—	—	—	—	2,060	—	2,060
Other comprehensive income:								
Unrealized loss on available-for-sale securities, net	—	—	—	—	—	—	(3,650 )	(3,650 )
Unrealized gain on derivative instruments, net	—	—	—	—	—	—	97	97
Issuance of common stock	—	—	57.6	1	1,802	—	—	1,803
Repurchase of common stock	—	—	(0.3 )	—	(7 )	—	—	(7 )
Preferred dividends declared	—	—	—	—	—	(7 )	—	(7 )
Common dividends declared	—	—	—	—	—	(912 )	—	(912 )
Balance, June 30, 2013	6.9	\$ 167	396.2	\$ 4	\$ 11,255	\$ 852	\$ (1,998 )	\$ 10,280
Balance, December 31, 2013	6.9	\$ 167	356.2	\$ 4	\$ 10,406	\$ (497 )	\$ (1,383 )	\$ 8,697
Net loss	—	—	—	—	—	(108 )	—	(108 )
Other comprehensive income:								
Unrealized gain on available-for-sale securities, net	—	—	—	—	—	—	1,312	1,312
Unrealized gain on derivative instruments, net	—	—	—	—	—	—	83	83
Issuance of preferred stock	—	169	—	—	—	—	—	169
Repurchase of common stock	—	—	(3.4 )	—	(74 )	—	—	(74 )
Preferred dividends declared	—	—	—	—	—	(9 )	—	(9 )
Common dividends declared	—	—	—	—	—	(459 )	—	(459 )
Balance, June 30, 2014	6.9	\$ 336	352.8	\$ 4	\$ 10,332	\$ (1,073 )	\$ 12	\$ 9,611

See accompanying notes to consolidated financial statements.

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

	Six months ended June 30,		
	2014	2013	
Operating activities:			
Net (loss) income	\$(108	) \$2,060	
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of agency securities premiums and discounts, net	251	232	
Amortization of accumulated other comprehensive loss on interest rate swaps de-designated as qualifying hedges	83	97	
(Gain) loss on sale of agency securities, net	(3	) 9	
Loss (gain) on derivative instruments and other securities, net	621	(1,346	)
Decrease (increase) in other assets	64	(10	)
Increase (decrease) in accounts payable and other accrued liabilities	24	(30	)
Net cash provided by operating activities	932	1,012	
Investing activities:			
Purchases of agency securities	(6,677	) (33,962	)
Proceeds from sale of agency securities	15,660	33,318	
Principal collections on agency securities	3,713	5,304	
Purchases of U.S. Treasury securities	(16,640	) (28,555	)
Proceeds from sale of U.S. Treasury securities	23,324	23,396	
Net (payments on) proceeds from reverse repurchase agreements	(4,740	) 2,388	
Net proceeds from (payments on) other derivative instruments	225	(306	)
Purchases of REIT equity securities	(204	) —	
Proceeds from sale of REIT equity securities	238	—	
Increase in restricted cash	(682	) (817	)
Other investing cash flows, net	(277	) —	
Net cash provided by investing activities	13,940	766	
Financing activities:			
Proceeds from repurchase arrangements	143,771	209,673	
Repayments on repurchase agreements	(158,590	) (211,700	)
Repayments on debt of consolidated variable interest entities	(76	) (128	)
Net proceeds from preferred stock issuance	169	—	
Net proceeds from common stock issuance	—	1,803	
Payments for common stock repurchases	(74	) (7	)
Cash dividends paid	(468	) (926	)
Net cash used in financing activities	(15,268	) (1,285	)
Net change in cash and cash equivalents	(396	) 493	
Cash and cash equivalents at beginning of period	2,143	2,430	
Cash and cash equivalents at end of period	\$1,747	\$2,923	
See accompanying notes to consolidated financial statements.			

AMERICAN CAPITAL AGENCY CORP.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

Note 1. Unaudited Interim Consolidated Financial Statements

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

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

Note 2. Organization

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

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

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

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

Note 3. Summary of Significant Accounting Policies  
Investment Securities



ASC Topic 320, Investments—Debt and Equity Securities ("ASC 320"), requires that at the time of purchase, we designate a security as held-to-maturity, available-for-sale or trading, depending on our ability and intent to hold such security to maturity. Securities classified as trading and available-for-sale are reported at fair value, while securities classified as held-to-maturity are reported at amortized cost. We may sell any of our agency securities as part of our overall management of our investment portfolio. Accordingly, we typically designate our agency securities as available-for-sale. All securities classified as available-for-sale are

reported at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss) ("OCI"), a separate component of stockholders' equity. Upon the sale of a security, we determine the cost of the security and the amount of unrealized gains or losses to reclassify out of accumulated OCI into earnings based on the specific identification method.

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

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

We estimate the fair value of our agency securities based on 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 8 for further discussion of fair value measurements.

We evaluate our agency securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis. The determination of whether a security is other-than-temporarily impaired may involve judgments and assumptions based on subjective and objective factors. When a security is impaired, an OTTI is considered to have occurred if any one of the following three conditions exist 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. 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 agency 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.

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

#### Interest Income

Interest income is accrued based on the outstanding principal amount of the investment securities and their contractual terms. Premiums or discounts associated with the purchase of investment securities are amortized or accreted into

interest income, respectively, over the projected lives of the securities, including contractual payments and estimated prepayments using the interest method in accordance with ASC Subtopic 310-20, Receivables—Nonrefundable Fees and Other Costs ("ASC 310-20").

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

#### Derivative Instruments

We use a variety of derivative instruments to hedge a portion of our exposure to market risks, including interest rate risk, prepayment risk and extension risk. The objective of our risk management strategy is to reduce fluctuations in net book value over a range of interest rate scenarios. In particular, we attempt to mitigate the risk of the cost of our variable rate liabilities increasing during a period of rising interest rates. The principal instruments that we use are interest rate swaps and options to enter into interest rate swaps ("swaptions"). We also utilize forward contracts for the purchase or sale of agency MBS securities on a generic pool basis, or a TBA contract, and on a non-generic, specified 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 other types of mortgage 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 also may 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 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.

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

Prior to September 30, 2011, we entered into interest rate swap agreements typically with the intention of qualifying for hedge accounting under ASC 815. However, as of September 30, 2011, we elected to discontinue hedge accounting for our interest rate swaps. Upon discontinuation of hedge accounting, the net deferred loss related to our

de-designated interest rate swaps remained in accumulated OCI and is being reclassified from accumulated OCI into interest expense on a straight-line basis over the remaining term of each interest rate swap.

Interest rate swap agreements

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

effect of offsetting the repricing characteristics of our repurchase agreements and cash flows on such liabilities. Our swap agreements are privately negotiated in the over-the-counter ("OTC") market and may be centrally cleared 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 to help mitigate the potential impact of larger changes in interest rates on the performance of our investment portfolio (referred to as "convexity risk"). 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 we may from time to time utilize TBA dollar roll transactions to finance agency MBS purchases.

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

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

#### U.S. Treasury securities

We purchase or sell short U.S. Treasury securities and U.S. Treasury futures contracts to help mitigate the potential impact of changes in interest rates on the performance of our portfolio. We borrow securities to cover short sales of U.S. Treasury securities under reverse repurchase agreements. We account for these as securities borrowing transactions and recognize an obligation to return the borrowed securities at fair value on the balance sheet based on the value of the underlying borrowed securities as of the reporting date. Gains and losses associated with purchases and short sales of U.S. Treasury securities and U.S. Treasury futures

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

#### Note 4. Investment Securities

As of June 30, 2014, we had agency MBS of \$53.6 billion at fair value, with a total cost basis of \$53.3 billion. The net unamortized premium balance on our agency MBS as of June 30, 2014 was \$2.4 billion, including interest and principal-only strips. The following tables summarize our investments in agency MBS as of June 30, 2014 (dollars in millions):

Agency MBS	June 30, 2014				
	Fannie Mae	Freddie Mac	Ginnie Mae	Total	
Available-for-sale agency MBS:					
Agency MBS, par	\$39,944	\$10,494	\$191	\$50,629	
Unamortized discount	(17 )	(5 )	—	(22 )	
Unamortized premium	1,777	515	5	2,297	
Amortized cost	41,704	11,004	196	52,904	
Gross unrealized gains	488	131	5	624	
Gross unrealized losses	(267 )	(134 )	—	(401 )	
Total available-for-sale agency MBS, at fair value	41,925	11,001	201	53,127	
Agency MBS remeasured at fair value through earnings:					
Interest-only and principal-only strips, amortized cost <sup>1</sup>	368	29	—	397	
Gross unrealized gains	27	3	—	30	
Gross unrealized losses	(2 )	(1 )	—	(3 )	
Total agency MBS remeasured at fair value through earnings	393	31	—	424	
Total agency MBS, at fair value	\$42,318	\$11,032	\$201	\$53,551	
Weighted average coupon as of June 30, 2014 <sup>2</sup>	3.60	% 3.75	% 3.54	% 3.63	%
Weighted average yield as of June 30, 2014 <sup>3</sup>	2.68	% 2.81	% 1.65	% 2.70	%
Weighted average yield for the quarter ended June 30, 2014 <sup>3</sup>	2.69	% 2.76	% 1.70	% 2.71	%

<sup>1</sup> The underlying unamortized principal balance ("UPB" or "par value") of our interest-only agency MBS strips was \$1.3 billion and the weighted average contractual interest we are entitled to receive was 5.48% of this amount as of June 30, 2014. The par value of our principal-only agency MBS strips was \$259 million as of June 30, 2014.

<sup>2</sup> The weighted average coupon includes the interest cash flows from our interest-only agency MBS strips taken together with the interest cash flows from our fixed rate, adjustable-rate and CMO agency MBS as a percentage of the par value of our agency MBS (excluding the UPB of our interest-only securities) as of June 30, 2014.

<sup>3</sup> Incorporates a weighted average future constant prepayment rate assumption of 8% based on forward rates as of June 30, 2014.

Agency MBS	June 30, 2014			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Fixed rate	\$50,691	\$581	\$(401)	\$50,871
Adjustable rate	967	21	—	988
CMO	1,246	22	—	1,268
Interest-only and principal-only strips	397	30	(3)	424
Total agency MBS	\$53,301	\$654	\$(404)	\$53,551





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

As of December 31, 2013, we had agency MBS of \$65.9 billion at fair value, with a total cost basis of \$67.0 billion. The net unamortized premium balance on our agency MBS as of December 31, 2013 was \$3.0 billion, including interest and principal-only strips. The following tables summarize our investments in agency MBS as of December 31, 2013 (dollars in millions):

Agency MBS	December 31, 2013			
	Fannie Mae	Freddie Mac	Ginnie Mae	Total
Available-for-sale agency MBS:				
Agency MBS, par	\$50,914	\$12,640	\$223	\$63,777
Unamortized discount	(25 )	(7 )	—	(32 )
Unamortized premium	2,210	631	7	2,848
Amortized cost	53,099	13,264	230	66,593
Gross unrealized gains	181	74	5	260
Gross unrealized losses	(991 )	(358 )	—	(1,349 )
Total available-for-sale agency MBS, at fair value	52,289	12,980	235	65,504
Agency MBS remeasured at fair value through earnings:				
Interest-only and principal-only strips, amortized cost <sup>1</sup>	400	32	—	432
Gross unrealized gains	13	3	—	16
Gross unrealized losses	(9 )	(2 )	—	(11 )
Total agency MBS remeasured at fair value through earnings	404	33	—	437
Total agency MBS, at fair value	\$52,693	\$13,013	\$235	\$65,941
Weighted average coupon as of December 31, 2013 <sup>2</sup>	3.53	% 3.78	% 3.56	% 3.58 %
Weighted average yield as of December 31, 2013 <sup>3</sup>	2.66	% 2.87	% 1.66	% 2.70 %
Weighted average yield for the year ended December 31, 2013 <sup>3</sup>	2.74	% 2.87	% 1.79	% 2.77 %

<sup>1</sup> The underlying unamortized principal balance ("UPB" or "par value") of our interest-only agency MBS strips was \$1.4 billion and the weighted average contractual interest we are entitled to receive was 5.50% of this amount as of December 31, 2013. The par value of our principal-only agency MBS strips was \$271 million as of December 31, 2013.

<sup>2</sup> The weighted average coupon includes the interest cash flows from our interest-only agency MBS strips taken together with the interest cash flows from our fixed rate, adjustable-rate and CMO agency MBS as a percentage of the par value of our agency MBS (excluding the UPB of our interest-only securities) as of December 31, 2013.

<sup>3</sup> Incorporates a weighted average future constant prepayment rate assumption of 7% based on forward rates as of December 31, 2013.

Agency MBS	December 31, 2013			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Fixed rate	\$64,057	\$242	\$(1,338 )	\$62,961
Adjustable rate	1,223	15	(3 )	1,235
CMO	1,313	3	(8 )	1,308
Interest-only and principal-only strips	432	16	(11 )	437
Total agency MBS	\$67,025	\$276	\$(1,360 )	\$65,941

The actual maturities of our agency MBS are generally shorter than the stated contractual maturities. Actual maturities are affected by the contractual lives of the underlying mortgages, periodic contractual principal payments and principal prepayments. As of June 30, 2014 and December 31, 2013, our weighted average expected constant prepayment rate ("CPR") over the remaining life of our aggregate agency MBS portfolio was 8% and 7%, respectively. Our estimates differ materially for different types of securities and thus individual holdings have a wide range of projected CPRs. We estimate long-term prepayment assumptions for different securities using a third-party service and market data. The third-party service estimates prepayment speeds using models that incorporate the forward yield curve, current mortgage rates and mortgage rates of the outstanding loans, age and size of the outstanding loans, loan-to-value ratios, volatility and other factors. We review the prepayment speeds estimated by the third-party service and compare the results to market consensus prepayment speeds, if available. We also consider historical prepayment speeds and current market conditions to validate reasonableness. As market conditions may change rapidly, we may make

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

adjustments for different securities based on our Manager's judgment. Various market participants could use materially different assumptions.

The following table summarizes our agency MBS classified as available-for-sale as of June 30, 2014 and December 31, 2013 according to their estimated weighted average life classification (dollars in millions):

Estimated Weighted Average Life of Agency MBS Classified as Available-for-Sale <sup>1</sup>	June 30, 2014				December 31, 2013			
	Fair Value	Amortized Cost	Weighted Average Coupon	Weighted Average Yield	Fair Value	Amortized Cost	Weighted Average Coupon	Weighted Average Yield
≤ 1 year	\$93	\$90	2.66%	2.31%	\$129	\$129	3.07%	2.53%
> 1 year and ≤ 3 years	163	158	4.61%	3.26%	498	491	4.08%	2.25%
> 3 years and ≤ 5 years	22,395	22,042	3.46%	2.46%	24,471	24,342	3.59%	2.57%
> 5 years and ≤ 10 years	29,833	29,955	3.54%	2.82%	38,522	39,635	3.39%	2.73%
> 10 years	643	659	3.82%	2.99%	1,884	1,996	3.66%	2.96%
Total	\$53,127	\$52,904	3.51%	2.68%	\$65,504	\$66,593	3.47%	2.68%

1. Excludes interest and principal-only strips.

The weighted average life of our interest-only strips was 6.5 and 6.3 years as of June 30, 2014 and December 31, 2013, respectively. The weighted average life of our principal-only strips was 8.8 and 8.6 years as of June 30, 2014 and December 31, 2013, respectively.

Our agency securities classified as available-for-sale are reported at fair value, with unrealized gains and losses excluded from earnings and reported in accumulated OCI. The following table summarizes changes in accumulated OCI, a separate component of stockholders' equity, for our available-for-sale securities for the three and six months ended June 30, 2014 and 2013 (in millions):

Agency Securities Classified as Available-for-Sale	Beginning Accumulated OCI Balance	Unrealized Gains and (Losses), Net	Reversal of Unrealized (Gains) and Losses, Net on Realization	Ending Accumulated OCI Balance
Three months ended June 30, 2014	\$ (566)	) 813	(22)	) \$225
Three months ended June 30, 2013	\$1,203	(2,796)	) (17)	) \$(1,610)
Six months ended June 30, 2014	\$ (1,087)	) 1,315	(3)	) \$225
Six months ended June 30, 2013	\$2,040	(3,659)	) 9	) \$(1,610)

The following table presents the gross unrealized loss and fair values of our available-for-sale agency securities by length of time that such securities have been in a continuous unrealized loss position as of June 30, 2014 and December 31, 2013 (in millions):

Agency Securities Classified as Available-for-Sale	Unrealized Loss Position For					
	Less than 12 Months Estimated Fair Value	Unrealized Loss	12 Months or More Estimated Fair Value	Unrealized Loss	Total Estimated Fair Value	Unrealized Loss
June 30, 2014	\$349	\$ (4)	\$19,583	\$ (397)	\$19,932	\$ (401)
December 31, 2013	\$42,853	\$ (1,248)	\$1,586	\$ (101)	\$44,439	\$ (1,349)

As of the end of each respective reporting period, a decision had not been made to sell any of these agency securities and we do not believe it is more likely than not we will be required to sell the agency securities before recovery of their amortized cost basis. The unrealized losses on these agency securities are not due to credit losses given the GSE guarantees, but are rather due to changes in interest rates and prepayment expectations. Accordingly, we did not recognize any OTTI charges on our investment securities for the three and six months ended June 30, 2014 and 2013. However, as we continue to actively manage our portfolio, we may recognize additional realized losses on our agency securities upon selecting specific securities to sell.

## Gains and Losses

The following table is a summary of our net gain (loss) from the sale of agency securities classified as available-for-sale for the three and six months ended June 30, 2014 and 2013 (in millions):

Agency Securities Classified as Available-for-Sale	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Agency MBS sold, at cost	\$ (7,166 )	\$ (15,069 )	\$ (16,877 )	\$ (35,397 )
Proceeds from agency MBS sold <sup>1</sup>	7,188	15,086	16,880	35,388
Net gain (loss) on sale of agency MBS	\$22	\$17	\$3	\$(9 )
Gross gain on sale of agency MBS	\$49	\$93	\$91	\$180
Gross loss on sale of agency MBS	(27 )	(76 )	(88 )	(189 )
Net gain (loss) on sale of agency MBS	\$22	\$17	\$3	\$(9 )

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

For the three and six months ended June 30, 2014, we recognized a net unrealized gain of \$15 million and \$27 million, respectively, and for the three and six months ended June 30, 2013 we recognized an unrealized loss of \$20 million and \$21 million, respectively, for the change in value of investments in interest and principal-only strips in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. Over the same periods, we did not recognize any realized gains or losses on our interest or principal-only securities.

## Securizations and Variable Interest Entities

As of June 30, 2014 and December 31, 2013, 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 \$1.4 billion and \$1.5 billion as of June 30, 2014 and December 31, 2013, respectively, and debt, at fair value, of \$844 million and \$910 million, respectively, in our accompanying consolidated balance sheets. As of June 30, 2014 and December 31, 2013, such agency securities had an aggregate unpaid principal balance of \$1.3 billion and \$1.4 billion, respectively, and such debt had an aggregate unpaid principal balance of \$823 million and \$900 million, respectively. We re-measure our consolidated debt at fair value through earnings in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. For the three and six months ended June 30, 2014, we recognized a net loss of \$9 million and \$12 million, respectively, and for the three and six months ended June 30, 2013 we recognized a net gain of \$20 million and \$34 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 June 30, 2014 and December 31, 2013, the fair value of our CMO securities and interest and principal-only securities was \$1.7 billion, excluding the consolidated CMO trusts discussed above, or \$2.2 billion and \$2.3 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 \$281 million and \$246 million as of June 30, 2014 and December 31, 2013, respectively.

Note 5. Repurchase Agreements and Other Debt

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

in interest rates, type of security and liquidity conditions within the banking, mortgage finance and real estate industries. If the fair value of our pledged securities declines, lenders will typically require us to post additional collateral or pay down borrowings to re-establish agreed upon collateral requirements, referred to as "margin calls." Similarly, if the fair value of our pledged securities increases, lenders may release collateral back to us. As of June 30, 2014, we have met all margin call requirements.

The following table summarizes our borrowings under repurchase arrangements and weighted average interest rates classified by remaining maturities as of June 30, 2014 and December 31, 2013 (dollars in millions):

Remaining Maturity	June 30, 2014			December 31, 2013		
	Repurchase Agreements	Weighted Average Interest Rate	Weighted Average Days to Maturity	Repurchase Agreements	Weighted Average Interest Rate	Weighted Average Days to Maturity
Agency MBS:						
≤ 1 month	\$11,119	0.34	% 15	\$23,577	0.42	% 15
> 1 to ≤ 3 months	14,511	0.36	% 54	20,490	0.43	% 61
> 3 to ≤ 6 months	10,293	0.42	% 138	6,946	0.45	% 140
> 6 to ≤ 9 months	4,735	0.48	% 236	2,232	0.53	% 230
> 9 to ≤ 12 months	2,585	0.49	% 309	3,607	0.54	% 323
> 12 to ≤ 24 months	2,273	0.59	% 485	3,261	0.60	% 603
> 24 to ≤ 36 months	600	0.59	% 782	500	0.62	% 930
> 36 to ≤ 48 months	502	0.63	% 1,355	202	0.71	% 1,257
> 48 to < 60 months	900	0.67	% 1,726	400	0.66	% 1,574
Total agency MBS	47,518	0.41	% 170	61,215	0.45	% 124
U.S. Treasury securities:						
1 day	1,196	(0.35)	)% 1	2,318	0.02	% 1
Total / Weighted Average	\$48,714	0.39	% 166	\$63,533	0.44	% 119

As of June 30, 2014 and December 31, 2013, debt of consolidated VIEs, at fair value ("other debt") was \$844 million and \$910 million, respectively. As of June 30, 2014 and December 31, 2013, our other debt had a weighted average interest rate of LIBOR plus 43 and 42 basis points and a principal balance of \$823 million and \$900 million, respectively. The actual maturities of our other debt are generally shorter than the stated contractual maturities. The actual maturities are affected by the contractual lives of the underlying agency MBS securitizing our other debt and periodic principal prepayments of such underlying securities. The estimated weighted average life of our other debt as of June 30, 2014 was 6.2 years.

As of June 30, 2014 and December 31, 2013, we also had outstanding forward commitments to purchase and sell agency securities through the TBA market (see Notes 3 and 6). These transactions, also referred to as TBA dollar roll transactions, represent a form of off-balance sheet financing and serve to either increase, in the case of forward purchases, or decrease, in the case of forward sales, our "at risk" leverage. However, pursuant to ASC 815, we account for such transactions as one or more series of derivative transactions and, consequently, they are not included in our on-balance sheet debt or measurement of commensurate leverage ratios.

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

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



derivative and other hedging instruments in Note 3.

Prior to September 30, 2011, our interest rate swaps were typically designated as cash flow hedges under ASC 815; however, as of September 30, 2011, we elected to discontinue hedge accounting for our interest rate swaps in order to increase our funding flexibility. For the three and six months ended June 30, 2014, we reclassified \$40 million and \$83 million, respectively, and for the three and six months ended June 30, 2013, we reclassified \$48 million and \$97 million, respectively, of net deferred losses

from accumulated OCI into interest expense related to our de-designated interest rate swaps and recognized an equal, but offsetting, amount in other comprehensive income. Our total net periodic interest costs on our swap portfolio was \$127 million and \$253 million for the three and six months ended June 30, 2014, respectively, and \$153 million and \$286 million for the three and six months ended June 30, 2013, respectively. The difference between our total net periodic interest costs on our swap portfolio and the amount recorded in interest expense related to our de-designated hedges is reported in our accompanying consolidated statements of comprehensive income in gain (loss) on derivative instruments and other securities, net (or \$87 million and \$170 million for the three and six months ended June 30, 2014, respectively, and \$105 million and \$189 million for the three and six months ended June 30, 2013, respectively). As of June 30, 2014, the remaining net deferred loss in accumulated OCI related to de-designated interest rate swaps was \$213 million and will be reclassified from OCI into interest expense over a remaining weighted average period of 1.7 years. As of June 30, 2014, the net deferred loss expected to be reclassified from OCI into interest expense over the next twelve months was \$128 million.

#### Derivative Assets (Liabilities), at Fair Value

The table below summarizes fair value information about our derivative assets and liabilities as of June 30, 2014 and December 31, 2013 (in millions):

Derivatives Instruments	Balance Sheet Location	June 30, 2014	December 31, 2013
Interest rate swaps	Derivative assets, at fair value	\$295	\$ 880
Swaptions	Derivative assets, at fair value	72	258
TBA securities	Derivative assets, at fair value	223	17
U.S. Treasury futures - short	Derivative assets, at fair value	3	39
		\$593	\$ 1,194
Interest rate swaps	Derivative liabilities, at fair value	\$(560 )	\$(400 )
TBA securities	Derivative liabilities, at fair value	(23 )	(22 )
		\$(583 )	\$(422 )

Additionally, as of June 30, 2014 and December 31, 2013, we had obligations to return U.S. Treasury securities borrowed under reverse repurchase agreements accounted for as securities borrowing transactions at a fair value of \$6.1 billion and \$1.8 billion, respectively. The borrowed securities were used to cover short sales of U.S. Treasury securities from which we received total proceeds of \$6.0 billion and \$1.9 billion, respectively. The change in fair value of the borrowed securities is recorded in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

The following tables summarize our interest rate swap agreements outstanding as of June 30, 2014 and December 31, 2013 (dollars in millions):

Payer Interest Rate Swaps	June 30, 2014				
	Notional Amount <sup>1</sup>	Average Fixed Pay Rate <sup>2</sup>	Average Receive Rate <sup>3</sup>	Net Estimated Fair Value	Average Maturity (Years) <sup>4</sup>
≤ 3 years	\$16,150	1.58	% 0.17	% \$(292 )	1.4
> 3 to ≤ 5 years	9,775	1.30	% 0.23	% 12	4.0
> 5 to ≤ 7 years	6,250	2.09	% 0.23	% (22 )	5.9
> 7 to ≤ 10 years	10,275	2.50	% 0.23	% 64	8.5
> 10 years	5,450	3.23	% 0.23	% (27 )	13.5
Total Payer Interest Rate Swaps	\$47,900	1.97	% 0.20	% \$(265 )	5.4

- 
1. Notional amount includes forward starting swaps of \$11.7 billion with an average forward start date of 1.7 years and an average maturity of 8.6 years from June 30, 2014.
  2. Average fixed pay rate includes forward starting swaps. Excluding forward starting swaps, the average fixed pay rate was 1.61% as of June 30, 2014.
  3. Average receive rate excludes forward starting swaps.
  4. Average maturity measured from June 30, 2014 through stated maturity date.

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

Payer Interest Rate Swaps <sup>1</sup>	December 31, 2013				
	Notional Amount	Average Fixed Pay Rate	Average Receive Rate	Net Estimated Fair Value	Average Maturity (Years)
≤ 3 years	\$16,750	1.57%	0.19%	\$(382)	1.6
> 3 to ≤ 5 years	10,225	1.07%	0.24%	81	3.9
> 5 to ≤ 7 years	5,700	1.97%	0.26%	113	6.0
> 7 to ≤ 10 years	8,825	2.28%	0.24%	499	8.8
> 10 years	1,750	2.79%	0.24%	169	14.7
Total Payer Interest Rate Swaps	\$43,250	1.70%	0.22%	\$480	4.7

<sup>1</sup> Notional amount includes forward starting swaps of \$4.0 billion with an average forward start date of 1.9 years from December 31, 2013.

<sup>2</sup> Average fixed pay rate includes forward starting swaps. Excluding forward starting swaps, the average fixed pay rate was 1.57% as of December 31, 2013.

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

<sup>4</sup> Average maturity measured from December 31, 2013 through stated maturity date.

The following tables summarize our interest rate swaption agreements outstanding as of June 30, 2014 and December 31, 2013 (dollars in millions):

Years to Expiration	June 30, 2014			Underlying Payer Swap			
	Option Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Fixed Pay Rate	Average Receive Rate (LIBOR)	Average Term (Years)
Payer Swaptions							
≤ 1 year	\$95	\$36	3	\$4,300	2.73%	3M	6.2
> 1 to ≤ 2 years	63	20	16	2,650	3.59%	3M	4.7
> 2 to ≤ 3 years	21	6	26	700	3.95%	3M	5.0
Total Payer Swaptions	\$179	\$62	10	\$7,650	3.14%	3M	5.6

Receiver Swaptions	June 30, 2014			Underlying Receiver Swap			
	Option Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Fixed Receive Rate	Average Pay Rate (LIBOR)	Average Term (Years)
Receiver Swaptions	\$9	\$10	8	\$1,750	2.37%	3M	10.0

Years to Expiration	December 31, 2013			Underlying Payer Swap			
	Option Cost	Fair Value	Average Months to Expiration	Notional Amount	Average Fixed Pay Rate	Average Receive Rate (LIBOR)	Average Term (Years)
Payer Swaptions							
≤ 1 year	\$193	\$117	4	\$9,400	2.87%	3M	7.8
> 1 to ≤ 2 years	105	92	19	3,600	3.40%	3M	5.6
> 2 to ≤ 3 years	35	45	30	1,150	3.81%	3M	5.8
> 3 to ≤ 5 years	2	4	52	100	4.80%	3M	7.0

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

Total Payer Swaptions	\$335	\$258	10	\$14,250	3.09%	3M	7.0
-----------------------	-------	-------	----	----------	-------	----	-----

16

---

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

We did not have any receiver swaptions outstanding as of December 31, 2013.

The following table summarizes our contracts to purchase and sell TBA contracts as of June 30, 2014 and December 31, 2013 (in millions):

Purchase and Sale Contracts for TBAs	June 30, 2014			Net Carrying Value <sup>4</sup>	December 31, 2013			Net Carrying Value <sup>4</sup>
	Notional Amount <sup>1</sup>	Cost Basis <sup>2</sup>	Market Value <sup>3</sup>		Notional Amount <sup>1</sup>	Cost Basis <sup>2</sup>	Market Value <sup>3</sup>	
TBA securities:								
Purchase contracts	\$21,380	\$21,923	\$22,136	\$212	\$6,660	\$6,882	\$6,864	\$(18)
Sale contracts	(3,569)	(3,739)	(3,752)	(12)	(4,541)	(4,606)	(4,593)	13
TBA securities, net <sup>5</sup>	\$17,811	\$18,184	\$18,384	\$200	\$2,119	\$2,276	\$2,271	\$(5)

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.

5. Includes 15-year and 30-year TBA securities of varying coupons

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

The tables below summarize changes in our derivative and other hedge portfolio and their effect on our consolidated statements of comprehensive income for the three and six months ended June 30, 2014 and 2013 (in millions):

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

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

Derivative and Other Hedging Instruments	Three Months Ended June 30, 2013				
	Notional Amount Long/(Short) March 31, 2013	Additions	Settlement, Termination, Expiration or Exercise	Notional Amount Long/(Short) June 30, 2013	Amount of Gain/(Loss) Recognized in Income on Derivatives <sup>1</sup>

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

Net TBA and forward settling agency securities	\$26,268	65,425	(77,285 )	\$ 14,408	\$ (572 )
Interest rate swaps	\$(51,250 )	(10,100 )	5,700	\$(55,650 )	1,135
Payer swaptions	\$(22,900 )	(3,200 )	2,350	\$(23,750 )	454
U.S. Treasury securities - short position	\$(12,560 )	(10,207 )	12,290	\$(10,477 )	346
U.S. Treasury securities - long position	\$—	7,304	(3,554 )	\$3,750	4
U.S. Treasury futures contracts - short position	\$(800 )	(2,830 )	1,200	\$(2,430 )	77
					\$ 1,444

17

---

Excludes a net loss of \$20 million on interest and principal-only securities and a net gain of \$20 million from debt 1. of consolidated VIEs recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

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

Excludes a net gain of \$73 million from investments in REIT equity securities, a net loss of \$12 million from debt 1. of consolidated VIEs, a net gain of \$27 million on 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.

Derivative and Other Hedging Instruments	Six Months Ended June 30, 2013					Amount of Gain/(Loss) Recognized in Income on Derivatives <sup>1</sup>
	Notional Amount Long/(Short) December 31, 2012	Additions	Settlement, Termination, Expiration or Exercise	Notional Amount Long/(Short) June 30, 2013		
Net TBA and forward settling agency securities	\$12,477	108,692	(106,761 )	\$ 14,408	\$ (674 )	
Interest rate swaps	\$(46,850 )	(15,850 )	7,050	\$(55,650 )	1,187	
Payer swaptions	\$(14,450 )	(14,350 )	5,050	\$(23,750 )	409	
U.S. Treasury securities - short position	\$(11,835 )	(20,142 )	21,500	\$(10,477 )	344	
U.S. Treasury securities - long position	\$—	7,304	(3,554 )	\$3,750	4	
U.S. Treasury futures contracts - short position	\$—	(3,630 )	1,200	\$(2,430 )	63	
					\$ 1,333	

Excludes a net loss of \$21 million on interest and principal-only securities and a net gain of \$34 million from debt 1. of consolidated VIEs recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

#### Note 7. Pledged Assets

Our repurchase agreements and derivative contracts require us to fully collateralize our obligations under the agreements based upon our counterparties' collateral requirements and their determination of the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, credit quality and liquidity conditions



within the investment banking, mortgage finance and real estate industries. In addition, obligations under our derivative agreements will typically vary over time based on similar factors as well as the remaining term of the derivative contract. We are also typically required to post initial collateral upon execution of derivative transactions, such as interest rate swap agreements and TBA contracts. If we breach any of these provisions, we will be required to fully settle our obligations under the agreements, which could include a forced liquidation of our pledged collateral. Our repurchase agreement and derivative counterparties also apply a "haircut" to our pledged collateral, which means our collateral is valued at slightly less than market value and limits the amount we can borrow against our securities. This haircut reflects the underlying risk of the specific collateral and protects our counterparty against a change in its value. Our agreements do not specify the haircut; rather haircuts are determined on an individual transaction basis. Consequently, the use of repurchase agreements and derivative instruments exposes us to credit risk relating to potential losses that could be recognized in the event that our counterparties fail to perform their obligations under such agreements. We

minimize this risk by limiting our repurchase agreement and derivative counterparties to major financial institutions with acceptable credit ratings or to a registered clearinghouse, and we monitor our positions with individual counterparties. In the event of a default by a counterparty we may have difficulty obtaining our assets pledged as collateral to such counterparty and may not receive payments provided for under the terms of our derivative agreements. In the case of centrally cleared instruments, we could be exposed to credit risk if the central clearing agency or a clearing member defaults on its respective obligation to perform under the contract. However, we believe that the risk is minimal due to the clearing exchanges' initial and daily mark to market margin requirements and clearinghouse guarantee funds and other resources that are available in the event of a clearing member default. Further, each of our International Swaps and Derivatives Association ("ISDA") Master Agreements also contains a cross default provision under which a default under certain of our other indebtedness in excess of a certain threshold causes an event of default under the agreement. Threshold amounts vary by lender. Following an event of default, we could be required to settle our obligations under the agreements. Additionally, under certain of our ISDA Master Agreements, we could be required to settle our obligations under the agreements if we fail to maintain certain minimum stockholders' equity thresholds or our REIT status or if we fail to comply with limits on our leverage above certain specified levels. As of June 30, 2014, the fair value of additional collateral that could be required to be posted as a result of the credit-risk-related contingent features being triggered was not material to our financial statements. As of June 30, 2014, our amount at risk with any counterparty related to our repurchase agreements was less than 4% of our stockholders' equity and our amount at risk with any counterparty related to our interest rate swap and swaption agreements, excluding centrally cleared swaps, was less than 1% of our stockholders' equity.

#### Assets Pledged to Counterparties

The following tables summarize our assets pledged as collateral under our repurchase agreements, debt of consolidated VIEs, derivative agreements and prime broker agreements by type, including securities pledged related to securities sold but not yet settled, as of June 30, 2014 and December 31, 2013 (in millions):

	June 30, 2014				
Assets Pledged to Counterparties	Repurchase Agreements	Debt of Consolidated VIEs	Derivative Agreements	Prime Broker Agreements	Total
Agency MBS - fair value	\$50,055	\$1,377	\$95	\$348	\$51,875
U.S. Treasury securities - fair value	1,176	—	71	—	1,247
Accrued interest on pledged securities	143	4	—	—	147
Restricted cash	1	—	534	248	783
Total	\$51,375	\$1,381	\$700	\$596	\$54,052

	December 31, 2013				
Assets Pledged to Counterparties	Repurchase Agreements	Debt of Consolidated VIEs	Derivative Agreements	Prime Broker Agreements	Total
Agency MBS - fair value	\$62,708	\$1,459	\$28	\$91	\$64,286
U.S. Treasury securities - fair value	3,708	—	70	—	3,778
Accrued interest on pledged securities	189	5	1	—	195
Restricted cash	3	—	41	57	101
Total	\$66,608	\$1,464	\$140	\$148	\$68,360

The cash and cash equivalents and agency securities pledged as collateral under our derivative agreements are included in restricted cash and agency securities, at fair value, respectively, on our consolidated balance sheets. The following table summarizes our securities pledged as collateral under repurchase agreements and debt of consolidated VIEs by remaining maturity, including securities pledged related to sold but not yet settled securities, as of June 30, 2014 and December 31, 2013 (in millions):

Agency Securities Pledged by Remaining Maturity of Repurchase Agreements and Debt of Consolidated VIEs	June 30, 2014			December 31, 2013		
	Fair Value of Pledged Securities	Amortized Cost of Pledged Securities	Accrued Interest on Pledged Securities	Fair Value of Pledged Securities	Amortized Cost of Pledged Securities	Accrued Interest on Pledged Securities
Agency MBS:						
≤ 30 days	\$14,505	\$14,403	\$39	\$27,694	\$28,125	\$76
> 30 and ≤ 60 days	13,730	13,638	38	14,955	15,210	42
> 60 and ≤ 90 days	3,725	3,699	11	10,117	10,290	28
> 90 days	19,472	19,476	55	11,401	11,623	32
Total agency MBS	51,432	51,216	143	64,167	65,248	178
U.S. Treasury securities:						
1 day	1,176	1,168	4	3,708	3,760	16
Total	\$52,608	\$52,384	\$147	\$67,875	\$69,008	\$194

As of June 30, 2014 and December 31, 2013, none of our repurchase agreement borrowings backed by agency MBS were due on demand or mature overnight.

#### Assets Pledged from Counterparties

As of June 30, 2014 and December 31, 2013, we also had assets pledged to us as collateral under our reverse repurchase and derivative agreements summarized in the tables below (in millions).

Assets Pledged to AGNC	June 30, 2014		
	Reverse Repurchase Agreements	Derivative Agreements	Total
U.S. Treasury securities - fair value	\$6,094	\$23	\$6,117
Cash	—	101	101
Total	\$6,094	\$124	\$6,218
Assets Pledged to AGNC	December 31, 2013		
	Reverse Repurchase Agreements	Derivative Agreements	Total
Agency MBS - fair value	\$—	\$82	\$82
U.S. Treasury securities - fair value	1,848	164	2,012
Cash	—	366	366
Total	\$1,848	\$612	\$2,460

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

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

Offsetting Assets and Liabilities

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

The following tables present information about our assets and liabilities that are subject to such arrangements and can potentially be offset on our consolidated balance sheets as of June 30, 2014 and December 31, 2013 (in millions):

Offsetting of Financial Assets and Derivative Assets

	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Assets Presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance		Net Amount
				Financial Instruments	Collateral Received <sup>2</sup>	
June 30, 2014						
Interest rate swap and swaption agreements, at fair value <sup>1</sup>	\$367	\$ —	\$ 367	\$(195 )	\$(121 )	\$51
Receivable under reverse repurchase agreements	6,621	—	6,621	(5,847 )	(774 )	—
Total derivative, other hedging instruments and other assets	\$6,988	\$ —	\$ 6,988	\$(6,042 )	\$(895 )	\$51
December 31, 2013						
Interest rate swap and swaption agreements, at fair value <sup>1</sup>	\$1,138	\$ —	\$ 1,138	\$(331 )	\$(610 )	\$197
Receivable under reverse repurchase agreements	1,881	—	1,881	(1,881 )	—	—
Total derivative, other hedging instruments and other assets	\$3,019	\$ —	\$ 3,019	\$(2,212 )	\$(610 )	\$197

Offsetting of Financial Liabilities and Derivative Liabilities

	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheets	Net Amounts of Liabilities Presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance		Net Amount
				Financial Instruments	Collateral Pledged <sup>2</sup>	
June 30, 2014						
Interest rate swap agreements, at fair value <sup>1</sup>	\$560	\$ —	\$ 560	\$(195 )	\$(365 )	\$—
Repurchase agreements	48,714	—	48,714	(5,847 )	(42,867 )	—
Total derivative, other hedging instruments and other liabilities	\$49,274	\$ —	\$ 49,274	\$(6,042 )	\$(43,232 )	\$—
December 31, 2013						
Interest rate swap agreements, at fair value <sup>1</sup>	\$400	\$ —	\$ 400	\$(331 )	\$(69 )	\$—

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

Repurchase agreements	63,533	—	63,533	(1,881 )	(61,652 )	—
Total derivative, other hedging instruments and other liabilities	\$63,933	\$ —	\$ 63,933	\$(2,212 )	\$(61,721 )	\$—

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

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

Note 8. Fair Value Measurements

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

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

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

The following table provides a summary of our assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013 (dollars in millions):

	Fair Value Hierarchy		
	Level 1	Level 2	Level 3
June 30, 2014			
Assets:			
Agency securities	\$—	\$52,174	\$—
Agency securities transferred to consolidated VIEs	—	1,377	—
U.S. Treasury securities	1,247	—	—
Interest rate swaps	—	295	—
Swaptions	—	72	—
REIT equity securities	202	—	—
U.S. Treasury futures	3	—	—
TBA securities	—	223	—
Total	\$1,452	\$54,141	\$—
Liabilities:			
Debt of consolidated VIEs	\$—	\$844	\$—
Obligation to return U.S. Treasury securities borrowed under reverse repurchase agreements	6,094	—	—
Interest rate swaps	—	560	—
TBA securities	—	23	—
Total	\$6,094	\$1,427	\$—
December 31, 2013			
Assets:			
Agency securities	\$—	\$64,482	\$—
Agency securities transferred to consolidated VIEs	—	1,459	—
U.S. Treasury securities	3,822	—	—
Interest rate swaps	—	880	—
Swaptions	—	258	—
REIT equity securities	237	—	—
U.S. Treasury futures	39	—	—
TBA securities	—	17	—
Total	\$4,098	\$67,096	\$—
Liabilities:			
Debt of consolidated VIEs	\$—	\$910	\$—
Obligation to return U.S. Treasury securities borrowed under reverse repurchase agreements	1,848	—	—
Interest rate swaps	—	400	—
TBA securities	—	22	—
Total	\$1,848	\$1,332	\$—

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 a market approach using Level 2 inputs from third-party pricing services and dealer quotes.

## Note 9. Stockholders' Equity

### Preferred Stock

Pursuant to our amended and restated certificate of incorporation, we are authorized to designate and issue up to 10.0 million shares of preferred stock in one or more classes or series. Our Board of Directors has designated 6.9 million shares as 8.000% Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock") and 8,050 shares as 7.750% Series B Cumulative Redeemable Preferred Stock ("Series B Preferred Stock"). As of June 30, 2014 we have 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. Upon completion of the offering we received proceeds, net of offering expenses, of approximately \$167 million. Our Series A Preferred Stock has no stated maturity and is not subject to any sinking fund or mandatory redemption. Under certain circumstances upon a change of control, our Series A Preferred Stock is convertible to shares of our common stock. Holders of Series A Preferred Stock have no voting rights, except under limited conditions, and holders are entitled to receive cumulative cash dividends at a rate of 8.000% per annum of the \$25.00 per share liquidation preference before holders of our common stock are entitled to receive any dividends. Shares of our Series A Preferred Stock are redeemable at \$25.00 per share plus accumulated and unpaid dividends (whether or not declared) exclusively at our option commencing on April 5, 2017, or earlier under certain circumstances intended to preserve our qualification as a REIT for Federal income tax purposes. Dividends are payable quarterly in arrears on the 15th day of each January, April, July and October. As of June 30, 2014, we had declared all required quarterly dividends on the Series A Preferred Stock.

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 approximately \$169 million. Each depositary share represents a 1/1,000th interest in a share of our Series B Preferred Stock. Our Series B Preferred Stock has no stated maturity, is not subject to any sinking fund or mandatory redemption and ranks on parity with our Series A Preferred Stock. Under certain circumstances upon a change of control, our Series B Preferred Stock is convertible to shares of our common stock. Holders of depositary shares have no voting rights, except under limited conditions, and are entitled to receive cumulative cash dividends at a rate of 7.750% per annum of the \$25.00 per depositary share liquidation preference before holders of our common stock are entitled to receive any dividends. Dividends are payable quarterly in arrears on the 15th day of each January, April, July and October. Depositary shares are redeemable at \$25.00 per depositary share plus accumulated and unpaid dividends (whether or not declared) exclusively at our option commencing on May 8, 2019, or earlier under certain circumstances intended to preserve our qualification as a REIT for federal income tax purposes. As of June 30, 2014, we had declared all required quarterly dividends on the Series B Preferred Stock underlying our depositary shares.

### Common Stock Repurchase Program

In October 2012, our Board of Directors adopted a program that provides for stock repurchases of up to \$500 million of our outstanding shares of common stock through December 31, 2013. In September 2013, our Board of Directors increased the authorized amount to \$1 billion of our outstanding shares of common stock and extended its authorization through December 31, 2014. In January 2014, our Board of Directors increased the authorized amount by an additional \$1 billion of our outstanding shares of common stock through December 31, 2014. 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. We intend to repurchase shares only when the purchase price is less than our estimate of our current net asset value per share of our common stock. 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.

We did not repurchase any shares of our common stock during the three months ended June 30, 2014. During the six months ended June 30, 2014, we repurchased approximately 3.4 million shares of our common stock at an average repurchase price of \$22.10 per share, including expenses, totaling \$74 million. As of June 30, 2014, the total remaining amount authorized for repurchases of our common stock was \$992 million.

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

Accumulated Other Comprehensive Income (Loss)

The following table summarizes changes to accumulated OCI for the three and six months ended June 30, 2014 and 2013 (in millions):

Accumulated Other Comprehensive Income (Loss)	Three Months Ended June 30, 2014		
	Net Unrealized Gain (Loss) on Available-for-Sale MBS	Net Unrealized Gain (Loss) on Swaps	Total Accumulated OCI Balance
Balance as of March 31, 2014	\$ (566)	) \$ (253)	) \$ (819)
OCI before reclassifications	813	—	813
Amounts reclassified from accumulated OCI	(22)	) 40	18
Balance as of June 30, 2014	\$ 225	) \$ (213)	) \$ 12

Accumulated Other Comprehensive Income (Loss)	Three Months Ended June 30, 2013		
	Net Unrealized Gain (Loss) on Available-for-Sale MBS	Net Unrealized Gain (Loss) on Swaps	Total Accumulated OCI Balance
Balance as of March 31, 2013	\$ 1,203	) \$ (436)	) \$ 767
OCI before reclassifications	(2,796)	) —	(2,796)
Amounts reclassified from accumulated OCI	(17)	) 48	31
Balance as of June 30, 2013	\$ (1,610)	) \$ (388)	) \$ (1,998)

Accumulated Other Comprehensive Income (Loss)	Six Months Ended June 30, 2014		
	Net Unrealized Gain (Loss) on Available-for-Sale MBS	Net Unrealized Gain (Loss) on Swaps	Total Accumulated OCI Balance
Balance as of December 31, 2013	\$ (1,087)	) \$ (296)	) \$ (1,383)
OCI before reclassifications	1,315	—	1,315
Amounts reclassified from accumulated OCI	(3)	) 83	80
Balance as of June 30, 2014	\$ 225	) \$ (213)	) \$ 12

Accumulated Other Comprehensive Income (Loss)	Six Months Ended June 30, 2013		
	Net Unrealized Gain (Loss) on Available-for-Sale MBS	Net Unrealized Gain (Loss) on Swaps	Total Accumulated OCI Balance
Balance as of December 31, 2012	\$ 2,040	) \$ (485)	) \$ 1,555
OCI before reclassifications	(3,659)	) —	(3,659)
Amounts reclassified from accumulated OCI	9	) 97	106
Balance as of June 30, 2013	\$ (1,610)	) \$ (388)	) \$ (1,998)

The following table summarizes reclassifications out of accumulated OCI for the three and six months ended June 30, 2014 and 2013 (in millions):

Amounts Reclassified from Accumulated OCI	Three Months Ended June 30,		Line Item in the Consolidated Statements of Comprehensive Income Where Net Income is Presented
	2014	2013	
Gain amounts reclassified from accumulated OCI for available-for-sale MBS	\$ (22	) \$ (17	) Gain (loss) on sale of agency securities, net
Periodic interest costs of interest rate swaps previously designated as hedges under GAAP, net	40	48	Interest expense
Total reclassifications	\$ 18	\$ 31	
Amounts Reclassified from Accumulated OCI	Six Months Ended June 30,		Line Item in the Consolidated Statements of Comprehensive Income Where Net Income is Presented
	2014	2013	
(Gain) loss amounts reclassified from accumulated OCI for available-for-sale MBS	\$ (3	) \$ 9	) Gain (loss) on sale of agency securities, net
Periodic interest costs of interest rate swaps previously designated as hedges under GAAP, net	83	97	Interest expense
Total reclassifications	\$ 80	\$ 106	

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

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

Executive Overview

Financial Condition

Results of Operations

Liquidity and Capital Resources

Forward-Looking Statements

### EXECUTIVE OVERVIEW

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

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

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

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

#### Our Investment Strategy

Our investment strategy is designed to:

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

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

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

27

---

### Our Risk Management Strategy

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

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

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

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

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

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

The principal instruments that we use to hedge a portion of our exposure to interest rate, prepayment and extension risks are interest rate swaps and options to enter into interest rate swaps ("interest rate swaptions"). We also utilize forward contracts for the purchase or sale of agency MBS securities on a generic pool basis, or a TBA contract, and on a non-generic, specified pool basis, and 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 other types of mortgage derivatives, such as interest and principal-only securities.

Our hedging instruments are generally not designed to protect our net book value from "spread risk" (also referred to as "basis risk"), which is the risk of an increase of the market spread between the yield on our agency securities and the benchmark yield on U.S. Treasury securities or interest rate swap rates. The inherent spread risk associated with our agency securities and the resulting fluctuations in fair value of these securities can occur independent of interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated monetary policy actions by the Federal Reserve ("Fed"), liquidity, or changes in required rates of return on different assets. Consequently, while we use interest rate swaps and other supplemental hedges to attempt to protect our net book value against moves in interest rates, such instruments typically

will not protect our net book value against spread risk and, therefore, the value of our agency securities and our net book value could decline.

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

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

#### Trends and Recent Market Impacts

The fixed income markets saw improvement and a return to relative stability during the first half of 2014, after being one of the hardest hit sectors during 2013. Fixed rate agency MBS prices were generally higher during both the first and second quarters of 2014, driven by a combination of lower long term rates, tighter mortgage spreads and lower levels of implied interest rate volatility (lower option prices). During the first half of 2014, the Fed began to reduce purchases under its asset purchase program ("QE3"), in line with its "tapering" guidance issued during December 2013. Mixed economic data and the "measured" tapering actions taken by the Fed during the first half of 2014 led to a meaningful flattening of the yield curve, as the market began to realize that the pace of tightening in Fed monetary policy would likely be more gradual and have a more moderate impact than many had initially expected. Agency mortgage spreads also tightened significantly during the first half of 2014, leading to considerably more price appreciation on agency MBS than on comparable duration U.S. Treasury securities. The relative outperformance of agency MBS is widely attributed to a combination of historically low mortgage origination volume, conservative positioning by fixed income investors, with many agency MBS investors meaningfully underweight their benchmark, and a favorable "stock-effect" due to the Fed's significant ownership of approximately one third, or nearly \$1.8 trillion, of the agency MBS market as of June 30, 2014.

In addition to the general outperformance of the agency MBS market, our performance during the first half of 2014 was also bolstered by very favorable financing rates in the TBA dollar roll market, our moderate leverage profile and our decision to maintain a larger "duration gap" (the estimated difference between the interest rate sensitivity of our assets and our liabilities and hedges). The combination of these factors drove our aggregate economic return of 15.2% for the first half of 2014, comprised of \$1.30 dividends per common share and a \$2.33 increase in our net book value per common share.

By the start of 2014, we had increased our 15 year fixed rate mortgage position to just over 50% of our portfolio, which benefited our first quarter performance as 15 year mortgages, on a hedge adjusted basis, generally outperformed 30 year mortgages during the first quarter. Early in the second quarter, the price of higher coupon 15 year agency MBS increased significantly relative to other agency MBS instruments, particularly 30 year agency MBS. In response to this changing dynamic, we reduced our 15 year position to approximately 38% of our portfolio and increased our 30 year position to 57%. This shift further benefited our performance in the second quarter as 30 year mortgages generally outperformed 15 year mortgages.

In addition to operating with a larger duration gap during the first half of 2014, we also shifted the composition of our hedge portfolio toward a greater share of hedges in the three to seven year part of the yield curve and avoided the negative impact of lower option prices by reducing the size of our swaption portfolio beginning in the fourth quarter of 2013.

Our decision to operate with a slightly larger duration gap was consistent with our moderate leverage profile and the minimal extension risk in our portfolio and in agency MBS more broadly. Our exposure to an increase in interest rates is the combination of our current duration plus the duration extension that occurs as interest rates increase. As such, when extension risk is viewed as more significant, we will tend to operate with a smaller duration gap and when



extension risk is deemed less significant, we will tend to operate with a larger duration gap. For further discussion of our interest rate sensitivity, refer to Quantitative and Qualitative Disclosures about Market Risk in this Form 10-Q. Given the very favorable implied financing terms available during the first half of 2014 in the TBA dollar roll market and lower relative benefits of holding specific mortgage pools, we increased our investment allocation in TBA securities, rather than settling specific mortgage pools and funding them with repurchase agreements. Our TBA dollar roll position increased from \$2.3 billion as of December 31, 2013 to \$18.4 billion as of June 30, 2014 (or from 3% to 26% of our portfolio). Gains and losses on TBA positions are treated as capital gains or losses for purposes of determining our taxable earnings. An additional benefit to gaining exposure to agency MBS in TBA form and continuing to roll the purchases forward to later settlement dates,

is that dollar roll income associated with these positions may be offset against our prior year capital loss carryforward. Therefore, given our relative shift towards dollar roll income, we expect that a portion of our 2014 dividends declared on our common stock will represent a "return of capital" for income tax purposes when the final determination is made after the end of our calendar year. For shareholders that hold our common stock in taxable accounts, this may result in an improvement in their after-tax returns. The final tax characterization of our dividends will be reported to shareholders on Form 1099-DIV after the end of the calendar year. Please also refer to Dividends and Income Taxes in our Results of Operations for further information regarding our estimated taxable earnings.

Looking ahead, we believe agency MBS valuations will benefit from favorable supply and demand technical factors throughout the remainder of 2014 and likely into 2015. An important driver of our outlook for agency MBS is our belief that the Fed will remain a significant purchaser of agency MBS, as it continues to reinvest paydowns on its portfolio into new agency MBS holdings, for a considerable time following the conclusion of QE3. In addition, we expect new loan origination volumes to be depressed as refinance activity will be muted in the absence of a significant decline in interest rates and as first time homebuyers continue to face a myriad of challenges. We also believe agency MBS are more attractive to fixed income investors relative to other fixed income investments, as agency MBS yields have increased by more than 100 bps since the start of QE3 through June 30, 2014, while yields on comparable duration investments have generally fallen. Agency MBS also offer several advantages over many other fixed-income products, such as greater liquidity and financing opportunities and a favorable "stock-effect" due to the Fed's significant ownership of agency MBS.

Given these factors, we believe agency MBS will perform well relative to other fixed income products and that TBA dollar roll financing will remain very attractive for some period of time, even if funding rates were to rise above, or become less "special" than, levels experienced during the first half of 2014. However, if conditions change resulting in higher interest rates and/or wider mortgage spreads, and assuming we took no further portfolio rebalancing actions, it would likely have an adverse impact on our net book value. For the estimated impact of changes in interest rates and mortgage spreads on our net book value please refer to Quantitative and Qualitative Disclosures about Market Risk in this Form 10-Q. However, since we employ an active management strategy, the size and composition of our assets, liabilities and hedges will evolve based on our Manager's view of the current market environment and relative risks and rewards. As such, the actual impact of changes in interest rates and mortgage spreads could differ materially from our estimates.

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

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

Interest Rate/Security Price <sup>1</sup>	June 30, 2013	Sept 30, 2013	Dec. 31, 2013	Mar. 31, 2014	June 30, 2014	June 30, 2014 vs. Mar. 31, 2014	June 30, 2014 vs. Dec. 31, 2013
<b>LIBOR:</b>							
1-Month	0.19%	0.18%	0.17%	0.15%	0.16%	+0.01 bps	--0.01 bps
3-Month	0.27%	0.25%	0.25%	0.23%	0.23%	— bps	--0.02 bps
6-Month	0.41%	0.37%	0.35%	0.33%	0.33%	— bps	--0.02 bps
<b>U.S. Treasury Security Rate:</b>							
2-Year U.S. Treasury	0.36%	0.32%	0.38%	0.42%	0.46%	+0.04 bps	+0.08 bps
3-Year U.S. Treasury	0.66%	0.63%	0.78%	0.90%	0.87%	--0.03 bps	+0.09 bps
5-Year U.S. Treasury	1.39%	1.38%	1.74%	1.72%	1.63%	--0.09 bps	--0.11 bps
10-Year U.S. Treasury	2.49%	2.61%	3.03%	2.72%	2.53%	--0.19 bps	--0.50 bps
30-Year U.S. Treasury	3.52%	3.69%	3.96%	3.56%	3.36%	--0.20 bps	--0.60 bps
<b>Interest Rate Swap Rate:</b>							
2-Year Swap	0.51%	0.46%	0.49%	0.55%	0.58%	+0.03 bps	+0.09 bps
3-Year Swap	0.82%	0.76%	0.88%	0.99%	1.00%	+0.01 bps	+0.12 bps
5-Year Swap	1.57%	1.54%	1.79%	1.80%	1.70%	--0.10 bps	--0.09 bps
10-Year Swap	2.70%	2.77%	3.09%	2.84%	2.63%	--0.21 bps	--0.46 bps
30-Year Swap	3.45%	3.66%	3.93%	3.54%	3.33%	--0.21 bps	--0.60 bps
<b>30-Year Fixed Rate MBS Price:</b>							
3.0%	\$97.72	\$97.70	\$95.11	\$96.53	\$98.77	+\$2.24	+\$3.66
3.5%	\$101.50	\$101.83	\$99.48	\$100.59	\$102.92	+\$2.33	+\$3.44
4.0%	\$104.16	\$104.86	\$103.11	\$103.94	\$106.11	+\$2.17	+\$3.00
4.5%	\$105.82	\$106.80	\$106.06	\$106.69	\$108.30	+\$1.61	+\$2.24
<b>15-Year Fixed Rate MBS Price:</b>							
2.5%	\$100.45	\$100.61	\$99.00	\$99.92	\$101.59	+\$1.67	+\$2.59
3.0%	\$102.82	\$103.53	\$102.05	\$102.72	\$103.88	+\$1.16	+\$1.83
3.5%	\$104.20	\$105.58	\$104.58	\$104.83	\$105.98	+\$1.15	+\$1.40
4.0%	\$105.32	\$106.25	\$105.94	\$105.78	\$106.17	+\$0.39	+\$0.23

Price information is for generic instruments only and is not reflective of our specific portfolio holdings. Price information can vary by source. Prices in the table above were obtained from a combination of Bloomberg and dealer indications. Interest rates were obtained from Bloomberg.

The following table summarizes recent prepayment trends for our portfolio:

Annualized Monthly Constant Prepayment Rates <sup>1</sup>	Dec. 2013	Jan. 2014	Feb. 2014	Mar. 2014	Apr. 2014	May 2014	June 2014
AGNC portfolio	8%	8%	7%	6%	8%	9%	9%

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

FINANCIAL CONDITION

As of June 30, 2014 and December 31, 2013, our investment portfolio consisted of \$53.6 billion and \$65.9 billion of agency MBS, respectively, and a \$18.4 billion and \$2.3 billion net long TBA position, at fair value, respectively. Our TBA positions are recorded as derivative instruments in our accompanying consolidated financial statements, with the TBA dollar roll transactions representing a form of off-balance sheet financing. As of June 30, 2014 and December 31, 2013, our TBA position had a net carrying value of \$200 million and \$(5) 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.

The following tables summarize certain characteristics of our agency MBS investment portfolio and our net TBA position as of June 30, 2014 and December 31, 2013 (dollars in millions):

June 30, 2014

Agency MBS Classified as Available-for-Sale ("AFS")	Par Value	Amortized Cost	Amortized Cost Basis	Fair Value	% Lower Loan Balance & HARP 2,3	Weighted Average WAC <sup>4</sup>	Yield <sup>5</sup>	Age (Mths)	Projected Life CPR <sup>5</sup>
Investments By									
Coupon: <sup>1</sup>									
Fixed Rate									
≤ 15-Year									
≤ 2.5%	\$7,315	\$7,465	102.0%	\$7,445	37%	2.97%	2.05%	19	7%
3.0%	4,942	5,096	103.1%	5,136	76%	3.50%	2.28%	26	8%
3.5%	8,940	9,292	103.9%	9,485	56%	3.93%	2.50%	39	10%
4.0%	5,156	5,400	104.7%	5,520	88%	4.40%	2.74%	43	11%
4.5%	537	565	105.2%	579	97%	4.87%	3.09%	46	11%
≥ 5.0%	7	7	104.4%	7	26%	6.46%	4.43%	78	14%
Total ≤ 15-Year	26,897	27,825	103.4%	28,172	62%	3.70%	2.40%	32	9%
20-Year									
≤ 3.0%	339	336	99.2%	345	28%	3.55%	3.10%	13	6%
3.5%	740	757	102.3%	774	63%	4.05%	3.07%	16	8%
4.0%	87	91	104.7%	94	47%	4.53%	3.03%	34	9%
4.5%	108	116	107.0%	118	99%	4.89%	3.08%	43	10%
≥ 5.0%	6	6	106.2%	6	—%	5.90%	3.35%	73	19%
Total 20-Year:	1,280	1,306	102.1%	1,337	55%	4.04%	3.08%	19	8%
30-Year:									
≤ 3.0%	224	228	101.8%	221	69%	3.69%	2.77%	17	6%
3.5%	8,476	8,972	105.9%	8,733	96%	4.02%	2.75%	25	6%
4.0%	8,459	9,014	106.6%	8,983	96%	4.47%	3.11%	30	7%
4.5%	2,695	2,878	106.8%	2,943	91%	4.95%	3.48%	38	8%
5.0%	196	209	106.6%	217	65%	5.45%	3.82%	74	10%
≥ 5.5%	237	259	109.3%	265	36%	6.23%	3.49%	90	17%
Total 30-Year	20,287	21,560	106.3%	21,362	94%	4.37%	3.02%	30	7%
Total Fixed Rate	48,464	50,691	104.6%	50,871	75%	3.99%	2.68%	31	8%
Adjustable Rate	948	967	101.9%	988	—%	3.03%	2.38%	33	20%
CMO	1,216	1,246	102.5%	1,268	—%	4.29%	2.88%	27	7%
Total / Weighted Average	\$50,628	\$52,904	104.5%	\$53,127	72%	3.98%	2.68%	31	8%



Agency MBS Remeasured at Fair Value Through Earnings	June 30, 2014			Weighted Average		Age (Mths)	Projected Life CPR <sup>5</sup>
	Underlying Unamortized Principal Balance	Amortized Cost	Fair Value	Coupon <sup>1</sup>	Yield <sup>5</sup>		
Interest-Only Strips	\$ 1,267	\$ 198	\$ 219	5.48%	7.95%	50	11%
Principal-Only Strips	259	199	205	—%	4.14%	30	7%
Total / Weighted Average	\$ 1,526	\$ 397	\$ 424	4.55%	6.04%	40	9%

The weighted average coupon on our agency MBS classified as "AFS" was 3.51% and the weighted average coupon on our total agency MBS portfolio, including agency MBS remeasured at fair value through earnings, was 3.63% as of June 30, 2014.

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 \$99,000 and \$95,000 for 15-year and 30-year securities, respectively, as of June 30, 2014.

HARP securities are defined as pools backed by 100% refinance loans with LTV ≥ 80%. Our HARP securities had a weighted average LTV of 108% and 107% for 15-year and 30-year securities, respectively, as of June 30, 2014.

<sup>3</sup> Includes \$973 million and \$2.1 billion of 15-year and 30-year securities with >105 LTV pools which are not deliverable into TBA securities.

<sup>4</sup> WAC represents the weighted average coupon of the underlying collateral.

<sup>5</sup> Portfolio yield incorporates a projected life CPR assumption based on forward rate assumptions as of June 30, 2014.

TBA Securities	June 30, 2014		Market Value <sup>3</sup>	Net Carrying Value <sup>4</sup>
	Notional Amount - Long (Short) <sup>1</sup>	Cost Basis <sup>2</sup>		
15-Year TBA securities:				
2.5%	\$ 1,415	\$ 1,425	\$ 1,438	\$ 13
3.0%	(294)	(301)	(305)	(4)
3.5%	(2,006)	(2,114)	(2,124)	(10)
4.0%	(50)	(53)	(53)	—
Total 15-Year TBAs	(935)	(1,043)	(1,044)	(1)
30-Year TBA securities:				
3.0%	2,680	2,625	2,648	23
3.5%	5,924	6,013	6,074	61
4.0%	10,530	11,004	11,125	121
4.5%	(388)	(415)	(419)	(4)
Total 30-Year TBAs	18,746	19,227	19,428	201
Total net TBA securities	\$ 17,811	\$ 18,184	\$ 18,384	\$ 200

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

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

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

<sup>4</sup> 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 on the accompanying consolidated balance sheets.



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

December 31, 2013

Agency MBS Classified as AFS	Par Value	Amortized Cost	Amortized Cost Basis	Fair Value	% Lower Loan Balance & HARP 2,3	Weighted Average		Age (Months)	Projected Life CPR <sup>5</sup>
						WAC <sup>4</sup>	Yield <sup>5</sup>		
Investments By									
Coupon: <sup>1</sup>									
Fixed Rate									
≤ 15-Year									
≤ 2.5%	\$11,189	\$11,400	101.9%	\$11,109	31%	2.96%	2.11%	14	6%
3.0%	6,037	6,220	103.0%	6,166	69%	3.48%	2.34%	21	7%
3.5%	14,049	14,632	104.2%	14,716	51%	3.93%	2.52%	31	9%
4.0%	5,700	5,981	104.9%	6,056	88%	4.40%	2.78%	37	9%
4.5%	588	619	105.3%	631	99%	4.87%	3.15%	40	10%
≥ 5.0%	8	9	104.5%	9	23%	6.49%	4.40%	73	14%
Total ≤ 15-Year	37,571	38,861	103.4%	38,687	55%	3.66%	2.42%	25	8%
20-Year									
≤ 3.0%	350	347	99.2%	346	28%	3.55%	3.10%	7	5%
3.5%	770	788	102.4%	785	63%	4.05%	3.11%	10	6%
4%	93	97	105.0%	97	47%	4.53%	3.10%	28	7%
4.5%	116	125	107.3%	124	97%	4.89%	3.20%	37	8%
≥ 5.0%	6	7	106.7%	7	—%	5.89%	3.39%	67	16%
Total 20-Year:	1,335	1,364	102.2%	1,359	56%	4.05%	3.11%	13	6%
30-Year:									
≤ 3.0%	231	236	101.8%	220	69%	3.69%	2.78%	11	5%
3.5%	8,530	9,051	106.1%	8,477	99%	4.02%	2.76%	19	5%
4%	9,077	9,669	106.5%	9,359	92%	4.46%	3.14%	22	6%
4.5%	4,075	4,355	106.9%	4,332	88%	4.95%	3.53%	33	7%
5.0%	211	226	106.6%	229	65%	5.46%	3.84%	69	10%
≥ 5.5%	271	295	108.8%	298	36%	6.25%	3.46%	84	19%
Total 30-Year	22,395	23,832	106.4%	22,915	93%	4.41%	3.08%	24	6%
Total Fixed Rate	61,301	64,057	104.5%	62,961	69%	3.95%	2.68%	24	7%
Adjustable Rate	1,196	1,223	102.2%	1,235	—%	2.58%	2.41%	26	17%
CMO	1,280	1,313	102.6%	1,308	—%	4.30%	2.88%	21	7%
Total / Weighted Average	\$63,777	\$66,593	104.4%	\$65,504	66%	3.93%	2.68%	24	7%

Agency MBS Remeasured at Fair Value Through Earnings	December 31, 2013			Weighted Average			Projected Life CPR <sup>5</sup>
	Underlying Unamortized Principal Balance	Amortized Cost	Fair Value	Coupon <sup>1</sup>	Yield <sup>5</sup>	Age (Months)	
Interest-Only Strips	\$1,379	\$223	\$ 232	5.50%	7.63%	45	11%
Principal-Only Strips	271	209	205	—%	3.84%	25	8%
Total / Weighted Average	\$1,650	\$432	\$ 437	4.59%	5.80%	35	9%

The weighted average coupon on our agency MBS classified as "AFS" held as of December 31, 2013 was 3.47% and the weighted average coupon on our total agency MBS portfolio, including agency MBS remeasured at fair value through earnings, held as of December 31, 2013 was 3.58%.



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

Lower loan balance securities represent pools backed by an original loan balance of up to  $\leq$  \$150,000. Our lower loan  
2. balance securities had a weighted average original loan balance of \$100,000 and \$95,000 for 15-year and 30-year  
securities, respectively, as of December 31, 2013.

HARP securities are defined as pools backed by 100% refinance loans with LTVs  $\geq$  80%. Our HARP securities had a  
3. weighted average LTV of 106% and 105% for 15-year and 30-year securities, respectively, as of December 31,  
2013