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American Capital Agency Corp  
Form 10-Q  
August 08, 2013

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

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FORM 10-Q

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

For the quarterly period ended June 30, 2013

OR

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

Commission file number 001-34057

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

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

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Indicate by check mark whether the registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter earlier period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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

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

|                         |                                     |                   |                          |
|-------------------------|-------------------------------------|-------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer | <input type="checkbox"/> |
|-------------------------|-------------------------------------|-------------------|--------------------------|

|                       |                          |                                               |                           |                          |
|-----------------------|--------------------------|-----------------------------------------------|---------------------------|--------------------------|
| Non-accelerated filer | <input type="checkbox"/> | (Do not check if a smaller reporting company) | Smaller Reporting Company | <input type="checkbox"/> |
|-----------------------|--------------------------|-----------------------------------------------|---------------------------|--------------------------|

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, 2013 was 396,179,272



AMERICAN CAPITAL AGENCY CORP.  
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

|                |                                                                                              |           |
|----------------|----------------------------------------------------------------------------------------------|-----------|
| <u>Item 1.</u> | <u>Financial Statements</u>                                                                  | <u>2</u>  |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>25</u> |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u>                            | <u>47</u> |
| <u>Item 4.</u> | <u>Controls and Procedures</u>                                                               | <u>50</u> |

PART II. OTHER INFORMATION

|                   |                                                                    |           |
|-------------------|--------------------------------------------------------------------|-----------|
| <u>Item 1.</u>    | <u>Legal Proceedings</u>                                           | <u>51</u> |
| <u>Item 1A.</u>   | <u>Risk Factors</u>                                                | <u>51</u> |
| <u>Item 2.</u>    | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>51</u> |
| <u>Item 3.</u>    | <u>Defaults Upon Senior Securities</u>                             | <u>51</u> |
| <u>Item 4.</u>    | <u>Mine Safety Disclosures</u>                                     | <u>51</u> |
| <u>Item 5.</u>    | <u>Other Information</u>                                           | <u>51</u> |
| <u>Item 6.</u>    | <u>Exhibits</u>                                                    | <u>51</u> |
| <u>Signatures</u> |                                                                    | <u>53</u> |

## PART I. - FINANCIAL INFORMATION

## Item 1. Financial Statements

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

|                                                                                                                                            | June 30, 2013<br>(Unaudited) | December 31,<br>2012 |
|--------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|----------------------|
| Assets:                                                                                                                                    |                              |                      |
| Agency securities, at fair value (including pledged securities of \$71,261 and \$79,966, respectively)                                     | \$75,926                     | \$83,710             |
| Agency securities transferred to consolidated variable interest entities, at fair value (pledged securities)                               | 1,281                        | 1,535                |
| U.S. Treasury securities (including pledged securities of \$2,569)                                                                         | 3,671                        | —                    |
| Cash and cash equivalents                                                                                                                  | 2,923                        | 2,430                |
| Restricted cash                                                                                                                            | 1,216                        | 399                  |
| Derivative assets, at fair value                                                                                                           | 1,876                        | 301                  |
| Receivable for securities sold (including pledged securities of \$1,338)                                                                   | 2,070                        | —                    |
| Receivable under reverse repurchase agreements                                                                                             | 9,430                        | 11,818               |
| Other assets                                                                                                                               | 270                          | 260                  |
| Total assets                                                                                                                               | \$98,663                     | \$100,453            |
| Liabilities:                                                                                                                               |                              |                      |
| Repurchase agreements                                                                                                                      | \$72,451                     | \$74,478             |
| Debt of consolidated variable interest entities, at fair value                                                                             | 783                          | 937                  |
| Payable for securities purchased                                                                                                           | 3,167                        | 556                  |
| Derivative liabilities, at fair value                                                                                                      | 1,544                        | 1,264                |
| Dividends payable                                                                                                                          | 420                          | 427                  |
| Obligation to return securities borrowed under reverse repurchase agreements, at fair value                                                | 9,931                        | 11,763               |
| Accounts payable and other accrued liabilities                                                                                             | 87                           | 132                  |
| Total liabilities                                                                                                                          | 88,383                       | 89,557               |
| Stockholders' equity:                                                                                                                      |                              |                      |
| Preferred stock - \$0.01 par value; 10.0 shares authorized:                                                                                |                              |                      |
| 8.000% Series A Cumulative Redeemable Preferred Stock; 6.9 shares issued and outstanding; liquidation preference of \$25 per share (\$173) | 167                          | 167                  |
| Common stock - \$0.01 par value; 600.0 shares authorized:                                                                                  |                              |                      |
| 396.2 and 338.9 shares issued and outstanding, respectively                                                                                | 4                            | 3                    |
| Additional paid-in capital                                                                                                                 | 11,255                       | 9,460                |
| Retained earnings (deficit)                                                                                                                | 852                          | (289)                |
| Accumulated other comprehensive (loss) income                                                                                              | (1,998)                      | 1,555                |
| Total stockholders' equity                                                                                                                 | 10,280                       | 10,896               |
| Total liabilities and stockholders' equity                                                                                                 | \$98,663                     | \$100,453            |

See accompanying notes to consolidated financial statements.



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

|                                                                             | Three months ended<br>June 30, |          | Six months ended<br>June 30, |           |   |
|-----------------------------------------------------------------------------|--------------------------------|----------|------------------------------|-----------|---|
|                                                                             | 2013                           | 2012     | 2013                         | 2012      |   |
| Interest income:                                                            |                                |          |                              |           |   |
| Interest income                                                             | \$545                          | \$504    | \$1,092                      | \$1,018   |   |
| Interest expense                                                            | 131                            | 120      | 271                          | 226       |   |
| Net interest income                                                         | 414                            | 384      | 821                          | 792       |   |
| Other income (loss), net:                                                   |                                |          |                              |           |   |
| Gain (loss) on sale of agency securities, net                               | 17                             | 417      | (9                           | ) 633     |   |
| Gain (loss) on derivative instruments and other securities, net             | 1,444                          | (1,029   | ) 1,346                      | (982      | ) |
| Total other income (loss), net                                              | 1,461                          | (612     | ) 1,337                      | (349      | ) |
| Expenses:                                                                   |                                |          |                              |           |   |
| Management fees                                                             | 37                             | 28       | 70                           | 50        |   |
| General and administrative expenses                                         | 9                              | 8        | 18                           | 14        |   |
| Total expenses                                                              | 46                             | 36       | 88                           | 64        |   |
| Income (loss) before income tax                                             | 1,829                          | (264     | ) 2,070                      | 379       |   |
| (Benefit) provision for income taxes, net                                   | —                              | (3       | ) 10                         | (1        | ) |
| Net income (loss)                                                           | 1,829                          | (261     | ) 2,060                      | 380       |   |
| Dividend on preferred stock                                                 | 3                              | 3        | 7                            | 3         |   |
| Net income (loss) available (attributable) to common shareholders           | \$1,826                        | \$(264   | ) \$2,053                    | \$377     |   |
| Net income (loss)                                                           | \$1,829                        | \$(261   | ) \$2,060                    | \$380     |   |
| Other comprehensive (loss) income:                                          |                                |          |                              |           |   |
| Unrealized (loss) gain on available-for-sale securities, net                | (2,813                         | ) 689    | (3,650                       | ) 583     |   |
| Unrealized gain on derivative instruments, net                              | 48                             | 52       | 97                           | 104       |   |
| Other comprehensive (loss) income                                           | (2,765                         | ) 741    | (3,553                       | ) 687     |   |
| Comprehensive (loss) income                                                 | (936                           | ) 480    | (1,493                       | ) 1,067   |   |
| Dividend on preferred stock                                                 | 3                              | 3        | 7                            | 3         |   |
| Comprehensive (loss) income (attributable) available to common shareholders | \$(939                         | ) \$477  | \$(1,500                     | ) \$1,064 |   |
| Weighted average number of common shares outstanding - basic and diluted    | 396.4                          | 301.0    | 376.4                        | 270.8     |   |
| Net income (loss) per common share - basic and diluted                      | \$4.61                         | \$(0.88  | ) \$5.45                     | \$1.39    |   |
| Comprehensive (loss) income per common share - basic and diluted            | \$(2.37                        | ) \$1.58 | \$(3.99                      | ) \$3.93  |   |
| Dividends declared per common share                                         | \$1.05                         | \$1.25   | \$2.30                       | \$2.50    |   |
| 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 |

See accompanying notes to consolidated financial statements.

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

|                                                                                                                | Six months ended June 30, |              |
|----------------------------------------------------------------------------------------------------------------|---------------------------|--------------|
|                                                                                                                | 2013                      | 2012         |
| Operating activities:                                                                                          |                           |              |
| Net income                                                                                                     | \$2,060                   | \$380        |
| Adjustments to reconcile net income to net cash provided by operating activities:                              |                           |              |
| Amortization of agency securities premiums and discounts, net                                                  | 232                       | 296          |
| Amortization of accumulated other comprehensive loss on interest rate swaps de-designated as qualifying hedges | 97                        | 104          |
| Loss (gain) on sale of agency securities, net                                                                  | 9                         | (633 )       |
| (Gain) loss on derivative instruments and other securities, net                                                | (1,346 )                  | ) 982        |
| Increase in other assets                                                                                       | (10 )                     | ) (54 )      |
| (Decrease) increase in accounts payable and other accrued liabilities                                          | (38 )                     | ) 11         |
| Accretion of discounts on debt of consolidated variable interest entities                                      | 8                         | —            |
| Net cash provided by operating activities                                                                      | 1,012                     | 1,086        |
| Investing activities:                                                                                          |                           |              |
| Purchases of agency securities                                                                                 | (33,962 )                 | ) (62,091 )  |
| Proceeds from sale of agency securities                                                                        | 33,318                    | 33,285       |
| Principal collections on agency securities                                                                     | 5,304                     | 4,337        |
| Purchases of U.S. Treasury securities                                                                          | (28,555 )                 | ) (20,358 )  |
| Proceeds from sale of U.S. Treasury securities                                                                 | 23,396                    | 20,728       |
| Net proceeds from (payments made) on reverse repurchase agreements                                             | 2,388                     | (511 )       |
| Net payments on other derivative instruments not designated as qualifying hedges                               | (306 )                    | ) (456 )     |
| (Increase) decrease in restricted cash                                                                         | (817 )                    | ) 34         |
| Net cash provided by (used in) investing activities                                                            | 766                       | (25,032 )    |
| Financing activities:                                                                                          |                           |              |
| Proceeds from repurchase arrangements                                                                          | 209,673                   | 207,471      |
| Payments made on repurchase agreements                                                                         | (211,700 )                | ) (185,612 ) |
| Proceeds from debt of consolidated variable interest entities                                                  | —                         | 901          |
| Repayments on debt of consolidated variable interest entities                                                  | (128 )                    | ) (9 )       |
| Net proceeds from preferred stock issuances                                                                    | —                         | 167          |
| Net proceeds from common stock issuances                                                                       | 1,803                     | 2,360        |
| Payments made on common stock repurchases                                                                      | (7 )                      | ) —          |
| Cash dividends paid                                                                                            | (926 )                    | ) (600 )     |
| Net cash (used in) provided by financing activities                                                            | (1,285 )                  | ) 24,678     |
| Net change in cash and cash equivalents                                                                        | 493                       | 732          |
| Cash and cash equivalents at beginning of period                                                               | 2,430                     | 1,367        |
| Cash and cash equivalents at end of period                                                                     | \$2,923                   | \$2,099      |
| 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 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 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 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 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 are externally managed by American Capital AGNC Management, LLC (our “Manager”), an affiliate of American Capital, Ltd. (“American Capital”).

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 government-sponsored entities, 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”). We refer to agency MBS and agency debenture securities collectively as “investment securities” and we refer to the specific investment securities in which we invest as our “investment portfolio”.

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, from time to time, sell any of our investment securities as part of our overall management of our investment portfolio. Accordingly, we typically designate our investment securities as available-for-sale. All securities classified as available-for-sale are reported at fair value, with unrealized gains and losses reported in accumulated 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-only 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-only and principal-only securities are included in agency MBS securities, at fair value on the accompanying consolidated balance sheets.

We estimate the fair value of our investment 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. Refer to Note 8 for further discussion of fair value measurements.

We evaluate securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. The determination of whether a security is other-than-temporarily impaired involves judgments and assumptions based on subjective and objective factors. When an investment security is impaired, an OTTI is considered to have occurred if (i) we intend to sell the investment security (i.e. a decision has been made as of the reporting date) or (ii) it is more likely than not that we will be required to sell the investment security before recovery of its amortized cost basis. If we intend to sell the security or if it is more likely than not that we will be required to sell the investment security before recovery of its amortized cost basis, 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.

#### Interest Income

Interest income is accrued based on the outstanding principal amount of the investment securities and their contractual terms. Premiums and discounts associated with the purchase of investment securities are amortized or accreted into interest income 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 their 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) actual prepayments to date plus current estimated future prepayments. If the actual and estimated future prepayment experience differs from our prior estimate of prepayments, we are required to record an adjustment in the current period to the amortization or accretion of premiums and discounts for the cumulative difference in the effective yield through the reporting date.

#### Derivative Instruments

We use a variety of derivative instruments to economically 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 (“interest rate swaptions”). We also utilize forward contracts for the purchase or sale of agency MBS securities on a generic pool, or to-be-announced, basis (“TBA contracts”) 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-only securities, and synthetic total return swaps, such as the Markit IOS Synthetic Total Return Swap Index (“Markit IOS Index”). We may also enter into TBA contracts as a means of investing in and financing agency securities. Pursuant to TBA contracts, we agree to purchase, 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 position (referred to as a "pair off"), net settling the paired off positions for cash, and simultaneously purchasing a similar TBA contract for a later settlement date. This transaction is commonly referred to as a "dollar roll." The agency securities purchased 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." 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 each 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 the third quarter of 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 economically 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 "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 a 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.

We estimate the fair value of our centrally cleared 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.

#### Interest rate swaptions

We purchase interest rate swaptions to help mitigate the potential impact of larger increases or decreases in interest rates on the performance of our investment portfolio (referred to as “convexity risk”). The 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.

Interest rates 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 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 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 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.

#### Forward commitments to purchase or sell specified agency MBS

We enter into forward commitments to purchase or sell specified agency MBS from time to time as a means of acquiring assets or as a hedge against short-term changes in interest rates. We account for contracts for the purchase or sale of specified agency MBS securities as derivatives if the delivery of the specified agency MBS and settlement extends beyond the shortest period possible for that type of security. Realized and unrealized gains and losses associated with forward commitments accounted for as derivatives 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 forward commitments to purchase or sell specified agency MBS based on similar methods used to value agency MBS, as well as the remaining length of time of the forward commitment.

#### 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 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, 2013, we had agency MBS at fair value of \$77.2 billion, with a total cost basis of \$78.8 billion. The net unamortized premium balance on our investment portfolio as of June 30, 2013 was \$3.9 billion, including interest-only and principal-only strips. The following tables summarize our investments in agency MBS as of June 30, 2013 (dollars in millions):

|                                                                                | June 30, 2013 |             |            |          |
|--------------------------------------------------------------------------------|---------------|-------------|------------|----------|
|                                                                                | Fannie Mae    | Freddie Mac | Ginnie Mae | Total    |
| Agency MBS                                                                     |               |             |            |          |
| Available-for-sale agency MBS:                                                 |               |             |            |          |
| Agency MBS, par                                                                | \$56,097      | \$18,385    | \$196      | \$74,678 |
| Unamortized premium                                                            | 2,800         | 870         | 8          | 3,678    |
| Amortized cost                                                                 | 58,897        | 19,255      | 204        | 78,356   |
| Gross unrealized gains                                                         | 179           | 77          | 3          | 259      |
| Gross unrealized losses                                                        | (1,373)       | (497)       | —          | (1,870)  |
| Total available-for-sale agency MBS, at fair value                             | 57,703        | 18,835      | 207        | 76,745   |
| Agency MBS remeasured at fair value through earnings:                          |               |             |            |          |
| Interest-only and principal-only strips, amortized cost <sup>(1)</sup>         | 433           | 45          | —          | 478      |
| Gross unrealized gains                                                         | 7             | 1           | —          | 8        |
| Gross unrealized losses                                                        | (13)          | (11)        | —          | (24)     |
| Total agency MBS remeasured at fair value through earnings                     | 427           | 35          | —          | 462      |
| Total agency MBS, at fair value                                                | \$58,130      | \$18,870    | \$207      | \$77,207 |
| Weighted average coupon as of June 30, 2013 <sup>(2)</sup>                     | 3.53          | % 3.65      | % 3.76     | % 3.56   |
| Weighted average yield as of June 30, 2013 <sup>(3)</sup>                      | 2.67          | % 2.85      | % 1.53     | % 2.71   |
| Weighted average yield for the three months ended June 30, 2013 <sup>(3)</sup> | 2.86          | % 3.07      | % 1.09     | % 2.92   |
| Weighted average yield for the six months ended June 30, 2013 <sup>(3)</sup>   | 2.83          | % 2.94      | % 1.34     | % 2.86   |

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 5.77% of this amount as of June 30, 2013. The par value of our principal-only agency MBS strips was \$287 million as of June 30, 2013.

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, 2013.

<sup>3</sup> Incorporates a weighted average future constant prepayment rate assumption of 7% based on forward rates as of June 30, 2013.

|                                         | June 30, 2013  |                       |                       |            |
|-----------------------------------------|----------------|-----------------------|-----------------------|------------|
|                                         | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Fair Value |
| Agency MBS                              |                |                       |                       |            |
| Fixed-Rate                              | \$77,535       | \$245                 | \$(1,870)             | \$75,910   |
| Adjustable-Rate                         | 682            | 12                    | —                     | 694        |
| CMO                                     | 139            | 2                     | —                     | 141        |
| Interest-only and principal-only strips | 478            | 8                     | (24)                  | 462        |
| Total agency MBS                        | \$78,834       | \$267                 | \$(1,894)             | \$77,207   |

As of December 31, 2012, we had agency MBS at fair value of \$85.2 billion, with a total cost basis of \$83.2 billion. The net unamortized premium balance on our investment portfolio as of December 31, 2012 was \$4.4 billion,

including interest-only and principal-only strips. The following tables summarize our investments in agency MBS as of December 31, 2012 (dollars in millions):

|                                                                            | December 31, 2012 |             |            |          |
|----------------------------------------------------------------------------|-------------------|-------------|------------|----------|
|                                                                            | Fannie Mae        | Freddie Mac | Ginnie Mae | Total    |
| Agency MBS                                                                 |                   |             |            |          |
| Available-for-sale agency MBS:                                             |                   |             |            |          |
| Agency MBS, par                                                            | \$58,912          | \$19,336    | \$238      | \$78,486 |
| Unamortized premium                                                        | 3,208             | 948         | 10         | 4,166    |
| Amortized cost                                                             | 62,120            | 20,284      | 248        | 82,652   |
| Gross unrealized gains                                                     | 1,585             | 481         | 6          | 2,072    |
| Gross unrealized losses                                                    | (18)              | (7)         | —          | (25)     |
| Available-for-sale agency MBS, at fair value                               | 63,687            | 20,758      | 254        | 84,699   |
| Agency MBS remeasured at fair value through earnings:                      |                   |             |            |          |
| Interest-only and principal-only strips, amortized cost <sup>(1)</sup>     | 486               | 55          | —          | 541      |
| Gross unrealized gains                                                     | 26                | 1           | —          | 27       |
| Gross unrealized losses                                                    | (9)               | (13)        | —          | (22)     |
| Agency MBS remeasured at fair value through earnings                       | 503               | 43          | —          | 546      |
| Total agency MBS, at fair value                                            | \$64,190          | \$20,801    | \$254      | \$85,245 |
| Weighted average coupon as of December 31, 2012 <sup>(2)</sup>             | 3.70              | % 3.67      | % 3.77     | % 3.69   |
| Weighted average yield as of December 31, 2012 <sup>(3)</sup>              | 2.62              | % 2.61      | % 1.60     | % 2.61   |
| Weighted average yield for the year ended December 31, 2012 <sup>(3)</sup> | 2.83              | % 2.83      | % 1.63     | % 2.82   |

The UPB of our interest-only securities was \$1.7 billion and the weighted average contractual interest we are entitled to receive was 5.78% of this amount as of December 31, 2012. The par value of our principal-only agency MBS strips was \$302 million as of December 31, 2012.

The weighted average coupon includes the interest cash flows from our interest-only securities taken together with the interest cash flows from our fixed-rate, adjustable-rate and CMO securities as a percentage of the par value of our agency securities (excluding the UPB of our interest-only securities) as of December 31, 2012.

Incorporates a weighted average future constant prepayment rate assumption of 11% based on forward rates as of December 31, 2012.

|                      | December 31, 2012 |                       |                       |            |
|----------------------|-------------------|-----------------------|-----------------------|------------|
|                      | Amortized Cost    | Gross Unrealized Gain | Gross Unrealized Loss | Fair Value |
| Agency MBS           |                   |                       |                       |            |
| Fixed-Rate           | \$81,617          | \$2,043               | \$(25)                | \$83,635   |
| Adjustable-Rate      | 865               | 26                    | —                     | 891        |
| CMO                  | 170               | 3                     | —                     | 173        |
| Interest-only strips | 541               | 27                    | (22)                  | 546        |
| Total agency MBS     | \$83,193          | \$2,099               | \$(47)                | \$85,245   |

As of June 30, 2013 and December 31, 2012, we did not have investments in agency debenture securities.

The actual maturities of our agency MBS securities 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, 2013 and December 31, 2012, our weighted average expected constant prepayment rate (“CPR”) over the remaining life of our aggregate agency MBS portfolio was 7% and 11%, 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 adjustments for different securities based on our Manager's judgment. Various market participants could use materially different assumptions.

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The following table summarizes our agency MBS classified as available-for-sale as of June 30, 2013 and December 31, 2012 according to their estimated weighted average life classification (dollars in millions):

| Estimated Weighted<br>Average Life of Agency<br>MBS Classified as<br>Available-for-Sale <sup>(1)</sup> | June 30, 2013 |                   |                               |                              |      | December 31, 2012 |                   |                               |                              |   |      |   |
|--------------------------------------------------------------------------------------------------------|---------------|-------------------|-------------------------------|------------------------------|------|-------------------|-------------------|-------------------------------|------------------------------|---|------|---|
|                                                                                                        | Fair<br>Value | Amortized<br>Cost | Weighted<br>Average<br>Coupon | Weighted<br>Average<br>Yield |      | Fair<br>Value     | Amortized<br>Cost | Weighted<br>Average<br>Coupon | Weighted<br>Average<br>Yield |   |      |   |
| ≤ 3 years                                                                                              | 244           | 239               | 4.91                          | %                            | 3.31 | %                 | 1,119             | 1,108                         | 4.18                         | % | 2.14 | % |
| > 3 years and ≤ 5 years                                                                                | 14,794        | 14,630            | 3.79                          | %                            | 2.76 | %                 | 27,448            | 26,750                        | 3.36                         | % | 2.29 | % |
| > 5 years and ≤ 10 years                                                                               | 42,629        | 43,565            | 3.39                          | %                            | 2.62 | %                 | 54,054            | 52,735                        | 3.69                         | % | 2.75 | % |
| > 10 years                                                                                             | 19,078        | 19,922            | 3.39                          | %                            | 2.79 | %                 | 2,078             | 2,059                         | 3.44                         | % | 2.65 | % |
| Total                                                                                                  | \$76,745      | \$78,356          | 3.47                          | %                            | 2.69 | %                 | \$84,699          | \$82,652                      | 3.59                         | % | 2.59 | % |

1. Excludes interest and principal-only strips.

The weighted average life of our interest-only strips was 6.4 and 5.7 years as of June 30, 2013 and December 31, 2012, respectively. The weighted average life of our principal-only strips was 8.1 and 6.4 years as of June 30, 2013 and December 31, 2012, 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, 2013 and 2012 (in millions):

| Agency Securities Classified as<br>Available-for-Sale | Beginning<br>Accumulated<br>OCI<br>Balance | Unrealized Gains<br>and (Losses),<br>Net | Reversal of Prior<br>Period Unrealized<br>(Gains) and Losses,<br>Net on Realization | Ending<br>Accumulated<br>OCI<br>Balance |
|-------------------------------------------------------|--------------------------------------------|------------------------------------------|-------------------------------------------------------------------------------------|-----------------------------------------|
| Three months ended June 30, 2013                      | \$ 1,204                                   | (2,796 )                                 | (17 )                                                                               | \$(1,609 )                              |
| Three months ended June 30, 2012                      | \$ 896                                     | 1,106                                    | (417 )                                                                              | \$ 1,585                                |
| Six months ended June 30, 2013                        | \$ 2,041                                   | (3,659 )                                 | 9                                                                                   | \$(1,609 )                              |
| Six months ended June 30, 2012                        | \$ 1,002                                   | 1,216                                    | (633 )                                                                              | \$ 1,585                                |

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, 2013 and December 31, 2012 (in millions):

| Agency Securities Classified as<br>Available-for-Sale | Unrealized Loss Position For                      |                    |                                              |                    | Total<br>Estimated<br>Fair<br>Value | Unrealized<br>Loss |
|-------------------------------------------------------|---------------------------------------------------|--------------------|----------------------------------------------|--------------------|-------------------------------------|--------------------|
|                                                       | Less than 12 Months<br>Estimated<br>Fair<br>Value | Unrealized<br>Loss | 12 Months or More<br>Estimated<br>Fair Value | Unrealized<br>Loss |                                     |                    |
| June 30, 2013                                         | \$60,971                                          | \$(1,866 )         | \$75                                         | \$(4 )             | \$61,046                            | \$(1,870 )         |
| December 31, 2012                                     | \$8,430                                           | \$(25 )            | \$—                                          | \$—                | \$8,430                             | \$(25 )            |

As of June 30, 2013 and December 31, 2012, 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

government-sponsored entity or government 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, 2013 and 2012.

**Gains and Losses**

The following table is a summary of our net gain (loss) from the sale of agency MBS for the three and six months ended June 30, 2013 and 2012 (in millions):

12

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|                                              | Three Months Ended |               | Six Months Ended |               |
|----------------------------------------------|--------------------|---------------|------------------|---------------|
|                                              | June 30, 2013      | June 30, 2012 | June 30, 2013    | June 30, 2012 |
| Agency MBS                                   |                    |               |                  |               |
| Agency MBS sold, at cost                     | \$(15,069 )        | \$(25,843 )   | \$(35,397 )      | \$(35,086 )   |
| Proceeds from agency MBS sold <sup>(1)</sup> | 15,086             | 26,260        | 35,388           | 35,719        |
| Net gain (loss) on sale of agency MBS        | \$17               | \$417         | \$(9 )           | \$633         |
| Gross gain on sale of agency MBS             | \$93               | \$425         | \$180            | \$645         |
| Gross loss on sale of agency MBS             | (76 )              | (8 )          | (189 )           | (12 )         |
| Net gain (loss) on sale of agency MBS        | \$17               | \$417         | \$(9 )           | \$633         |

1. 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, 2013, we recognized an unrealized loss of \$20 million and \$21 million, respectively, and for the three and six months ended June 30, 2012 we recognized an unrealized loss of \$2 million and \$1 million, respectively, in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income for the change in value of investments in interest-only and principal-only strips, net of prior period reversals. For the three and six months ended June 30, 2013 and 2012, there were no sales of interest-only or principal-only securities.

Pledged Assets

The following tables summarize our assets pledged as collateral under repurchase agreements, debt of consolidated variable interest entities ("VIEs"), derivative agreements and prime broker agreements by type, including securities pledged related to securities sold but not yet settled, as of June 30, 2013 and December 31, 2012 (in millions):

| June 30, 2013                          |                       |                           |                       |                         |          |
|----------------------------------------|-----------------------|---------------------------|-----------------------|-------------------------|----------|
| Assets Pledged                         | Repurchase Agreements | Debt of Consolidated VIEs | Derivative Agreements | Prime Broker Agreements | Total    |
| Agency MBS - fair value                | \$72,380              | \$1,281                   | \$38                  | \$181                   | \$73,880 |
| U. S. Treasury securities - fair value | 2,523                 | —                         | 46                    | —                       | 2,569    |
| Accrued interest on pledged securities | 176                   | 4                         | —                     | —                       | 180      |
| Restricted cash <sup>(1)</sup>         | 703                   | —                         | 176                   | 1,166                   | 2,045    |
| Total                                  | \$75,782              | \$1,285                   | \$260                 | \$1,347                 | \$78,674 |

1. Restricted cash in the table above excludes net cash received from counterparties recorded as a contra-asset within restricted cash.

| December 31, 2012                      |                       |                           |                       |                         |          |
|----------------------------------------|-----------------------|---------------------------|-----------------------|-------------------------|----------|
| Assets Pledged                         | Repurchase Agreements | Debt of Consolidated VIEs | Derivative Agreements | Prime Broker Agreements | Total    |
| Agency MBS - fair value                | \$78,400              | \$1,535                   | \$1,065               | \$501                   | \$81,501 |
| Accrued interest on pledged securities | 217                   | 5                         | 3                     | 1                       | 226      |
| Restricted cash                        | —                     | —                         | 249                   | 150                     | 399      |
| Total                                  | \$78,617              | \$1,540                   | \$1,317               | \$652                   | \$82,126 |

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, 2013 and December 31, 2012 (in millions):



|                                                                                                        | June 30, 2013                    |                                      |                                        | December 31, 2012                |                                      |                                        |
|--------------------------------------------------------------------------------------------------------|----------------------------------|--------------------------------------|----------------------------------------|----------------------------------|--------------------------------------|----------------------------------------|
| Agency Securities Pledged by Remaining Maturity of Repurchase Agreements and Debt of Consolidated VIEs | 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:                                                                                            |                                  |                                      |                                        |                                  |                                      |                                        |
| Less than 30 days                                                                                      | \$24,002                         | \$24,459                             | \$56                                   | \$29,284                         | \$28,525                             | \$82                                   |
| 31 - 59 days                                                                                           | 19,196                           | 19,628                               | 44                                     | 21,716                           | 21,251                               | 58                                     |
| 60 - 90 days                                                                                           | 12,445                           | 12,739                               | 28                                     | 16,188                           | 15,780                               | 45                                     |
| Greater than 90 days                                                                                   | 18,018                           | 18,378                               | 49                                     | 12,747                           | 12,447                               | 37                                     |
| Total agency MBS                                                                                       | 73,661                           | 75,204                               | 177                                    | 79,935                           | 78,003                               | 222                                    |
| U.S. Treasury securities:                                                                              |                                  |                                      |                                        |                                  |                                      |                                        |
| 1 day                                                                                                  | \$2,523                          | \$2,513                              | \$3                                    | \$—                              | \$—                                  | \$—                                    |
| Total                                                                                                  | \$76,184                         | \$77,717                             | \$180                                  | \$79,935                         | \$78,003                             | \$222                                  |

As of June 30, 2013 and December 31, 2012, none of our repurchase agreement borrowings backed by agency MBS were due on demand or mature overnight.

#### Securitizations and Variable Interest Entities

As of June 30, 2013 and December 31, 2012, 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.

As of June 30, 2013 and December 31, 2012, the fair value of our CMO securities and interest and principal-only securities, excluding the consolidated CMO trusts discussed below, was \$603 million and \$719 million, respectively, or \$1.1 billion and \$1.3 billion, respectively, including the net asset value of our consolidated CMO trusts discussed below. Our maximum exposure to loss related to our CMO securities and interest and principal-only securities, including our consolidated CMO trusts, was \$238 million and \$343 million as of June 30, 2013 and December 31, 2012, respectively.

In connection with the consolidated trusts, as of June 30, 2013 and December 31, 2012, we recognized agency securities with a total fair value of \$1.3 billion and \$1.5 billion, respectively, and debt, at fair value, of \$783 million and \$937 million, respectively, in our accompanying consolidated balance sheets. As of June 30, 2013 and December 31, 2012, such agency securities had an aggregate unpaid principal balance of \$1.2 billion and \$1.4 billion, respectively, and such debt had an aggregate unpaid principal balance of \$780 million and \$908 million, respectively. For the three and six months ended June 30, 2013, we recognized a net gain of \$20 million and \$34 million, respectively, and for both the three and six months ended June 30, 2012, we recognized a net loss of \$8 million from debt of consolidated VIEs re-measured at fair value through earnings in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income. 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.

#### 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. 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. In response to declines in fair

value of pledged securities, lenders may require us to post additional collateral or pay down borrowings to re-establish agreed upon collateral requirements, referred to as margin calls. As of June 30, 2013 and December 31, 2012, we have met all margin call requirements.

The following table summarizes our borrowings under repurchase arrangements and weighted average interest rates classified by original maturities as of June 30, 2013 and December 31, 2012 (dollars in millions):

| Original Maturity         | June 30, 2013         |                                |                                   | December 31, 2012     |                                |                                   |
|---------------------------|-----------------------|--------------------------------|-----------------------------------|-----------------------|--------------------------------|-----------------------------------|
|                           | 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                 | \$6,127               | 0.38                           | % 17                              | \$4,011               | 0.48                           | % 13                              |
| > 1 to ≤ 3 months         | 28,216                | 0.40                           | % 32                              | 28,307                | 0.49                           | % 37                              |
| > 3 to ≤ 6 months         | 16,171                | 0.42                           | % 57                              | 24,303                | 0.49                           | % 63                              |
| > 6 to ≤ 9 months         | 5,730                 | 0.48                           | % 123                             | 5,222                 | 0.54                           | % 79                              |
| > 9 to ≤ 12 months        | 8,365                 | 0.54                           | % 193                             | 7,813                 | 0.58                           | % 222                             |
| > 12 to ≤ 24 months       | 2,542                 | 0.60                           | % 453                             | 1,917                 | 0.65                           | % 564                             |
| > 24 to ≤ 36 months       | 2,565                 | 0.65                           | % 784                             | 2,803                 | 0.69                           | % 963                             |
| > 36 months               | 602                   | 0.70                           | % 1,652                           | 102                   | 0.73                           | % 1,751                           |
| Total agency MBS          | 70,318                | 0.45                           | % 119                             | 74,478                | 0.51                           | % 118                             |
| U.S. Treasury securities: |                       |                                |                                   |                       |                                |                                   |
| 1 day                     | 2,133                 | 0.11                           | % 1                               | \$—                   | —                              | % —                               |
| Total / Weighted Average  | \$72,451              | 0.44                           | % 116                             | \$74,478              | 0.51                           | % 118                             |

As of June 30, 2013 and December 31, 2012, we did not have an amount at risk with any repurchase agreement counterparty greater than 3% and 4% of our stockholders' equity, respectively.

As of June 30, 2013 and December 31, 2012, debt of consolidated VIEs, at fair value ("other debt") was \$783 million and \$937 million, respectively. As of June 30, 2013 and December 31, 2012, our other debt had a weighted average interest rate of LIBOR plus 43 and 43 basis points, respectively, and a principal balance of \$780 million and \$908 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, 2013 was 6.4 years.

As of June 30, 2013 and December 31, 2012, we also had net forward purchase commitments, including TBA dollar roll transactions, outstanding of \$15.3 billion and \$12.8 billion, at cost, respectively (see Notes 3 and 6). Forward purchase commitments and TBA dollar roll transactions represent a form of off-balance sheet financing. Pursuant to ASC 815, we typically account for such transactions as one or more series of derivative transactions and, consequently, they are not reflected in our on-balance sheet debt and 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 may enter into agreements for interest rate swaps, interest rate swaptions, interest rate cap or floor contracts and futures or forward contracts. 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-only securities, and synthetic total return swaps, such as the Markit IOS Index. 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, 2013 we reclassified \$48 million and \$97 million, respectively, and for the three and six months ended June 30, 2012, we reclassified \$52 million and \$104 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 \$153 million and \$286 million for the three and six months ended June 30, 2013, respectively, and \$114 million and \$205 million for the three and six months ended June 30, 2012, respectively. The difference of \$105 million and \$189 million for the three and six months ended June 30, 2013, respectively, and \$62 million and \$101 million for the three and six months ended June 30, 2012, respectively, is reported in our accompanying consolidated statements of comprehensive income in gain (loss) on derivative instruments and other

securities, net. As of June 30, 2013, the remaining net deferred loss in accumulated OCI related to de-designated interest rate swaps was \$389 million and will be reclassified from OCI into interest expense over a remaining weighted average period of 2.5 years (see Note 9). The net deferred loss expected to be reclassified from OCI into interest expense over the next twelve months is \$176 million as of June 30, 2013.

For the current and prior years periods presented below, none of our derivative instruments were designated as cash flow hedges under ASC 815.

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

The table below summarizes fair value information about our derivative assets and liabilities as of June 30, 2013 and December 31, 2012 (in millions):

| Derivatives Instruments                                | Balance Sheet Location                | June 30,<br>2013 | December 31,<br>2012 |
|--------------------------------------------------------|---------------------------------------|------------------|----------------------|
| Interest rate swaps                                    | Derivative assets, at fair value      | \$822            | \$ 14                |
| Payer swaptions                                        | Derivative assets, at fair value      | 842              | 171                  |
| Purchase of TBA and forward settling agency securities | Derivative assets, at fair value      | 25               | 116                  |
| Sale of TBA and forward settling agency securities     | Derivative assets, at fair value      | 131              | —                    |
| U.S. Treasury futures - short                          | Derivative assets, at fair value      | 56               | —                    |
|                                                        |                                       | \$1,876          | \$ 301               |
| Interest rate swaps                                    | Derivative liabilities, at fair value | \$(617 )         | \$(1,243 )           |
| Purchase of TBA and forward settling agency securities | Derivative liabilities, at fair value | (892 )           | (1 )                 |
| Sale of TBA and forward settling agency securities     | Derivative liabilities, at fair value | (35 )            | (20 )                |
|                                                        |                                       | \$(1,544 )       | \$(1,264 )           |

Additionally, as of June 30, 2013 and December 31, 2012, 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 \$9.9 billion and \$11.8 billion, respectively. The borrowed securities were used to cover short sales of U.S. Treasury securities from which we received total proceeds of \$10.2 billion and \$11.7 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, 2013 and December 31, 2012 (dollars in millions):

| Interest Rate Swaps <sup>(1)</sup>                   | June 30, 2013   |                        |                      |                          |                          |
|------------------------------------------------------|-----------------|------------------------|----------------------|--------------------------|--------------------------|
|                                                      | Notional Amount | Average Fixed Pay Rate | Average Receive Rate | Net Estimated Fair Value | Average Maturity (Years) |
| Three years or less                                  | \$16,150        | 1.44                   | % 0.23               | % \$(347 )               | 1.9                      |
| Greater than 3 years and less than/equal to 5 years  | 19,950          | 1.29                   | % 0.27               | % (37 )                  | 4.1                      |
| Greater than 5 years and less than/equal to 7 years  | 6,200           | 1.63                   | % 0.29               | % 66                     | 6.0                      |
| Greater than 7 years and less than/equal to 10 years | 9,350           | 2.08                   | % 0.28               | % 376                    | 9.3                      |
| Greater than 10 years                                | 4,000           | 2.71                   | % 0.28               | % 147                    | 13.8                     |
| Total Payer Interest Rate Swaps                      | \$55,650        | 1.61                   | % 0.26               | % \$205                  | 5.2                      |

1. Amounts include forward starting swaps of \$2.5 billion ranging up to three months from June 30, 2013.



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| Interest Rate Swaps <sup>(1)</sup>                   | December 31, 2012 |                        |                      |                          |   | Average Maturity (Years) |
|------------------------------------------------------|-------------------|------------------------|----------------------|--------------------------|---|--------------------------|
|                                                      | Notional Amount   | Average Fixed Pay Rate | Average Receive Rate | Net Estimated Fair Value |   |                          |
| Three years or less                                  | \$14,600          | 1.23                   | % 0.26               | % \$(294                 | ) | 2.0                      |
| Greater than 3 years and less than/equal to 5 years  | 20,250            | 1.48                   | % 0.29               | % (666                   | ) | 4.1                      |
| Greater than 5 years and less than/equal to 7 years  | 5,600             | 1.53                   | % 0.34               | % (163                   | ) | 6.1                      |
| Greater than 7 years and less than/equal to 10 years | 5,200             | 1.89                   | % 0.35               | % (113                   | ) | 9.2                      |
| Greater than 10 years                                | 1,200             | 1.79                   | % 0.31               | % 7                      |   | 10.2                     |
| Total Payer Interest Rate Swaps                      | \$46,850          | 1.46                   | % 0.29               | % \$(1,229               | ) | 4.4                      |

1. Amounts include forward starting swaps of \$1.7 billion ranging up to four months from December 31, 2012. The following tables summarize our interest rate swaption agreements outstanding as of June 30, 2013 and December 31, 2012 (dollars in millions):

| Payer Swaptions                                     | June 30, 2013 |       |            | Underlying Swap              |                 |                        |                      | Average Term (Years) |
|-----------------------------------------------------|---------------|-------|------------|------------------------------|-----------------|------------------------|----------------------|----------------------|
|                                                     | Option        | Cost  | Fair Value | Average Months to Expiration | Notional Amount | Average Fixed Pay Rate | Average Receive Rate |                      |
| One year or less                                    |               | \$217 | \$354      | 6                            | \$13,400        | 2.60                   | % 3M LIBOR           | 8.5                  |
| Greater than 1 year and less than/equal to 2 years  |               | 64    | 125        | 18                           | 3,250           | 2.78                   | % 3M LIBOR           | 7.0                  |
| Greater than 2 years and less than/equal to 3 years |               | 143   | 265        | 29                           | 5,100           | 3.60                   | % 3M LIBOR           | 9.4                  |
| Greater than 3 years and less than/equal to 4 years |               | 12    | 22         | 40                           | 450             | 3.20                   | % 3M LIBOR           | 6.1                  |
| Greater than 4 years and less than/equal to 5 years |               | 47    | 76         | 55                           | 1,550           | 3.87                   | % 3M LIBOR           | 6.9                  |
| Total/Wtd Avg                                       |               | \$483 | \$842      | 16                           | \$23,750        | 2.94                   | % 3M LIBOR           | 8.4                  |

| Payer Swaptions                                     | December 31, 2012 |       |            | Underlying Swap              |                 |                        |                      | Average Term (Years) |
|-----------------------------------------------------|-------------------|-------|------------|------------------------------|-----------------|------------------------|----------------------|----------------------|
|                                                     | Option            | Cost  | Fair Value | Average Months to Expiration | Notional Amount | Average Fixed Pay Rate | Average Receive Rate |                      |
| One year or less                                    |                   | \$76  | \$15       | 4                            | \$5,150         | 2.65                   | % 1M / 3M LIBOR      | 8.6                  |
| Greater than 1 year and less than/equal to 2 years  |                   | 65    | 34         | 19                           | 4,050           | 2.82                   | % 3M LIBOR           | 6.7                  |
| Greater than 2 years and less than/equal to 3 years |                   | 97    | 87         | 33                           | 3,900           | 3.51                   | % 3M LIBOR           | 8.6                  |
| Greater than 3 years and less than/equal to 4 years |                   | 12    | 11         | 46                           | 450             | 3.20                   | % 3M LIBOR           | 6.1                  |
| Greater than 4 years and less than/equal to 5 years |                   | 24    | 24         | 59                           | 900             | 3.33                   | % 3M LIBOR           | 5.0                  |
| Total/Wtd Avg                                       |                   | \$274 | \$171      | 21                           | \$14,450        | 2.99                   | % 1M / 3M LIBOR      | 7.8                  |



The following table summarizes our contracts to purchase and sell TBA and specified agency securities on a forward basis as of June 30, 2013 and December 31, 2012 (in millions):

| Purchase and Sale Contracts for TBAs and Forward Settling Securities | June 30, 2013       |                |                  |                        | December 31, 2012   |                |                  |                        |
|----------------------------------------------------------------------|---------------------|----------------|------------------|------------------------|---------------------|----------------|------------------|------------------------|
|                                                                      | Notional Amount (1) | Cost Basis (2) | Market Value (3) | Net Carrying Value (4) | Notional Amount (1) | Cost Basis (2) | Market Value (3) | Net Carrying Value (4) |
| TBA securities:                                                      |                     |                |                  |                        |                     |                |                  |                        |
| Purchase contracts                                                   | \$25,308            | \$26,498       | \$25,631         | \$(867 )               | \$21,705            | \$22,603       | \$22,719         | \$116                  |
| Sale contracts                                                       | (9,099 )            | (9,287 )       | (9,225 )         | 62                     | (9,378 )            | (9,991 )       | (10,011 )        | (20 )                  |
| TBA securities, net (5)                                              | 16,209              | 17,211         | 16,406           | (805 )                 | 12,327              | 12,612         | 12,708           | 96                     |
| Forward settling securities:                                         |                     |                |                  |                        |                     |                |                  |                        |
| Purchase contracts                                                   | —                   | —              | —                | —                      | 150                 | 163            | 162              | (1 )                   |
| Sale contracts                                                       | (1,801 )            | (1,926 )       | (1,892 )         | 34                     | —                   | —              | —                | —                      |
| Forward settling securities, net (6)                                 | (1,801 )            | (1,926 )       | (1,892 )         | 34                     | 150                 | 163            | 162              | (1 )                   |
| Total TBA and forward settling securities, net                       | \$14,408            | \$15,285       | \$14,514         | \$(771 )               | \$12,477            | \$12,775       | \$12,870         | \$95                   |

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 of the TBA contract as of period-end and the cost basis 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

6. Includes 30-year fixed securities of varying coupons

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

The tables below summarize the effect of derivative instruments on our consolidated statements of comprehensive income for the three and six months ended June 30, 2013 and 2012 (in millions):

| Derivative and Other Hedging Instruments       | Three Months Ended June 30, 2013            |           |                                                 |                                            | Amount of Gain/(Loss) Recognized in Income on Derivatives <sup>(1)</sup> |
|------------------------------------------------|---------------------------------------------|-----------|-------------------------------------------------|--------------------------------------------|--------------------------------------------------------------------------|
|                                                | Notional Amount Long/(Short) March 31, 2013 | Additions | Settlement, Termination, Expiration or Exercise | Notional Amount Long/(Short) June 30, 2013 |                                                                          |
| 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                                                                      |
| Short sales of U.S. Treasury securities        | \$(12,560 )                                 | (10,207 ) | 12,290                                          | \$ (10,477 )                               | 346                                                                      |
| U.S. Treasury futures                          | \$(800 )                                    | (2,830 )  | 1,200                                           | \$ (2,430 )                                | 77                                                                       |
|                                                |                                             |           |                                                 |                                            | \$ 1,440                                                                 |

Excludes a net loss of \$20 million from interest-only and principal-only securities, a net gain of \$4 million on U.S. Treasury securities and a net gain of \$20 million from debt of consolidated VIEs re-measured at fair value through earnings recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.



| Three Months Ended June 30, 2012               |                                                         |           |                                                          |                                                     |                                                                              |
|------------------------------------------------|---------------------------------------------------------|-----------|----------------------------------------------------------|-----------------------------------------------------|------------------------------------------------------------------------------|
| Derivative and Other Hedging Instruments       | Notional<br>Amount<br>Long/(Short)<br>March 31,<br>2012 | Additions | Settlement,<br>Termination,<br>Expiration or<br>Exercise | Notional<br>Amount<br>Long/(Short)<br>June 30, 2012 | Amount of<br>Gain/(Loss)<br>Recognized in<br>Income on<br>Derivatives<br>(1) |
| Net TBA and forward settling agency securities | \$ (7,266                                               | ) (15,652 | ) 19,514                                                 | \$ (3,404                                           | ) \$ (124                                                                    |
| Interest rate swaps                            | \$ (38,100                                              | ) (12,000 | ) 1,550                                                  | \$ (48,550                                          | ) (586                                                                       |
| Payer swaptions                                | \$ (10,500                                              | ) (2,200  | ) 3,900                                                  | \$ (8,800                                           | ) (74                                                                        |
| Short sales of U.S. Treasury securities        | \$ (3,865                                               | ) (7,940  | ) 10,555                                                 | \$ (1,250                                           | ) (153                                                                       |
| US Treasury futures                            | \$ (1,653                                               | ) (2,185  | ) 1,919                                                  | \$ (1,919                                           | ) (84                                                                        |
| Markit IOS total return swaps, net             | \$ (155                                                 | ) —       | 11                                                       | \$ (144                                             | ) 3                                                                          |
|                                                |                                                         |           |                                                          |                                                     | \$ (1,018                                                                    |

1. Excludes a net loss of \$1 million from U.S. Treasury securities, a net of loss of \$2 million on interest-only and principal-only securities re-measured at fair value through earnings and a net loss of \$8 million from other debt in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

| Six Months Ended June 30, 2013                 |                                                            |           |                                                          |                                                        |                                                                              |
|------------------------------------------------|------------------------------------------------------------|-----------|----------------------------------------------------------|--------------------------------------------------------|------------------------------------------------------------------------------|
| Derivative and Other Hedging Instruments       | Notional<br>Amount<br>Long/(Short)<br>December<br>31, 2012 | Additions | Settlement,<br>Termination,<br>Expiration or<br>Exercise | Notional<br>Amount<br>Long/(Short)<br>June 30,<br>2013 | Amount of<br>Gain/(Loss)<br>Recognized in<br>Income on<br>Derivatives<br>(1) |
| 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                                                                        |
| Short sales of U.S. Treasury securities        | \$ (11,835                                                 | ) (20,142 | ) 21,500                                                 | \$ (10,477                                             | ) 344                                                                        |
| U.S. Treasury futures                          | \$ —                                                       | (3,630    | ) 1,200                                                  | \$ (2,430                                              | ) 63                                                                         |
|                                                |                                                            |           |                                                          |                                                        | \$ 1,329                                                                     |

1. Excludes a net loss of \$21 million from interest-only and principal-only securities, a net gain of \$4 million on U.S. Treasury securities and a net gain of \$34 million from debt of consolidated VIEs re-measured at fair value through earnings recognized in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

| Six Months Ended June 30, 2012           |                                                            |           |                                                          |                                                        |                                                                              |
|------------------------------------------|------------------------------------------------------------|-----------|----------------------------------------------------------|--------------------------------------------------------|------------------------------------------------------------------------------|
| Derivative and Other Hedging Instruments | Notional<br>Amount<br>Long/(Short)<br>December 31,<br>2011 | Additions | Settlement,<br>Termination,<br>Expiration or<br>Exercise | Notional<br>Amount<br>Long/(Short)<br>June 30,<br>2012 | Amount of<br>Gain/(Loss)<br>Recognized in<br>Income on<br>Derivatives<br>(1) |
|                                          | \$ (104                                                    | ) (24,168 | ) 20,868                                                 | \$ (3,404                                              | ) \$ (108                                                                    |

Net TBA and forward settling agency securities

|                                         |           |           |          |           |         |   |
|-----------------------------------------|-----------|-----------|----------|-----------|---------|---|
| Interest rate swaps                     | \$(30,250 | ) (19,850 | ) 1,550  | \$(48,550 | ) (630  | ) |
| Payer swaptions                         | \$(3,200  | ) (10,150 | ) 4,550  | \$(8,800  | ) (71   | ) |
| Short sales of U.S. Treasury securities | \$(880    | ) (18,930 | ) 18,560 | \$(1,250  | ) (100  | ) |
| US Treasury futures                     | \$(783    | ) (3,838  | ) 2,702  | \$(1,919  | ) (63   | ) |
| Markit IOS total return swaps, net      | \$(165    | ) —       | 21       | \$(144    | ) —     | ) |
|                                         |           |           |          |           | \$ (972 | ) |

1. Excludes a net loss of \$1 million from U.S. Treasury securities, a net loss of \$1 million on interest-only and principal-only securities and a net loss of \$8 million from other debt re-measured at fair value through earnings in gain (loss) on derivative instruments and other securities, net in our consolidated statements of comprehensive income.

Credit Risk-Related Contingent Features

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 minimize this risk by limiting our counterparties for instruments which are not centrally cleared on a registered exchange to major financial institutions with acceptable

credit ratings and monitoring positions with individual counterparties. In addition, we may be required to pledge assets as collateral for our derivatives, whose amounts vary over time based on the market value, notional amount and remaining term of the derivative contract. In the event of a default by a counterparty we may not receive payments provided for under the terms of our derivative agreements, and may have difficulty obtaining our assets pledged as collateral for our derivatives. The cash and cash equivalents and agency securities pledged as collateral for our derivative instruments is included in restricted cash and agency securities, respectively, on our consolidated balance sheets.

Each of our International Swaps and Derivatives Association ("ISDA") Master Agreements and central clearing exchange agreements contains provisions under which we are required to fully collateralize our obligations under our interest rate swap agreements if at any point the fair value of the swap represents a liability greater than the minimum transfer amount contained within our agreements. We were also required to post initial collateral upon execution of certain of our swap transactions. If we breach any of these provisions, we will be required to settle our obligations under the agreements at their termination values.

Further, each of our 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 at their termination values. Additionally, under certain of our ISDA Master Agreements, we could be required to settle our obligations under the agreements at their termination values if we fail to maintain certain minimum shareholders' equity thresholds or our REIT status or if we fail to comply with limits on our leverage above certain specified levels.

Excluding centrally cleared swaps, as of June 30, 2013, our amount at risk with any counterparty related to our interest rate swap and swaption agreements was less than 1% of our stockholders' equity.

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

#### Note 7. 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, 2013 and December 31, 2012 (in millions):

##### Offsetting of Financial Assets and Derivative Assets:

|                                                                             | Gross<br>Amounts of<br>Recognized<br>Assets | Gross<br>Amounts<br>Offset in the<br>Consolidated<br>Balance<br>Sheets | Net Amounts<br>of Assets<br>Presented in<br>the<br>Consolidated<br>Balance<br>Sheets | Gross Amounts Not<br>Offset<br>in the<br>Consolidated Balance<br>Sheets | Collateral<br>Received<br>(2) | Net<br>Amount |
|-----------------------------------------------------------------------------|---------------------------------------------|------------------------------------------------------------------------|--------------------------------------------------------------------------------------|-------------------------------------------------------------------------|-------------------------------|---------------|
| June 30, 2013                                                               |                                             |                                                                        |                                                                                      |                                                                         |                               |               |
| Interest rate swap and swaption<br>agreements, at fair value <sup>(1)</sup> | \$ 1,664                                    | \$ —                                                                   | \$ 1,664                                                                             | \$(525 )                                                                | \$(1,131 )                    | \$8           |
| Receivable under reverse repurchase<br>agreements                           | 9,430                                       | —                                                                      | 9,430                                                                                | (9,093 )                                                                | (337 )                        | —             |
|                                                                             | \$ 11,094                                   | \$ —                                                                   | \$ 11,094                                                                            | \$(9,618 )                                                              | \$(1,468 )                    | \$8           |

Total derivative, other hedging  
instruments and other assets

December 31, 2012

|                                                                             |           |      |           |             |            |       |
|-----------------------------------------------------------------------------|-----------|------|-----------|-------------|------------|-------|
| Interest rate swap and swaption<br>agreements, at fair value <sup>(1)</sup> | \$ 185    | \$ — | \$ 185    | \$(185 )    | \$—        | \$—   |
| Receivable under reverse repurchase<br>agreements                           | 11,818    | —    | 11,818    | (10,482 )   | (1,157 )   | 179   |
| Total derivative, other hedging<br>instruments and other assets             | \$ 12,003 | \$ — | \$ 12,003 | \$(10,667 ) | \$(1,157 ) | \$179 |

# Offsetting of Financial Liabilities and Derivative Liabilities:

|                                                                   | Gross<br>Amounts of<br>Recognized<br>Liabilities | Gross<br>Amounts<br>Offset in the<br>Consolidated<br>Balance<br>Sheets | Net Amounts<br>of Liabilities<br>Presented in<br>the<br>Consolidated<br>Balance<br>Sheets | Gross Amounts Not<br>Offset<br>in the<br>Consolidated Balance<br>Sheets | Collateral<br>Pledged <sup>(2)</sup> | Net<br>Amount |
|-------------------------------------------------------------------|--------------------------------------------------|------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|-------------------------------------------------------------------------|--------------------------------------|---------------|
| June 30, 2013                                                     |                                                  |                                                                        |                                                                                           |                                                                         |                                      |               |
| Interest rate swap agreements, at fair value <sup>(1)</sup>       | \$ 617                                           | \$ —                                                                   | \$ 617                                                                                    | \$(525 )                                                                | \$(92 )                              | \$—           |
| Repurchase agreements                                             | 72,451                                           | —                                                                      | 72,451                                                                                    | (9,093 )                                                                | (63,358 )                            | —             |
| Total derivative, other hedging instruments and other liabilities | \$ 73,068                                        | \$ —                                                                   | \$ 73,068                                                                                 | \$(9,618 )                                                              | \$(63,450 )                          | \$—           |
| December 31, 2012                                                 |                                                  |                                                                        |                                                                                           |                                                                         |                                      |               |
| Interest rate swap agreements, at fair value <sup>(1)</sup>       | \$ 1,243                                         | \$ —                                                                   | \$ 1,243                                                                                  | \$(185 )                                                                | \$(1,058 )                           | \$—           |
| Repurchase agreements                                             | 74,478                                           | —                                                                      | 74,478                                                                                    | (10,482 )                                                               | (63,996 )                            | —             |
| Total derivative, other hedging instruments and other liabilities | \$ 75,721                                        | \$ —                                                                   | \$ 75,721                                                                                 | \$(10,667 )                                                             | \$(65,054 )                          | \$—           |

<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.

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. Refer to Note 4 for additional information regarding assets pledged as collateral.

## 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, 2013. 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, 2013 and December 31, 2012 (dollars in millions):

|                                                                                            | Fair Value Hierarchy |          |         |
|--------------------------------------------------------------------------------------------|----------------------|----------|---------|
|                                                                                            | Level 1              | Level 2  | Level 3 |
| June 30, 2013                                                                              |                      |          |         |
| Assets:                                                                                    |                      |          |         |
| Agency securities                                                                          | \$—                  | \$77,207 | \$—     |
| U.S. Treasury securities                                                                   | 3,671                | —        | —       |
| Interest rate swaps                                                                        | —                    | 822      | —       |
| Payer swaptions                                                                            | —                    | 842      | —       |
| Net TBA and forward settling agency securities                                             | —                    | 156      | —       |
| U.S. Treasury futures - short                                                              | 56                   | —        | —       |
| Total                                                                                      | \$3,727              | \$79,027 | \$—     |
| Liabilities:                                                                               |                      |          |         |
| Debt of consolidated VIEs                                                                  | \$—                  | \$783    | \$—     |
| Obligation to return U.S. Treasury securities borrowed under reverse repurchase agreements | 9,931                | —        | —       |
| Interest rate swaps                                                                        | —                    | 617      | —       |
| Net TBA and forward settling agency securities                                             | —                    | 927      | —       |
| Total                                                                                      | \$9,931              | \$2,327  | \$—     |
| December 31, 2012                                                                          |                      |          |         |
| Assets:                                                                                    |                      |          |         |
| Agency securities                                                                          | \$—                  | \$85,245 | \$—     |
| Interest rate swaps                                                                        | —                    | 14       | —       |
| Payer swaptions                                                                            | —                    | 171      | —       |
| Net TBA and forward settling agency securities                                             | —                    | 116      | —       |
| Total                                                                                      | \$—                  | \$85,546 | \$—     |
| Liabilities:                                                                               |                      |          |         |
| Debt of consolidated VIEs                                                                  | \$—                  | \$937    | \$—     |
| Obligation to return U.S. Treasury securities borrowed under reverse repurchase agreements | 11,763               | —        | —       |
| Interest rate swaps                                                                        | —                    | 1,243    | —       |
| Net TBA and forward settling agency securities                                             | —                    | 21       | —       |
| Total                                                                                      | \$11,763             | \$2,201  | \$—     |

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

## Follow-On Equity Offering

In March 2013, we completed a public offering in which 57.5 million shares of our common stock were sold to the underwriters at a price of \$31.34 per share. Upon completion of the March offering, we received proceeds, net of offering expenses, of approximately \$1.8 billion. The underwriters in the offering sold the shares of our common stock in one or more transactions on the NASDAQ Global Select Market, in the over-the-counter market, through negotiated transactions or otherwise at market prices prevailing at the time of sale.

## At-the-Market Offering Program

We have entered into sales agreements with sales agents to publicly offer and sell shares of our common stock in privately negotiated and/or at-the-market transactions from time to time. During the six months ended June 30, 2013, we had no sales under this program. As of June 30, 2013, 16.7 million shares remain available for issuance under these sales agreements. The sales agreements will remain in effect until all of the shares are sold under the agreements, subject to early termination rights.

## Dividend Reinvestment and Direct Stock Purchase Plan

We sponsor a dividend reinvestment and direct stock purchase plan through which stockholders may purchase additional shares of our common stock by reinvesting some or all of the cash dividends received on shares of our common stock. Stockholders may also make optional cash purchases of shares of our common stock subject to certain limitations detailed in the plan prospectus. During the six months ended June 30, 2013, there were no shares issued under the plan. As of June 30, 2013, 21.7 million shares remain under the plan.

## Stock Repurchase Program

In October 2012, our Board of Directors adopted a program that may provide for stock repurchases of up to \$500 million of our outstanding shares of common stock through December 31, 2013. 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 and Exchange Commission. 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 SEC Rule 10b-18, which sets certain restrictions on the method, timing, price and volume of stock repurchases. During the three and six months ended June 30, 2013, we made open market purchases of 0.3 million shares of our common stock at an average repurchase price of \$25.44 per share, or \$7 million. As of June 30, 2013, we had \$416 million remaining available for stock repurchases under the program.

## Accumulated Other Comprehensive Income (Loss)

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

|                                               | 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 |
| Accumulated Other Comprehensive Income (Loss) |                                                      |                                     |                               |
| Balance as of March 31, 2013                  | \$1,204                                              | \$(437)                             | ) \$767                       |
| OCI before reclassifications                  | (2,796)                                              | ) —                                 | (2,796)                       |
| Amounts reclassified from accumulated OCI     | (17)                                                 | ) 48                                | 31                            |
| Net current period OCI                        | (2,813)                                              | ) 48                                | (2,765)                       |
| Balance as of June 30, 2013                   | \$(1,609)                                            | ) \$(389)                           | ) \$(1,998)                   |



| Accumulated Other Comprehensive Income (Loss) | Six Months Ended June 30, 2013                       |                                     |   | Total Accumulated OCI Balance |
|-----------------------------------------------|------------------------------------------------------|-------------------------------------|---|-------------------------------|
|                                               | Net Unrealized Gain (Loss) on Available-for-Sale MBS | Net Unrealized Gain (Loss) on Swaps |   |                               |
| Balance as of December 31, 2012               | \$2,041                                              | \$(486)                             | ) | \$1,555                       |
| OCI before reclassifications                  | (3,659)                                              | ) —                                 |   | (3,659)                       |
| Amounts reclassified from accumulated OCI     | 9                                                    | 97                                  |   | 106                           |
| Net current period OCI                        | (3,650)                                              | ) 97                                |   | (3,553)                       |
| Balance as of June 30, 2013                   | \$(1,609)                                            | ) \$(389)                           | ) | \$(1,998)                     |

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

| Amounts Reclassified from Accumulated OCI                                                      | Three Months Ended June 30, 2013 | Six Months Ended June 30, 2013 | Line Item in the Consolidated Statements of Comprehensive Income Where Net Income is Presented |
|------------------------------------------------------------------------------------------------|----------------------------------|--------------------------------|------------------------------------------------------------------------------------------------|
| (Gain) loss amounts reclassified from accumulated OCI for available-for-sale MBS               | \$(17)                           | ) \$9                          | Gain (loss) on sale of agency securities, net                                                  |
| Periodic interest costs of interest rate swaps previously designated as hedges under GAAP, net | 48                               | 97                             | Interest expense                                                                               |
| Total reclassifications                                                                        | \$31                             | \$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 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. These investments consist of residential mortgage pass-through securities and collateralized mortgage obligations ("CMOs") for which the principal and interest payments are guaranteed by government-sponsored entities, 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"). We refer to agency mortgage-backed securities and agency debenture securities collectively as "agency securities" and we refer to the specific investment securities in which we invest as our "investment portfolio".

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.

#### Our Investment Strategy

Our investment strategy is designed to:

- manage an investment portfolio consisting of 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 and prepayment rate risks;

- preserve our net book value;

- provide regular quarterly distributions to our stockholders;

- 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.

### Our Risk Management Strategy

We use a variety of strategies to economically 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 some of our exposure to potential interest rate mismatches between the interest we earn on our longer term investments and the costs on our shorter term borrowings. Because a majority of our leverage 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 rates that we pay on our repurchase agreements. We may experience reduced income or losses based on these 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 most 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 and our convexity exposure. Duration is the estimated percentage change in market value of our assets that would be caused by a parallel change in short and long-term interest rates. Convexity exposure relates to the way the duration of a mortgage security changes when the interest rate and 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 earlier 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 loan, 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 purchase or sell TBAs, specified agency securities on a forward basis, U.S. Treasury securities and U.S. Treasury futures contracts; purchase or write put or call options on TBA securities; and invest in other types of mortgage derivatives, such as interest-only securities, and synthetic total return swaps, such as the Markit IOS Synthetic Total Return Swap Index ("Markit IOS Index").

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, 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

On September 13, 2012, the Federal Reserve announced their third quantitative easing program, commonly known as QE3, and extended their guidance to keep the federal funds rate at exceptionally low levels through at least mid-2015. QE3 entails large-scale purchases of agency mortgage-backed securities ("MBS") at the pace of \$40 billion per month in addition to the Federal Reserve's existing policy of reinvesting principal payments from its holdings of agency MBS into new agency MBS purchases. The program is open-ended in nature, and is intended to put downward pressure on longer-term interest rates, support mortgage markets, and help make the broader financial conditions more accommodative. The Federal Reserve plans to continue their purchases of agency MBS and employ other policy tools, as appropriate, until they foresee substantial improvement in the outlook for the U.S. labor market.

The Federal Reserve's purchases have been concentrated in newly-issued, fixed-rate agency MBS (i.e., the part of the mortgage market with the greatest impact on mortgage rates offered to borrowers). The Federal Reserve has purchased an average of approximately \$70 billion in agency securities per month during the first two quarters of 2013, representing nearly half of the average monthly gross issuance of fixed-rate agency MBS over this period.

Following the Federal Reserve's announcement of QE3, mortgage spreads relative to U.S. Treasury securities and interest rate swaps narrowed sharply and prices across the agency MBS spectrum rose to at or near historical highs, with specified pre-payment protected MBS significantly outperforming generic MBS as investors were focused on pre-payment protection.

By early 2013, mortgage spreads had retracted some of their decline, but remained well below their historical average with both specified and generic MBS prices remaining at or near historical highs. However, during the first quarter of 2013, investor perceptions around the future of monetary policy began to shift as concerns grew around the timing and impact of the Federal Reserve's eventual withdrawal from the mortgage market. These concerns regarding the Federal Reserve's eventual withdrawal from the mortgage market combined with generally stronger economic data, pushed interest rates higher and mortgage spreads returned to near pre-QE3 levels by the end of the second quarter. Price premiums (or "pay-ups" over generic MBS prices) on specified pools of securities with favorable prepayment attributes also declined during the period, as investor sentiment shifted from prepayment concerns to extension risk and "up rate" protection.

As previously noted, our risk management strategy is designed to protect against larger moves in interest rates and will generally not protect our assets against spread risk inherent in our business. Consequently, our hedges provided little protection against declining asset values seen during the first half of 2013 due to spread widening, but performed well against declines driven by the significant rise in long-term interest rates during the second quarter, with net hedge gains on our interest rate swaps, swaptions and short treasury positions of \$5.47 per common share, compared to \$0.35 per common share during the first quarter which experienced a fairly benign increase in rates.

As the Federal Reserve continues to deliberate the timing of a potential slowing or discontinuation of QE3 and as agency MBS investors react to changing expectations of the Federal Reserve's actions, we expect the agency MBS market will continue to experience significant volatility. Consequently, during the first two quarters of 2013, we took actions to rebalance the composition of our asset portfolio toward lower duration assets, which are less sensitive to

changes in interest rates and mortgage spreads. In addition, we increased the size of our hedge portfolio to 101% of our repurchase agreements, other debt and net TBA position as of June 30, 2013. Collectively, these actions provide us with greater book value protection in a rising rate environment. However, in the event that interest rates decline, as of June 30, 2013, we continued to hold 60% of our fixed-rate mortgage assets, inclusive of our net TBA position, in pre-pay protected securities (i.e., securities backed by original loan balances of up to \$150,000, referred to as "lower loan balance securities", and securities backed by 100% refinance loans with original loan-to-value ratios of greater than 80% originated under HARP, referred to as "HARP securities"). Substantially all

of our pre-pay protected securities as of June 30, 2013 were deliverable into TBA contracts and, therefore, had largely the same liquidity profile as generic agency securities. Further, our pre-pay protected securities had a weighted average pay-up across our fixed-rate assets, inclusive of our net TBA position, of approximately 0.24% as of June 30, 2013. Therefore, if pay-ups had declined to zero, it would have resulted in less than a 2.5% decline in our net asset value as of June 30, 2013. For further details of our portfolio composition as of June 30, 2013 refer to Financial Condition below.

While our focus is on maintaining a defensive posture in the current market environment, we expect that the combination of portfolio rebalancing actions and a higher hedge ratio will result in lower net spread income (net interest income, less periodic costs on interest rate swaps and operating expenses) over the short to intermediate-term as we prioritize protecting our net asset value and longer-term earnings potential over short-term profit maximization. The table below summarizes interest rates and prices of generic fixed-rate agency mortgage-backed securities as of the end of each respective quarter since June 30, 2012:

| Interest Rate/Security Price <sup>(1)</sup> | June 30,<br>2013 | Mar.<br>31,<br>2013 | Dec. 31,<br>2012 | Sept.<br>30,<br>2012 | June 30,<br>2012 | June 30,<br>2013<br>vs.<br>Dec. 31,<br>2012 | June 30,<br>2013<br>vs.<br>June 30,<br>2012 |
|---------------------------------------------|------------------|---------------------|------------------|----------------------|------------------|---------------------------------------------|---------------------------------------------|
| <b>LIBOR:</b>                               |                  |                     |                  |                      |                  |                                             |                                             |
| 1-Month                                     | 0.19%            | 0.20%               | 0.21%            | 0.21%                | 0.25%            | --0.02 bps                                  | --0.06 bps                                  |
| 3-Month                                     | 0.27%            | 0.28%               | 0.31%            | 0.36%                | 0.46%            | --0.04 bps                                  | --0.19 bps                                  |
| 6-Month                                     | 0.41%            | 0.44%               | 0.51%            | 0.64%                | 0.73%            | --0.10 bps                                  | --0.32 bps                                  |
| <b>U.S. Treasury Security Rate:</b>         |                  |                     |                  |                      |                  |                                             |                                             |
| 2-Year U.S. Treasury                        | 0.36%            | 0.24%               | 0.25%            | 0.23%                | 0.30%            | +0.11 bps                                   | +0.06 bps                                   |
| 5-Year U.S. Treasury                        | 1.39%            | 0.77%               | 0.72%            | 0.63%                | 0.72%            | +0.67 bps                                   | +0.67 bps                                   |
| 10-Year U.S. Treasury                       | 2.49%            | 1.85%               | 1.76%            | 1.63%                | 1.65%            | +0.73 bps                                   | +0.84 bps                                   |
| <b>Interest Rate Swap Rate:</b>             |                  |                     |                  |                      |                  |                                             |                                             |
| 2-Year Swap                                 | 0.51%            | 0.42%               | 0.39%            | 0.37%                | 0.55%            | +0.12 bps                                   | --0.04 bps                                  |
| 5-Year Swap                                 | 1.57%            | 0.95%               | 0.86%            | 0.76%                | 0.97%            | +0.71 bps                                   | +0.60 bps                                   |
| 10-Year Swap                                | 2.70%            | 2.01%               | 1.84%            | 1.70%                | 1.78%            | +0.86 bps                                   | +0.92 bps                                   |
| <b>30-Year Fixed Rate MBS Price:</b>        |                  |                     |                  |                      |                  |                                             |                                             |
| 3.0%                                        | \$97.72          | \$103.11            | \$104.84         | \$105.58             | \$102.55         | -\$7.12                                     | -\$4.83                                     |
| 3.5%                                        | \$101.50         | \$105.58            | \$106.66         | \$107.25             | \$105.11         | -\$5.16                                     | -\$3.61                                     |
| 4.0%                                        | \$104.16         | \$106.61            | \$107.22         | \$107.75             | \$106.44         | -\$3.06                                     | -\$2.28                                     |
| 4.5%                                        | \$105.82         | \$107.73            | \$108.03         | \$108.25             | \$107.28         | -\$2.21                                     | -\$1.46                                     |
| 5.0%                                        | \$107.65         | \$108.34            | \$108.33         | \$109.06             | \$108.23         | -\$0.68                                     | -\$0.58                                     |
| 5.5%                                        | \$108.65         | \$109.08            | \$108.64         | \$109.63             | \$109.08         | +\$0.01                                     | -\$0.43                                     |
| 6.0%                                        | \$108.78         | \$109.56            | \$109.22         | \$110.44             | \$109.91         | -\$0.44                                     | -\$1.13                                     |
| <b>15-Year Fixed Rate MBS Price:</b>        |                  |                     |                  |                      |                  |                                             |                                             |
| 2.5%                                        | \$100.45         | \$103.75            | \$104.61         | \$105.13             | \$103.09         | -\$4.16                                     | -\$2.64                                     |
| 3.0%                                        | \$102.82         | \$105.17            | \$105.61         | \$106.00             | \$104.77         | -\$2.79                                     | -\$1.95                                     |
| 3.5%                                        | \$104.20         | \$106.03            | \$106.14         | \$106.41             | \$105.66         | -\$1.94                                     | -\$1.46                                     |
| 4.0%                                        | \$105.32         | \$107.00            | \$107.00         | \$106.91             | \$106.34         | -1.68                                       | -\$1.02                                     |
| 4.5%                                        | \$106.00         | \$107.67            | \$107.55         | \$107.84             | \$107.17         | -\$1.55                                     | -\$1.17                                     |

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 obtained from a combination of Bloomberg and dealer indications. Interest rates obtained from Bloomberg.

The table below summarizes pay-ups on specified pools over the corresponding generic agency MBS as of the end of each respective quarter for a select sample of specified securities. Price information provided in the table below is for illustrative purposes only and is not meant to be reflective of our specific portfolio holdings. Actual pay-ups are dependent on specific securities held in our portfolio and prices can vary depending on the source:

| Pay-ups on Specified Mortgage Pools over<br>Generic TBA Price <sup>(1)(2)</sup> | June 30,<br>2013 | Mar.<br>31,<br>2013 | Dec.<br>31,<br>2012 | Sept.<br>30,<br>2012 | June<br>30,<br>2012 | June 30,<br>2013<br>vs.<br>Dec. 31,<br>2012 | June 30,<br>2013<br>vs.<br>June 30,<br>2012 |
|---------------------------------------------------------------------------------|------------------|---------------------|---------------------|----------------------|---------------------|---------------------------------------------|---------------------------------------------|
| 30-Year Lower Loan Balance Pay-ups (\$85k -<br>\$110k): <sup>(3)</sup>          |                  |                     |                     |                      |                     |                                             |                                             |
| 3.0%                                                                            | \$—              | \$0.13              | \$0.69              | \$0.09               | N/A                 | -\$0.69                                     | N/A                                         |
| 3.5%                                                                            | \$0.22           | \$0.91              | \$1.64              | \$1.02               | \$0.75              | -\$1.42                                     | -\$0.53                                     |
| 4.0%                                                                            | \$0.91           | \$3.28              | \$4.19              | \$3.45               | \$2.00              | -\$3.28                                     | -\$1.09                                     |
| 30-Year HARP Pay-ups (95% - 100% LTV):<br><sup>(4)</sup>                        |                  |                     |                     |                      |                     |                                             |                                             |
| 3.0%                                                                            | \$—              | \$0.07              | \$0.47              | \$0.06               | N/A                 | -\$0.47                                     | N/A                                         |
| 3.5%                                                                            | \$0.16           | \$0.70              | \$1.52              | \$1.00               | \$0.63              | -\$1.36                                     | -\$0.47                                     |
| 4.0%                                                                            | \$0.59           | \$2.85              | \$4.06              | \$3.25               | \$1.94              | -\$3.47                                     | -\$1.35                                     |

1. Source: Bloomberg and dealer indications

"Pay-ups" represent the value of the price premium of specified securities over generic TBA pools. The table above includes pay-ups for newly originated specified pools. Price information is provided for information only and is not meant to be reflective of our specific portfolio holdings. Prices can vary materially depending on the source.

2. Lower loan balance securities in table above represent pools backed by an original loan balance of \$85,000 to \$110,000.

3. HARP securities in table above represent pools backed by 100% refinance loans with loan-to-values ("LTV") of 95% to 100%.

4. N/A = Not applicable, as TBA coupon was not actively traded as of the applicable date.

The following table summarizes recent prepayment trends for our portfolio and, for comparison, Fannie Mae 2011 30-year fixed-rate generic mortgage-backed securities universe.

| Annualized Monthly Constant<br>Prepayment Rates <sup>(1)</sup>    | December<br>2012 | January<br>2013 | February<br>2013 | March<br>2013 | April<br>2013 | May<br>2013 | June<br>2013 |
|-------------------------------------------------------------------|------------------|-----------------|------------------|---------------|---------------|-------------|--------------|
| AGNC portfolio                                                    | 10%              | 11%             | 10%              | 10%           | 11%           | 11%         | 12%          |
| Fannie Mae 2011 30-year fixed-rate<br>MBS universe <sup>(2)</sup> | 35%              | 31%             | 30%              | 26%           | 26%           | 26%         | 27%          |

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

2. Source: JP Morgan.

## FINANCIAL CONDITION

As of June 30, 2013 and December 31, 2012, our investment portfolio consisted of \$77.2 billion and \$85.2 billion, respectively, of agency MBS and \$14.5 billion and \$12.9 billion, respectively, of net TBA positions, at fair value. Our net 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, 2013 and December 31, 2012, our net TBA positions had a net carrying value of \$(771) million and \$95 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 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, 2013 and December 31, 2012 (dollars in millions):

June 30, 2013

| Agency MBS<br>Classified as<br>Available-for-Sale<br>("AFS") | Par<br>Value | Amortized<br>Cost | Amortized<br>Cost Basis | Fair<br>Value | % Lower<br>Loan<br>Balance &<br>HARP<br>(2)(3) | Weighted Average<br>WAC<br>(4) | Yield<br>(5) | Age<br>(Months) | Projected<br>Life<br>CPR (5) |
|--------------------------------------------------------------|--------------|-------------------|-------------------------|---------------|------------------------------------------------|--------------------------------|--------------|-----------------|------------------------------|
| Investments By Issuer:                                       |              |                   |                         |               |                                                |                                |              |                 |                              |
| Fannie Mae                                                   | \$56,097     | \$ 58,897         | 105.0%                  | \$57,703      | 75%                                            | 3.91%                          | 2.65%        | 15              | 7%                           |
| Freddie Mac                                                  | 18,385       | 19,255            | 104.7%                  | 18,835        | 72%                                            | 4.07%                          | 2.83%        | 18              | 7%                           |
| Ginnie Mae                                                   | 196          | 204               | 104.1%                  | 207           | —%                                             | 4.12%                          | 1.53%        | 30              | 21%                          |
| Total / Weighted<br>Average                                  | \$74,678     | \$ 78,356         | 104.9%                  | \$76,745      | 73%                                            | 3.95%                          | 2.69%        | 16              | 7%                           |
| Investments By Coupon: (1)                                   |              |                   |                         |               |                                                |                                |              |                 |                              |
| Fixed-Rate                                                   |              |                   |                         |               |                                                |                                |              |                 |                              |
| ≤ 15-Year                                                    |              |                   |                         |               |                                                |                                |              |                 |                              |
| ≤ 2.5%                                                       | \$15,846     | \$ 16,345         | 103.1%                  | \$15,958      | 22%                                            | 2.95%                          | 1.91%        | 5               | 6%                           |
| 3.0%                                                         | 1,843        | 1,917             | 104.0%                  | 1,901         | 95%                                            | 3.46%                          | 2.13%        | 17              | 8%                           |
| 3.5%                                                         | 5,708        | 5,886             | 103.1%                  | 5,980         | 93%                                            | 3.93%                          | 2.76%        | 27              | 9%                           |
| 4.0%                                                         | 6,463        | 6,777             | 104.9%                  | 6,835         | 87%                                            | 4.40%                          | 2.80%        | 31              | 10%                          |
| 4.5%                                                         | 668          | 703               | 105.3%                  | 715           | 98%                                            | 4.87%                          | 3.18%        | 34              | 10%                          |
| ≥ 5.0%                                                       | 10           | 10                | 104.6%                  | 11            | 29%                                            | 6.39%                          | 4.35%        | 65              | 14%                          |
| Total ≤ 15-Year                                              | 30,538       | 31,638            | 103.6%                  | 31,400        | 56%                                            | 3.52%                          | 2.30%        | 16              | 8%                           |
| 20-Year                                                      |              |                   |                         |               |                                                |                                |              |                 |                              |
| ≤ 3.0%                                                       | 45           | 47                | 104.4%                  | 46            | 99%                                            | 3.52%                          | 2.37%        | 5               | 5%                           |
| 3.5%                                                         | 155          | 161               | 104.9%                  | 158           | 96%                                            | 4.14%                          | 2.73%        | 15              | 6%                           |
| 4.0%                                                         | 100          | 105               | 105.0%                  | 106           | 47%                                            | 4.53%                          | 3.09%        | 22              | 8%                           |
| 4.5%                                                         | 128          | 137               | 107.1%                  | 137           | 96%                                            | 4.89%                          | 3.21%        | 31              | 8%                           |
| ≥ 5.0%                                                       | 7            | 8                 | 106.7%                  | 8             | —%                                             | 5.90%                          | 3.41%        | 61              | 17%                          |
| Total 20-Year:                                               | 435          | 458               | 105.5%                  | 455           | 84%                                            | 4.42%                          | 2.93%        | 21              | 7%                           |
| 30-Year:                                                     |              |                   |                         |               |                                                |                                |              |                 |                              |
| ≤ 3.0%                                                       | 5,336        | 5,501             | 103.1%                  | 5,216         | 23%                                            | 3.64%                          | 2.66%        | 5               | 4%                           |
| 3.5%                                                         | 19,349       | 20,478            | 105.8%                  | 19,647        | 99%                                            | 4.02%                          | 2.79%        | 11              | 6%                           |
| 4.0%                                                         | 12,689       | 13,549            | 106.8%                  | 13,277        | 93%                                            | 4.46%                          | 3.10%        | 18              | 6%                           |
| 4.5%                                                         | 4,588        | 4,894             | 106.7%                  | 4,890         | 86%                                            | 4.94%                          | 3.52%        | 28              | 8%                           |
| 5.0%                                                         | 621          | 665               | 107.0%                  | 670           | 60%                                            | 5.41%                          | 3.74%        | 45              | 11%                          |

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|                             |          |           |        |          |     |       |       |    |     |
|-----------------------------|----------|-----------|--------|----------|-----|-------|-------|----|-----|
| ≥ 5.5%                      | 326      | 352       | 108.1% | 355      | 34% | 6.26% | 3.40% | 78 | 21% |
| Total 30-Year               | 42,909   | 45,439    | 105.9% | 44,055   | 86% | 4.24% | 2.96% | 15 | 6%  |
| Total Fixed-Rate            | 73,882   | 77,535    | 104.9% | 75,910   | 73% | 3.95% | 2.69% | 16 | 7%  |
| Adjustable-Rate             | 661      | 682       | 103.2% | 694      | —%  | 3.68% | 2.36% | 48 | 20% |
| CMO                         | 135      | 139       | 103.4% | 141      | —%  | 4.76% | 2.85% | 71 | 12% |
| Total / Weighted<br>Average | \$74,678 | \$ 78,356 | 104.9% | \$76,745 | 73% | 3.95% | 2.69% | 16 | 7%  |

30

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| Agency MBS Remeasured at Fair Value Through Earnings | June 30, 2013                            |                |            | Weighted Average      |                      | Age (Months) | 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                                 |                                          |                |            |                       |                      |              |                                   |
| Fannie Mae                                           | \$1,165                                  | \$206          | \$202      | 5.84%                 | 7.00%                | 34           | 12%                               |
| Freddie Mac                                          | 259                                      | 44             | 34         | 5.56%                 | 9.56%                | 87           | 16%                               |
| Principal-Only Strips                                |                                          |                |            |                       |                      |              |                                   |
| Fannie Mae                                           | 288                                      | 228            | 226        | —%                    | 3.96%                | 20           | 9%                                |
| Total / Weighted Average                             | \$1,712                                  | \$478          | \$462      | 4.82%                 | 5.78%                | 32           | 11%                               |

The weighted average coupon on our agency MBS classified as "AFS" held as of June 30, 2013 was 3.47% and the 1. weighted average coupon on our total agency MBS portfolio, including agency MBS remeasured at fair value through earnings, held as of June 30, 2013 was 3.56%.

Lower loan balance securities represent pools backed by an original loan balance of ≤ \$150,000. Our lower loan 2. balance securities had a weighted average original loan balance of \$98,000 and \$96,000 for 15-year and 30-year securities, respectively, as of June 30, 2013.

HARP securities are defined as pools backed by 100% refinance loans with LTV ≥ 80%. Our HARP securities had a weighted average LTV of 95% and 103% for 15-year and 30-year securities, respectively, as of June 30, 2013.

3. Includes \$0.2 billion and \$3.3 billion of 15-year and 30-year securities with >105 LTV pools which are not deliverable into TBA securities.

4. WAC represents the weighted average coupon of the underlying collateral.

5. Portfolio yield incorporates a projected life CPR assumption based on forward rate assumptions as of June 30, 2013.

| TBAs and Forward Settling Securities       | June 30, 2013                                 |                           | 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%                                       | 612                                           | 710                       | 608                         | (102 )                            |
| 3.0%                                       | 4,829                                         | 4,999                     | 4,975                       | (24 )                             |
| 3.5%                                       | 1,425                                         | 1,485                     | 1,483                       | (2 )                              |
| 4.0%                                       | 150                                           | 159                       | 158                         | (1 )                              |
| Total 15-Year TBAs                         | 7,016                                         | 7,353                     | 7,224                       | (129 )                            |
| 30-Year TBA securities:                    |                                               |                           |                             |                                   |
| 3.0%                                       | 7,567                                         | 8,017                     | 7,390                       | (627 )                            |
| 3.5%                                       | (4,374 )                                      | (4,481 )                  | (4,441 )                    | 40 )                              |
| 4.0%                                       | 6,000                                         | 6,322                     | 6,233                       | (89 )                             |
| Total 30-Year TBAs                         | 9,193                                         | 9,858                     | 9,182                       | (676 )                            |
| 30-Year 4.0% forward settling securities   | (1,801 )                                      | (1,926 )                  | (1,892 )                    | 34 )                              |
| Total TBAs and forward settling securities | \$14,408                                      | \$15,285                  | \$14,514                    | \$(771 )                          |

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.

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

5. Represents dollar roll income (or price drop) on our portfolio stated as a percent of the TBA cost basis on an  
annualized basis.

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December 31, 2012

| Agency MBS<br>Classified as AFS              | Par<br>Value | Amortized<br>Cost | Amortized<br>Cost Basis | Fair<br>Value | % Lower<br>Loan<br>Balance<br>& HARP<br>(2)(3) | Weighted Average<br>WAC<br>(4) | Yield<br>(5) | Age<br>(Months) | Projected<br>Life<br>CPR <sup>(5)</sup> |
|----------------------------------------------|--------------|-------------------|-------------------------|---------------|------------------------------------------------|--------------------------------|--------------|-----------------|-----------------------------------------|
| <b>Investments By Issuer:</b>                |              |                   |                         |               |                                                |                                |              |                 |                                         |
| Fannie Mae                                   | \$58,912     | \$62,120          | 105.4%                  | \$63,687      | 77%                                            | 3.59%                          | 2.60%        | 13              | 10%                                     |
| Freddie Mac                                  | 19,336       | 20,284            | 104.9%                  | 20,758        | 75%                                            | 3.58%                          | 2.58%        | 14              | 12%                                     |
| Ginnie Mae                                   | 238          | 248               | 104.2%                  | 254           | —%                                             | 3.77%                          | 1.60%        | 24              | 19%                                     |
| Total / Weighted Average                     | \$78,486     | \$82,652          | 105.3%                  | \$84,699      | 76%                                            | 3.59%                          | 2.59%        | 13              | 11%                                     |
| <b>Investments By Coupon: <sup>(1)</sup></b> |              |                   |                         |               |                                                |                                |              |                 |                                         |
| <b>Fixed-Rate ≤ 15-Year</b>                  |              |                   |                         |               |                                                |                                |              |                 |                                         |
| ≤ 2.5%                                       | \$11,483     | \$11,979          | 104.3%                  | \$12,014      | 18%                                            | 3.01%                          | 1.52%        | 3               | 11%                                     |
| 3.0%                                         | 1,787        | 1,859             | 104.0%                  | 1,910         | 97%                                            | 3.45%                          | 2.07%        | 12              | 10%                                     |
| 3.5%                                         | 6,409        | 6,600             | 103.0%                  | 6,888         | 93%                                            | 3.93%                          | 2.69%        | 21              | 13%                                     |
| 4.0%                                         | 7,709        | 8,051             | 104.4%                  | 8,323         | 85%                                            | 4.40%                          | 2.64%        | 25              | 16%                                     |
| 4.5%                                         | 763          | 802               | 105.0%                  | 831           | 98%                                            | 4.86%                          | 3.03%        | 28              | 15%                                     |
| ≥ 5.0%                                       | 12           | 12                | 104.4%                  | 13            | 34%                                            | 6.34%                          | 4.29%        | 58              | 17%                                     |
| Total ≤ 15-Year                              | 28,163       | 29,303            | 104.1%                  | 29,979        | 61%                                            | 3.68%                          | 2.17%        | 15              | 13%                                     |
| <b>20-Year</b>                               |              |                   |                         |               |                                                |                                |              |                 |                                         |
| ≤ 3.0%                                       | 938          | 983               | 104.7%                  | 987           | 1%                                             | 3.60%                          | 2.15%        | 4               | 9%                                      |
| 3.5%                                         | 315          | 330               | 104.7%                  | 338           | 49%                                            | 4.04%                          | 2.57%        | 10              | 10%                                     |
| 4%                                           | 113          | 118               | 104.5%                  | 123           | 45%                                            | 4.52%                          | 2.92%        | 16              | 14%                                     |
| 4.5%                                         | 141          | 151               | 106.9%                  | 158           | 96%                                            | 4.89%                          | 2.88%        | 26              | 14%                                     |
| ≥ 5.0%                                       | 10           | 10                | 106.6%                  | 10            | —%                                             | 5.93%                          | 3.50%        | 56              | 18%                                     |
| Total 20-Year:                               | 1,517        | 1,592             | 104.9%                  | 1,616         | 23%                                            | 3.90%                          | 2.37%        | 8               | 10%                                     |
| <b>30-Year:</b>                              |              |                   |                         |               |                                                |                                |              |                 |                                         |
| ≤ 3.0%                                       | 3,675        | 3,866             | 105.2%                  | 3,863         | 58%                                            | 3.58%                          | 2.34%        | 3               | 7%                                      |
| 3.5%                                         | 20,005       | 21,180            | 105.9%                  | 21,579        | 89%                                            | 4.01%                          | 2.67%        | 7               | 8%                                      |
| 4%                                           | 17,790       | 18,946            | 106.5%                  | 19,605        | 96%                                            | 4.46%                          | 2.95%        | 13              | 10%                                     |
| 4.5%                                         | 5,163        | 5,475             | 106.0%                  | 5,706         | 85%                                            | 4.94%                          | 3.35%        | 22              | 12%                                     |
| 5.0%                                         | 731          | 778               | 106.4%                  | 803           | 59%                                            | 5.41%                          | 3.56%        | 41              | 15%                                     |
| ≥ 5.5%                                       | 441          | 477               | 108.2%                  | 484           | 31%                                            | 6.31%                          | 3.61%        | 72              | 18%                                     |
| Total 30-Year                                | 47,805       | 50,722            | 106.1%                  | 52,040        | 88%                                            | 4.29%                          | 2.84%        | 12              | 9%                                      |
| Total Fixed-Rate                             | 77,485       | 81,617            | 105.3%                  | 83,635        | 77%                                            | 3.58%                          | 2.59%        | 13              | 11%                                     |
| Adjustable-Rate                              | 837          | 865               | 103.4%                  | 891           | —%                                             | 4.12%                          | 2.40%        | 43              | 22%                                     |
| CMO                                          | 164          | 170               | 103.2%                  | 173           | —%                                             | 3.75%                          | 2.85%        | 66              | 15%                                     |
| Total / Weighted Average                     | \$78,486     | \$82,652          | 105.3%                  | \$84,699      | 76%                                            | 3.59%                          | 2.59%        | 13              | 11%                                     |

December 31, 2012

| Agency MBS Remeasured at Fair<br>Value Through Earnings | Underlying<br>Unamortized<br>Principal | Amortized<br>Cost | Fair Value | Weighted Average<br>Coupon<br>(1) | Yield <sup>(5)</sup> | Age<br>(Months) | Projected<br>Life CPR <sup>(5)</sup> |
|---------------------------------------------------------|----------------------------------------|-------------------|------------|-----------------------------------|----------------------|-----------------|--------------------------------------|
|---------------------------------------------------------|----------------------------------------|-------------------|------------|-----------------------------------|----------------------|-----------------|--------------------------------------|

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|                          | Balance |       |        |       |        |    |     |
|--------------------------|---------|-------|--------|-------|--------|----|-----|
| Interest-Only Strips     |         |       |        |       |        |    |     |
| Fannie Mae               | \$1,332 | \$245 | \$ 249 | 5.82% | 6.98%  | 30 | 16% |
| Freddie Mac              | 328     | 55    | 43     | 5.60% | 11.84% | 82 | 17% |
| Principal-Only Strips    |         |       |        |       |        |    |     |
| Fannie Mae               | 302     | 241   | 254    | —%    | 3.17%  | 14 | 9%  |
| Total / Weighted Average | \$1,962 | \$541 | \$ 546 | 4.89% | 5.78%  | 28 | 13% |

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The weighted average coupon on our agency MBS classified as "AFS" held as of December 31, 2012 was 3.59% and 1. the weighted average coupon on our total agency MBS portfolio, including agency MBS remeasured at fair value through earnings, held as of December 31, 2012 was 3.69%.

Lower loan balance securities represent pools backed by an original loan balance of up to ≤ \$150,000. Our lower loan balance securities had a weighted average original loan balance of \$98,000 and \$101,000 for 15-year and 30-year securities, respectively, as of December 31, 2012.

HARP securities are defined as pools backed by 100% refinance loans with LTVs ≥ 80%. Our HARP securities had a weighted average LTV of 95% and 104% for 15-year and 30-year securities, respectively, as of December 31, 2012.

WAC represents the weighted average coupon of the underlying collateral.

Portfolio yield incorporates a projected life CPR assumption based on forward rate assumptions as of December 31, 2012.

| TBAs and Forward Settling Securities     | December 31, 2012                           |                |                  |                           |
|------------------------------------------|---------------------------------------------|----------------|------------------|---------------------------|
|                                          | Notional<br>Amount<br>Long / (Short)<br>(1) | Cost Basis (2) | Market Value (3) | Net Carrying<br>Value (4) |
| 15-Year TBA securities                   |                                             |                |                  |                           |
| 2.0%                                     | \$(50 )                                     | \$(51 )        | \$(51 )          | \$—                       |
| 2.5%                                     | 8,448                                       | 8,797          | 8,837            | 40                        |
| 3.0%                                     | (25 )                                       | (26 )          | (26 )            | —                         |
| 3.5%                                     | (90 )                                       | (95 )          | (95 )            | —                         |
| Total 15-Year TBAs                       | 8,283                                       | 8,625          | 8,665            | 40                        |
| 30-Year TBA securities                   |                                             |                |                  |                           |
| 3.0%                                     | 13,256                                      | 13,805         | 13,880           | 75                        |
| 3.5%                                     | (5,793 )                                    | (6,162 )       | (6,172 )         | (10 )                     |
| 4.0%                                     | (3,419 )                                    | (3,656 )       | (3,665 )         | (9 )                      |
| Total 30-Year TBAs                       | 4,044                                       | 3,987          | 4,043            | 56                        |
| 30-Year 3.5% forward settling securities | 150                                         | 163            | 162              | (1 )                      |
| Total TBAs                               | \$12,477                                    | \$12,775       | \$12,870         | \$95                      |

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.

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

5. Represents dollar roll income (or price drop) on our portfolio stated as a percent of the TBA cost basis on an annualized basis.

As of June 30, 2013 and December 31, 2012, the combined weighted average yield of our agency MBS portfolio, inclusive of interest and principal-only strips, was 2.71% and 2.61%, respectively.

As of June 30, 2013 and December 31, 2012, the weighted average dollar roll spread, or net carry, on our net TBA position was 2.95% and 2.81%, respectively.

The stated contractual final maturity of the mortgage loans underlying our agency MBS portfolio ranges up to 40 years. As of June 30, 2013 and December 31, 2012, the weighted average final contractual maturity of our agency MBS portfolio was 23 and 24 years, respectively.

The actual maturities of agency MBS are generally shorter than their stated contractual maturities primarily as a result of prepayments of principal of the underlying mortgages. The weighted average expected maturity of our agency MBS portfolio was 7.9 and 6.6 years as of June 30, 2013 and December 31, 2012, respectively. In determining the estimated weighted average years to maturity of our agency MBS and the yield on our agency MBS, we have assumed a weighted average CPR over the remaining life of our agency MBS portfolio of 7% and 11% as of June 30, 2013 and

December 31, 2012, respectively. We amortize or accrete premiums and discounts associated with purchases of our agency MBS into interest income over the estimated life of our securities based on actual and projected CPRs, using the effective yield method. Since the weighted average cost basis of our agency MBS portfolio, including principal and interest-only strips, was 105.2% of par value as of June 30, 2013, slower actual and projected prepayments can have a meaningful positive impact on our asset yields, while faster actual or projected prepayments can have a meaningful negative impact on our asset yields.

The following table summarizes our agency MBS classified as available-for-sale, at fair value, according to their estimated weighted average life classifications as of June 30, 2013 and December 31, 2012 (dollars in millions):

|                                                                                                        | June 30, 2013 |                   |                               |                              |   | December 31, 2012 |                   |                               |                              |   |
|--------------------------------------------------------------------------------------------------------|---------------|-------------------|-------------------------------|------------------------------|---|-------------------|-------------------|-------------------------------|------------------------------|---|
| Estimated Weighted<br>Average Life of Agency<br>MBS Classified as<br>Available-for-Sale <sup>(1)</sup> | Fair<br>Value | Amortized<br>Cost | Weighted<br>Average<br>Coupon | Weighted<br>Average<br>Yield |   | Fair<br>Value     | Amortized<br>Cost | Weighted<br>Average<br>Coupon | Weighted<br>Average<br>Yield |   |
| ≤ 3 years                                                                                              | \$244         | \$239             | 4.91                          | % 3.31                       | % | \$1,119           | \$1,108           | 4.18                          | % 2.14                       | % |
| > 3 years and ≤ 5 years                                                                                | 14,794        | 14,630            | 3.79                          | % 2.76                       | % | 27,448            | 26,750            | 3.36                          | % 2.29                       | % |
| > 5 years and ≤10 years                                                                                | 42,629        | 43,565            | 3.39                          | % 2.62                       | % | 54,054            | 52,735            | 3.69                          | % 2.75                       | % |
| > 10 years                                                                                             | 19,078        | 19,922            | 3.39                          | % 2.79                       | % | 2,078             | 2,059             | 3.44                          | % 2.65                       | % |
| Total                                                                                                  | \$76,745      | \$78,356          | 3.47                          | % 2.69                       | % | \$84,699          | \$82,652          | 3.59                          | % 2.59                       | % |

1. Excludes interest and principal-only strips.

The weighted average life of our interest-only strips was 6.4 and 5.7 years as of June 30, 2013 and December 31, 2012, respectively, and the weighted average life of our principal-only strips was 8.1 and 6.4 years as of June 30, 2013 and December 31, 2012, respectively.

Our pass-through agency MBS collateralized by adjustable rate mortgage loans ("ARMs") have coupons linked to various indices. As of June 30, 2013 and December 31, 2012, our ARM securities had a weighted average next reset date of 38 months and 43 months, respectively.

As of June 30, 2013 and December 31, 2012, we did not have investments in agency debenture securities.

## RESULTS OF OPERATIONS

In addition to the results presented in accordance with GAAP, our results of operations discussed below include certain non-GAAP financial information, including adjusted net interest expense, net spread income and estimated taxable income and certain financial metrics derived from non-GAAP information, such as cost of funds and estimated undistributed taxable income. By providing users of our financial information with such measures in addition to the related GAAP measures, we believe it gives users greater transparency into the information used by our management in its financial and operational decision-making and, in the case of estimated taxable income, information that is directly related to the amount of dividends we are required to distribute in order to maintain our REIT qualification status. However, because such measures are incomplete measures of our financial performance and involve differences from results computed in accordance with GAAP, they should be considered as supplementary to, and not as a substitute for, our results computed in accordance with GAAP. In addition, because not all companies use identical calculations, our presentation of such non-GAAP measures may not be comparable to other similarly-titled measures of other companies. Furthermore, estimated taxable income can include certain information that is subject to potential adjustments up to the time of filing our income tax returns, which occurs after the end of our fiscal year. The following analysis of our financial condition and results of operations should be read in conjunction with our interim consolidated financial statements and the notes thereto. The tables below present our condensed consolidated balance sheets as of June 30, 2013 and December 31, 2012 and our condensed consolidated statements of comprehensive income and key statistics for the three and six months ended June 30, 2013 and 2012 (in millions, except per share amounts):

| Balance Sheet Data                                                          | June 30, 2013 | December 31, 2012 |                  |         |
|-----------------------------------------------------------------------------|---------------|-------------------|------------------|---------|
|                                                                             | (unaudited)   |                   |                  |         |
| Investment portfolio, at fair value                                         | \$77,207      | \$85,245          |                  |         |
| Total assets                                                                | \$98,663      | \$100,453         |                  |         |
| Repurchase agreements and other debt                                        | \$73,234      | \$75,415          |                  |         |
| Total liabilities                                                           | \$88,383      | \$89,557          |                  |         |
| Total stockholders' equity                                                  | \$10,280      | \$10,896          |                  |         |
| Net asset value per common share as of period end <sup>(1)</sup>            | \$25.51       | \$31.64           |                  |         |
|                                                                             |               | Three Months      | Six Months Ended |         |
|                                                                             |               | Ended June 30,    | June 30,         |         |
| Statement of Comprehensive Income Data (unaudited)                          | 2013          | 2012              | 2013             | 2012    |
| Interest income                                                             | \$545         | \$504             | \$1,092          | \$1,018 |
| Interest expense <sup>(2)</sup>                                             | 131           | 120               | 271              | 226     |
| Net interest income                                                         | 414           | 384               | 821              | 792     |
| Other income (loss), net <sup>(2)</sup>                                     | 1,461         | (612 )            | 1,337            | (349 )  |
| Expenses                                                                    | 46            | 36                | 88               | 64      |
| Income (loss) before income tax                                             | 1,829         | (264 )            | 2,070            | 379     |
| (Benefit) provision for income tax, net                                     | —             | (3 )              | 10               | (1 )    |
| Net income (loss)                                                           | 1,829         | (261 )            | 2,060            | 380     |
| Dividend on preferred stock                                                 | 3             | 3                 | 7                | 3       |
| Net income (loss) available (attributable) to common shareholders           | \$1,826       | \$(264 )          | \$2,053          | \$377   |
| Net income (loss)                                                           | \$1,829       | \$(261 )          | \$2,060          | \$380   |
| Other comprehensive (loss) income <sup>(2)</sup>                            | (2,765 )      | 741               | (3,553 )         | 687     |
| Comprehensive (loss) income                                                 | (936 )        | 480               | (1,493 )         | 1,067   |
| Dividend on preferred stock                                                 | 3             | 3                 | 7                | 3       |
| Comprehensive (loss) income (attributable) available to common shareholders | \$(939 )      | \$477             | \$(1,500 )       | \$1,064 |
| Weighted average number of common shares outstanding - basic and diluted    | 396.4         | 301.0             | 376.4            | 270.8   |
| Net income (loss) per common share - basic and diluted                      | \$4.61        | \$(0.88 )         | \$5.45           | \$1.39  |
| Comprehensive (loss) income per common share - basic and diluted            | \$(2.37 )     | \$1.58            | \$(3.99 )        | \$3.93  |
| Dividends declared per common share                                         | \$1.05        | \$1.25            | \$2.30           | \$2.50  |

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|                                                                                                         | Three Months Ended<br>June 30, |          | Six Months Ended June<br>30, |          |
|---------------------------------------------------------------------------------------------------------|--------------------------------|----------|------------------------------|----------|
| Other Data (unaudited)                                                                                  | 2013                           | 2012     | 2013                         | 2012     |
| Average agency securities, at par                                                                       | \$70,851                       | \$70,549 | \$72,387                     | \$64,814 |
| Average agency securities, at cost                                                                      | \$74,816                       | \$74,007 | \$76,413                     | \$67,948 |
| Average total assets, at fair value                                                                     | \$96,640                       | \$82,566 | \$96,037                     | \$75,463 |
| Net TBA dollar roll position - as of period end, at par                                                 | \$14,408                       | NM       | \$14,408                     | NM       |
| Net TBA dollar roll position - as of period end, at cost                                                | \$15,285                       | NM       | \$15,285                     | NM       |
| Net TBA dollar roll position - as of period end, at market value                                        | \$14,514                       | NM       | \$14,514                     | NM       |
| Net TBA dollar roll position - as of period end, carrying value<br>(3)                                  | \$(771 )                       | NM       | \$(771 )                     | NM       |
| Average net TBA dollar roll position, at cost                                                           | \$28,904                       | NM       | \$23,398                     | NM       |
| Average repurchase agreements and other debt                                                            | \$66,060                       | \$67,997 | \$68,313                     | \$62,738 |
| Average stockholders' equity (4)                                                                        | \$11,256                       | \$9,071  | \$11,051                     | \$8,028  |
| Average coupon (5)                                                                                      | 3.63 %                         | 3.96 %   | 3.66 %                       | 4.05 %   |
| Average asset yield (6)                                                                                 | 2.92 %                         | 2.73 %   | 2.86 %                       | 2.99 %   |
| Average cost of funds (7)                                                                               | (1.43 )%                       | (1.08 )% | (1.36 )%                     | (1.04 )% |
| Average net interest rate spread (8)                                                                    | 1.49 %                         | 1.65 %   | 1.50 %                       | 1.95 %   |
| Average net interest rate spread, including estimated TBA<br>dollar roll income (9)                     | 1.86 %                         | NM       | 1.86 %                       | NM       |
| Average coupon (as of period end)                                                                       | 3.56 %                         | 3.86 %   | 3.56 %                       | 3.86 %   |
| Average asset yield (as of period end)                                                                  | 2.71 %                         | 2.81 %   | 2.71 %                       | 2.81 %   |
| Average cost of funds (as of period end) (10)                                                           | (1.47 )%                       | (1.19 )% | (1.47 )%                     | (1.19 )% |
| Average net interest rate spread (as of period end)                                                     | 1.24 %                         | 1.62 %   | 1.24 %                       | 1.62 %   |
| Average net interest rate spread, including estimated TBA<br>dollar roll income (as of period end) (11) | 1.59 %                         | NM       | 1.59 %                       | NM       |
| Net comprehensive (loss) income return on average common<br>equity - annualized (12)                    | (34.0 )%                       | 21.5 %   | (28.0 )%                     | 26.9 %   |
| Economic (loss) return on common equity - annualized (13)                                               | (32.9 )%                       | 22.1 %   | (24.3 )%                     | 30.4 %   |
| Leverage (average during the period) (14)                                                               | 5.9:1                          | 7.5:1    | 6.2:1                        | 7.8:1    |
| Leverage, including net TBA dollar roll position (average<br>during the period) (15)                    | 8.4:1                          | NM       | 8.3:1                        | NM       |
| Leverage (as of period end) (16)                                                                        | 7.0:1                          | 7.6:1    | 7.0:1                        | 7.6:1    |
| Leverage, including net TBA dollar roll position (as of period<br>end) (17)                             | 8.5:1                          | NM       | 8.5:1                        | NM       |
| Expenses % of average assets - annualized (18)                                                          | 0.19 %                         | 0.18 %   | 0.18 %                       | 0.17 %   |
| Expenses % of average assets, including average net TBA<br>dollar roll position - annualized            | 0.15 %                         | NM       | 0.15 %                       | NM       |
| Expenses % of average equity - annualized (19)                                                          | 1.64 %                         | 1.59 %   | 1.61 %                       | 1.60 %   |

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

NM = Not meaningful. Prior to the fourth quarter of 2012, our net TBA position primarily consisted of short TBAs used for hedging purposes.

Net asset value per common share calculated as our total stockholders' equity, less our 8.000% Series A Cumulative 1. Redeemable Preferred Stock liquidation preference of \$25 per preferred share, divided by our number of common shares outstanding as of period end.

We voluntarily discontinued hedge accounting for our interest rate swaps as of September 30, 2011. Please refer to our Interest Expense and Cost of Funds discussion further below and Notes 3 and 6 of our Consolidated Financial Statements in this Report on Form 10-Q for additional information regarding our discontinuance of hedge accounting.

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

Average stockholders' equity calculated as our average month-ended stockholders' equity during the period.

Weighted average coupon for the period was calculated by dividing our total coupon (or cash) interest income on agency securities by our average agency securities held at par.

Average asset yield for the period was calculated by dividing our total cash interest income on agency securities, less amortization of premiums and discounts, by our average amortized cost of agency securities held.

Cost of funds includes repurchase agreements, debt of consolidated VIEs and interest rate swaps, but excludes interest rate swap termination fees and costs associated with other supplemental hedges such as interest rate swaptions and short U.S. Treasury or TBA positions. Weighted average cost of funds for the period was calculated by dividing our total cost of funds by our average repurchase agreements and debt of consolidated VIEs outstanding for the period.

Net interest rate spread for the period was calculated by subtracting our average cost of funds from our average asset yield.

Estimated TBA dollar roll income is net of short TBAs used for hedging purposes. Dollar roll income excludes the impact of other supplemental hedges, and is recognized in gain (loss) on derivative instruments and other securities, net.

10. Average cost of funds as of period end includes repurchase agreements and debt of consolidated VIEs outstanding, plus the impact of interest rate swaps in effect as of each period end and forward starting swaps becoming effective, net of swaps expiring, within three months of each period end, but excludes costs associated with other supplemental hedges such as swaptions and short treasury or TBA positions.

11. Estimated TBA dollar roll income is net of short TBAs used for hedging purposes. Dollar roll income excludes the impact of other supplemental hedges, and is recognized in gain (loss) on derivative instruments and other securities, net.

12. Net comprehensive income (loss) return on average common equity for the period was calculated by dividing our comprehensive income available to common shareholders by our average stockholders' equity, net of the 8.000% Series A Cumulative Redeemable Preferred Stock liquidation preference.

13. Economic (loss) return on common equity represents the sum of the change in our net asset value per common share and our dividends declared on common stock during the period over our beginning net asset value per common share.

14. Leverage during the period was calculated by dividing our daily weighted average agency MBS repurchase agreements and debt of consolidated VIEs outstanding for the period by our average stockholders' equity for the period. Leverage excludes U.S. Treasury repurchase agreements.

15. Leverage, including net TBA dollar roll position, during the period includes the components of "leverage (average during the period)", plus our daily weighted average net TBA dollar position (at cost) during the period.

16. Leverage at period end was calculated by dividing the sum of the amount outstanding under our agency MBS repurchase agreements, net receivable / payable for unsettled agency securities and debt of consolidated VIEs by our total stockholders' equity at period end. Leverage excludes U.S. Treasury repurchase agreements.

17. Leverage at period end, including net TBA dollar roll position, includes the components of "leverage (as of period end)" plus our net TBA position outstanding as of period end, at cost.

18. Expenses as a percentage of average total assets calculated by dividing our total expenses by our average total assets for the period on an annualized basis.

19. Expenses as a percentage of average stockholders' equity, calculated by dividing our total expenses by our average stockholders' equity on an annualized basis.

#### Interest Income and Asset Yield

The following table summarizes our interest income for the three and six months ended June 30, 2013 and 2012 (dollars in millions):

|                                                                          | Three Months Ended June 30, |         |        |         | Six Months Ended June 30, |         |         |         |
|--------------------------------------------------------------------------|-----------------------------|---------|--------|---------|---------------------------|---------|---------|---------|
|                                                                          | 2013                        |         | 2012   |         | 2013                      |         | 2012    |         |
|                                                                          | Amount                      | Yield   | Amount | Yield   | Amount                    | Yield   | Amount  | Yield   |
| Cash/coupon interest income                                              | \$643                       | 3.63%   | \$700  | 3.96%   | \$1,324                   | 3.66%   | \$1,314 | 4.05%   |
| Premium amortization                                                     | (98)                        | (0.71)% | (196)  | (1.23)% | (232)                     | (0.80)% | (296)   | (1.06)% |
| Interest income                                                          | \$545                       | 2.92%   | \$504  | 2.73%   | \$1,092                   | 2.86%   | \$1,018 | 2.99%   |
| Actual portfolio CPR                                                     | 11%                         |         | 10%    |         | 11%                       |         | 10%     |         |
| Projected life CPR as of period end                                      | 7%                          |         | 12%    |         | 7%                        |         | 12%     |         |
| Average 30-year fixed-rate mortgage rate as of period end <sup>(1)</sup> | 4.46%                       |         | 3.66%  |         | 4.46%                     |         | 3.66%   |         |
| 10-year U.S. Treasury rate as of period end                              | 2.49%                       |         | 1.65%  |         | 2.49%                     |         | 1.65%   |         |

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

The principal elements impacting interest income were the size of our agency MBS investment portfolio and the yield on our investments. The following is a summary of the estimated impact of each of these elements on changes in interest income between the current three and six months ended June 30, 2013 over the corresponding prior year period (in millions):

#### Impact of Changes in Principal Elements Impacting

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Interest Income

Period Ended June 30, 2013 vs. June 30, 2012

|                    |          | Due to Change in Average <sup>(1)</sup> |        |
|--------------------|----------|-----------------------------------------|--------|
|                    | Net      | Portfolio                               | Asset  |
|                    | Increase | Size                                    | Yield  |
| Three months ended | \$41     | \$6                                     | \$35   |
| Six months ended   | \$74     | \$114                                   | \$(40) |

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

The primary driver of the increase in interest income for the three months ended June 30, 2013 was an increase in the average yield on our investments from 2.73% for the three months ended June 30, 2012 to 2.92% for the three months ended June 30, 2013, which was largely a function of the decrease in the average projected life CPRs of our assets from 12% CPR as of June 30, 2012 to 7% CPR as of June 30, 2013, reflective of higher long-term interest rates. During the three months ended June 30, 2013, we recognized approximately \$55 million of estimated "catch-up" premium amortization benefit due to a decline in our average projected CPR relative to the preceding quarter-end (or March 31, 2013) of 218 basis points, compared to approximately \$33 million of estimated "catch-up" premium amortization cost recognized during the three months ended June 30, 2012 due to an increase in projected CPRs relative to the preceding quarter-end (or March 31, 2012) of 226 basis points. The benefit of lower projected CPRs was partially offset by a decline in the average coupon on our investments from 3.96% for the three months ended June 30, 2012 to 3.63% for the three months ended June 30, 2013, due to changes in asset composition.

The primary driver of the increase in our interest income for the six months ended June 30, 2013 was an increase in the average size of our agency MBS portfolio attributed to deployment of new equity capital from preferred and common stock offerings. Partially offsetting this was a decline in the average yield on our assets over the period primarily due to a decrease in the average coupon on our assets from 4.05% for the six months ended June 30, 2012 to 3.66% for the six months ended June 30, 2013 from changes in our asset composition. The decline in our average asset yield is net of lower premium amortization costs from lower forecasted CPR estimates. During the six months ended June 30, 2013, we recognized approximately \$87 million of estimated "catch-up" premium amortization benefit due to changes in our projected CPR estimates, compared to approximately \$5 million of estimated "catch-up" premium amortization cost recognized during the six months ended June 30, 2012.

#### Leverage

Our leverage was 7.1 times and 6.9 times our stockholders' equity as of June 30, 2013 and December 31, 2012, respectively, or 7.0 times and 7.0 times our stockholders' equity, respectively, when adjusted for the net payables and receivables for unsettled securities and excluding U.S. Treasury repurchase agreements. Inclusive of our net TBA position, our leverage was 8.5 times and 8.2 times our stockholders' equity as of June 30, 2013 and December 31, 2012, respectively. While TBA commitments are treated as derivatives under GAAP and, thus, not included in our repurchase agreement ("repo") and other debt leverage calculations, they do carry similar risks as purchases made on our balance sheet of agency assets. (Refer to Liquidity and Capital Resources for further discussion of TBA dollar roll positions).

The table below presents our quarterly average and quarter-end repo and other debt balance outstanding and leverage ratios for the three months ended June 30, 2013, December 31, 2012 and June 30, 2012 (dollars in millions):

| Quarter Ended     | Repurchase Agreements and Other Debt |                                  |                           | Average Daily Interest Rate on Amounts Outstanding | Average Interest Rate on Ending Amount Outstanding | Average Leverage <sup>(1)</sup> | Leverage as of Period End <sup>(2)</sup> | Leverage as of Period End, Net of Unsettled Trades <sup>(3)</sup> | Adjusted Leverage as of Period End, Including Net TBA Position <sup>(4)</sup> |
|-------------------|--------------------------------------|----------------------------------|---------------------------|----------------------------------------------------|----------------------------------------------------|---------------------------------|------------------------------------------|-------------------------------------------------------------------|-------------------------------------------------------------------------------|
|                   | Average Daily Amount Outstanding     | Maximum Daily Amount Outstanding | Ending Amount Outstanding |                                                    |                                                    |                                 |                                          |                                                                   |                                                                               |
| June 30, 2013     | \$66,060                             | \$73,234                         | \$73,234                  | 0.50%                                              | 0.44%                                              | 5.9:1                           | 7.1:1                                    | 7.0:1                                                             | 8.5:1                                                                         |
| March 31, 2013    | \$70,591                             | \$75,580                         | \$67,122                  | 0.52%                                              | 0.47%                                              | 6.5:1                           | 5.8:1                                    | 5.7:1                                                             | 8.1:1                                                                         |
| December 31, 2012 | \$74,649                             | \$80,262                         | \$75,415                  | 0.51%                                              | 0.51%                                              | 6.7:1                           | 6.9:1                                    | 7.0:1                                                             | 8.2:1                                                                         |
| June 30, 2012     | \$67,997                             | \$70,495                         | \$70,494                  | 0.40%                                              | 0.42%                                              | 7.5:1                           | 7.7:1                                    | 7.6:1                                                             | NM                                                                            |
| March 31, 2012    | \$57,480                             | \$69,867                         | \$69,866                  | 0.38%                                              | 0.37%                                              | 8.2:1                           | 8.0:1                                    | 8.4:1                                                             | NM                                                                            |

Average leverage during the period was calculated by dividing the daily weighted average repurchase agreements and debt of consolidated VIEs outstanding for the period by our average month-ended stockholders' equity for the period.

2. Leverage as of period end was calculated by dividing the amount outstanding under our repurchase agreements and debt of consolidated VIEs by our stockholders' equity at period end.

3. Leverage as of period end, net of unsettled trades was calculated by dividing the sum of the amount outstanding under our agency MBS repurchase agreements, net payables and receivables for unsettled agency MBS securities and debt of consolidated VIEs by our total stockholders' equity at period end. Leverage excludes our U.S. Treasury repurchase agreements.

4. Adjusted leverage as of period end was calculated by dividing the sum of the amounts outstanding under our agency MBS repurchase agreements, debt of consolidated VIEs, the cost basis (or contract price) of our net long TBA position and net payables and receivables for unsettled agency securities by our total stockholders' equity at period end. Leverage excludes our U.S. Treasury repurchase agreements.

NM = Not meaningful. Prior to the fourth quarter of 2012, our net TBA position primarily consisted of short TBAs used for hedging purposes.

## Interest Expense and Cost of Funds

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

Our "adjusted net interest expense", also referred to as our "cost of funds" when stated as a percentage of our outstanding repurchase agreements and other debt balance, includes periodic interest costs on our interest rate swaps reported in other income (loss) in our consolidated statements of comprehensive income. Our cost of funds does not include swap termination fees and costs associated with our other supplemental hedges, such as swaptions, short U.S. Treasury positions or TBA positions. Our cost of funds also does not include the implied financing cost/benefit of our net TBA dollar roll position.

The table below presents a reconciliation of our interest expense (the most comparable GAAP financial measure) to our adjusted net interest expense (a non-GAAP financial measure) for the three and six months ended June 30, 2013 and 2012 (dollars in millions):

|                                                                                                | Three Months Ended June 30, |                  |        |                  | Six Months Ended June 30, |                  |        |                  |
|------------------------------------------------------------------------------------------------|-----------------------------|------------------|--------|------------------|---------------------------|------------------|--------|------------------|
|                                                                                                | 2013                        |                  | 2012   |                  | 2013                      |                  | 2012   |                  |
| Adjusted Net Interest Expense and Cost of Funds                                                | Amount                      | % <sup>(1)</sup> | Amount | % <sup>(1)</sup> | Amount                    | % <sup>(1)</sup> | Amount | % <sup>(1)</sup> |
| Interest expense:                                                                              |                             |                  |        |                  |                           |                  |        |                  |
| Repurchase agreement and other debt interest expense                                           | \$83                        | 0.50 %           | \$68   | 0.40 %           | \$174                     | 0.51 %           | \$122  | 0.39 %           |
| Periodic interest costs of interest rate swaps previously designated as hedges under GAAP, net | 48                          | 0.29 %           | 52     | 0.31 %           | 97                        | 0.29 %           | 104    | 0.33 %           |
| Total interest expense                                                                         | 131                         | 0.79 %           | 120    | 0.71 %           | 271                       | 0.80 %           | 226    | 0.72 %           |
| Other periodic interest costs of interest rate swaps, net                                      | 105                         | 0.64 %           | 62     | 0.37 %           | 189                       | 0.56 %           | 101    | 0.32 %           |
| Total adjusted net interest expense and cost of funds                                          | \$236                       | 1.43 %           | \$182  | 1.08 %           | \$460                     | 1.36 %           | \$327  | 1.04 %           |

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

The increase in our adjusted net interest expense was primarily a function of maintaining a higher hedge ratio of interest rate swaps to our outstanding repo balance and higher repo rates mainly due to extending the average original days-to-maturity of our repo funding to 182 days as of June 30, 2013 from 121 days as of June 30, 2012, which were partially offset by a decline in the weighted average pay rate on our interest rate swap portfolio.

The following is a summary of the estimated impact of changes in the principle elements of our adjusted net interest expense for the three and six months ended June 30, 2013 and the corresponding prior year period (in millions):

### Impact of Changes in the Principle Elements of Adjusted Net Interest Expense Period Ended June 30, 2013 vs. June 30, 2012

|                                              | Increase | Due to Change in Average <sup>(1)</sup> |                                      |
|----------------------------------------------|----------|-----------------------------------------|--------------------------------------|
|                                              |          | Repurchase Agreements and Swap Balance  | Repurchase Agreements and Swap Rates |
| Three months ended:                          |          |                                         |                                      |
| Repurchase agreements and other debt expense | \$15     | \$(2)                                   | \$17                                 |

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|                                                  |      |       |       |   |
|--------------------------------------------------|------|-------|-------|---|
| Periodic interest rate swap costs <sup>(2)</sup> | 39   | 117   | (78   | ) |
| Total change in adjusted net interest expense    | \$54 | \$115 | \$(61 | ) |

Six months ended:

|                                                  |       |       |       |   |
|--------------------------------------------------|-------|-------|-------|---|
| Repurchase agreements and other debt expense     | \$52  | \$12  | \$40  |   |
| Periodic interest rate swap costs <sup>(2)</sup> | 81    | 218   | (137  | ) |
| Total change in adjusted net interest expense    | \$133 | \$230 | \$(97 | ) |

39

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Variances that are the combined effect of changes in our repurchase agreement/interest rate swap balance and 1. changes in repurchase agreement/swap interest rates, but cannot be separately identified, are allocated to each variance based on their respective relative amounts.

Includes amounts recognized in interest expense and in gain (loss) on derivatives and other securities in our 2. consolidated statements of comprehensive income. Change due to interest rate reflects impact of change on the weighted average fixed pay rate, net of change in the weighted average receive rate.

The table below presents a summary of our debt and interest rate swaps outstanding for the three and six months ended June 30, 2013 and 2012 (dollars in millions):

|                                                                                                           | Three Months Ended<br>June 30, |          | Six Months Ended June<br>30, |          |
|-----------------------------------------------------------------------------------------------------------|--------------------------------|----------|------------------------------|----------|
|                                                                                                           | 2013                           | 2012     | 2013                         | 2012     |
| Average Debt and Interest Rate Swaps Outstanding                                                          |                                |          |                              |          |
| Average repurchase agreements and other debt                                                              | \$66,060                       | \$67,997 | \$68,313                     | \$62,738 |
| Average notional amount of interest rate swaps                                                            | \$49,412                       | \$38,671 | \$47,177                     | \$33,790 |
| Average notional amount of interest rate swaps as a percentage<br>of repurchase agreements and other debt | 75                             | % 57     | % 69                         | % 54     |
| Weighted average pay rate on interest rate swaps                                                          | 1.23                           | % 1.51   | % 1.32                       | % 1.53   |

Our average interest rate swaps outstanding in the table above exclude our forward starting swaps not in effect during the periods presented. Forward starting interest rate swaps do not impact our adjusted net interest expense and cost of funds until they commence accruing net interest settlements on their forward start dates. We enter into forward starting interest rate swaps based on a variety of factors, including our Manager's view of the forward yield curve and the timing of potential changes in short-term interest rates, time to deploy new capital, amount and timing of expirations of our existing interest swap portfolio and current and anticipated swap spreads. As of June 30, 2013, we had \$2.5 billion of forward starting interest rate swaps outstanding with forward start dates through September 2013 and no interest rate swaps set to expire over the same period. As of June 30, 2012, we had \$4.6 billion of forward starting interest rate swaps outstanding with forward start dates through October 2012, compared to \$200 million of interest rate swaps set to expire over the same time period.

#### Net Spread Income

The table below presents a reconciliation of our net interest income (the most comparable GAAP financial measure) to our net spread income (a non-GAAP financial measure) for the three and six months ended June 30, 2013 and 2012 (dollars in millions).

|                                                                             | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |        |
|-----------------------------------------------------------------------------|--------------------------------|--------|------------------------------|--------|
|                                                                             | 2013                           | 2012   | 2013                         | 2012   |
| Net interest income                                                         | \$414                          | \$384  | \$821                        | \$792  |
| Other periodic interest costs of interest rate swaps, net <sup>(1)</sup>    | 105                            | 62     | 189                          | 101    |
| Adjusted net interest income                                                | 309                            | 322    | 632                          | 691    |
| Operating expenses                                                          | 46                             | 36     | 88                           | 64     |
| Net spread income                                                           | 263                            | 286    | 544                          | 627    |
| Dividend on preferred stock                                                 | 3                              | 3      | 7                            | 3      |
| Net spread income available to common shareholders                          | 260                            | 283    | 537                          | 624    |
| TBA dollar roll income <sup>(1)(2)</sup>                                    | 195                            | —      | 337                          | —      |
| Net spread and dollar roll income available to common<br>shareholders       | \$455                          | \$283  | \$874                        | \$624  |
| Weighted average number of common shares outstanding -<br>basic and diluted | 396.4                          | 301.0  | 376.4                        | 270.8  |
| Net spread income per common share - basic and diluted                      | \$0.66                         | \$0.94 | \$1.43                       | \$2.30 |

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|                                                                        |        |        |        |        |
|------------------------------------------------------------------------|--------|--------|--------|--------|
| Net spread and dollar roll income per common share - basic and diluted | \$1.15 | \$0.94 | \$2.32 | \$2.30 |
|------------------------------------------------------------------------|--------|--------|--------|--------|

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1. Reported in gain (loss) on derivatives and other securities in our consolidated statements of comprehensive income.

2. During the three and six months ended June 30, 2012, we did not have dollar roll income since we primarily held short TBA contracts for hedging purposes.

The decline in net spread income per common share was primarily due to maintaining a portion of our mortgage assets in TBA form during the current year period and margin compression due to lower asset yields and higher cost of funds.

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

The following table is a summary of our net gain (loss) on sale of agency MBS for the three and six months ended June 30, 2013 and 2012 (in millions):

|                                              | Three Months Ended<br>June 30, |              | Six Months Ended<br>June 30, |              |
|----------------------------------------------|--------------------------------|--------------|------------------------------|--------------|
|                                              | 2013                           | 2012         | 2013                         | 2012         |
| Agency MBS sold, at cost                     | \$ (15,069                     | ) \$ (25,843 | ) \$ (35,397                 | ) \$ (35,086 |
| Proceeds from agency MBS sold <sup>(1)</sup> | 15,086                         | 26,260       | 35,388                       | 35,719       |
| Net gain (loss) on sale of agency MBS        | \$ 17                          | \$ 417       | \$ (9                        | ) \$ 633     |
| Gross gain on sale of agency MBS             | \$ 93                          | \$ 425       | \$ 180                       | \$ 645       |
| Gross loss on sale of agency MBS             | (76                            | ) (8         | ) (189                       | ) (12        |
| Net gain (loss) on sale of agency MBS        | \$ 17                          | \$ 417       | \$ (9                        | ) \$ 633     |

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

Asset sales were primarily a function of repositioning our agency MBS portfolio towards securities with attributes our Manager believes provide a greater relative value and risk-adjusted returns in light of current and anticipated interest rates, federal government programs, general economic conditions and other factors.

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

The following table is a summary of our gain (loss) on derivative instruments and other securities, net for the three and six months ended June 30, 2013 and 2012 (in millions):

|                                                                                            | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|--------------------------------------------------------------------------------------------|--------------------------------|----------|------------------------------|-----------|
|                                                                                            | 2013                           | 2012     | 2013                         | 2012      |
| Periodic interest costs of interest rate swaps, net <sup>(1)</sup>                         | \$ (105                        | ) \$ (62 | ) \$ (189                    | ) \$ (101 |
| Realized gain (loss) on derivative instruments and other securities, net:                  |                                |          |                              |           |
| Net TBAs and forward settling agency securities                                            | 188                            | (101     | ) 192                        | (68       |
| Interest rate payer swaptions                                                              | (11                            | ) (21    | ) (53                        | ) (26     |
| U.S. Treasury securities                                                                   | (12                            | ) (1     | ) (12                        | ) (1      |
| Short sales of U.S. Treasury securities                                                    | 12                             | (91      | ) 87                         | (97       |
| U.S. Treasury futures                                                                      | 6                              | (47      | ) 7                          | (65       |
| Interest rate swap termination fees                                                        | 42                             | (52      | ) 18                         | (52       |
| Other                                                                                      | —                              | 3        | —                            | —         |
| Total realized gain (loss) on derivative instruments and other securities, net             | 225                            | (310     | ) 239                        | (309      |
| Unrealized gain (loss) on derivative instruments and other securities, net: <sup>(2)</sup> |                                |          |                              |           |
| Net TBAs and forward settling agency securities                                            | (760                           | ) (23    | ) (866                       | ) (40     |
| Interest rate swaps                                                                        | 1,198                          | (472     | ) 1,358                      | (477      |
| Interest rate payer swaptions                                                              | 465                            | (53      | ) 462                        | (45       |
| Interest-only and principal-only strips                                                    | (20                            | ) (2     | ) (21                        | ) (1      |
| U.S. Treasury securities                                                                   | 16                             | —        | 16                           | —         |
| Short sales of U.S. Treasury securities                                                    | 334                            | (62      | ) 257                        | (3        |
| U.S. Treasury Futures                                                                      | 71                             | (37      | ) 56                         | 2         |
| Debt of consolidated VIEs                                                                  | 20                             | (8       | ) 34                         | (8        |
| Total unrealized gain (loss) on derivative instruments and other securities, net           | 1,324                          | (657     | ) 1,296                      | (572      |

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Total gain (loss) on derivative instruments and other securities, net      \$1,444      \$(1,029 )      \$1,346      \$(982 )

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1. Please refer to Interest Expense and Cost of Funds discussion above for additional information regarding other periodic interest costs of interest rate swaps, net.
  2. Unrealized gain (loss) from derivative instruments and other securities, net includes reversals of prior period amounts for settled or expired derivative instruments and other securities.

Gains and losses from purchases and sales of TBAs and forward settling positions totaled a net loss of \$572 million for the three months ended June 30, 2013, consisting of \$195 million of net TBA dollar roll income and a net loss of \$767 million due to price declines. Gains and losses from purchases and sales of TBAs and forward settling positions totaled a net loss of \$674 million for the six months ended June 30, 2013, consisting of \$337 million of net TBA dollar roll income and a net loss of \$1,011 million due to price declines.

For further details regarding our use of derivative instruments and related activity refer to Notes 3 and 6 of our consolidated financial statements in this Quarterly Report on Form 10-Q.

#### Management Fees and General and Administrative Expenses

We pay our Manager a base management fee payable monthly in arrears in an amount equal to one twelfth of 1.25% of our Equity. Our Equity is defined as our month-end stockholders' equity, adjusted to exclude the effect of any unrealized gains or losses included in either retained earnings or accumulated OCI, each as computed in accordance with GAAP. There is no incentive compensation payable to our Manager pursuant to the management agreement. We incurred management fees of \$37 million and \$28 million during the three months ended June 30, 2013 and 2012, respectively, and \$70 million and \$50 million during the six months ended June 30, 2013 and 2012, respectively; the period-over-period increase was primarily a function of our follow-on equity raises. General and administrative expenses were \$9 million and \$8 million during the three months ended June 30, 2013 and 2012, respectively, and \$18 million and \$14 million during the six months ended June 30, 2013 and 2012, respectively. Our general and administrative expenses primarily consisted of prime broker fees, information technology costs, accounting fees, legal fees, Board of Director fees, insurance expense and general overhead expense. Our total operating expense as a percentage of our average stockholders' equity on an annualized basis was 1.64% and 1.59% for the current and prior year three month period, respectively, and 1.61% and 1.60% for the current and prior year six month period, respectively.

#### Dividends and Income Taxes

For the three months ended June 30, 2013 and 2012, we had estimated taxable income available to common shareholders of \$411 million and \$489 million (or \$1.04 and \$1.62 per common share), respectively, and for the six months ended June 30, 2013 and 2012, we had estimated taxable income available to common shareholders of \$587 million and \$978 million (or \$1.56 and \$3.61 per common share), respectively.

As a REIT, we are required to distribute annually 90% of our taxable income to maintain our status as a REIT and all of our taxable income to avoid Federal and state corporate income taxes. We can treat dividends declared by September 15 and paid by December 31 as having been a distribution of our taxable income for our prior tax year ("spill-back provision"). Income as determined under GAAP differs from income as determined under tax rules because of both temporary and permanent differences in income and expense recognition. The primary differences are (i) unrealized gains and losses associated with interest rate swaps and other derivatives and securities marked-to-market in current income for GAAP purposes, but excluded from taxable income until realized or settled, (ii) temporary differences related to the amortization of premiums paid on investments, (iii) timing differences in the recognition of certain realized gains and losses, and (iv) permanent differences for excise tax expense. Furthermore, our estimated taxable income is subject to potential adjustments up to the time of filing our appropriate tax returns, which occurs after the end of our fiscal year. The following is a reconciliation of our GAAP net income to our estimated taxable income for the three and six months ended June 30, 2013 and 2012 (dollars in millions).

|                               | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |       |
|-------------------------------|--------------------------------|---------|------------------------------|-------|
|                               | 2013                           | 2012    | 2013                         | 2012  |
| Net income                    | \$1,829                        | \$(261) | \$2,060                      | \$380 |
| Book to tax differences:      |                                |         |                              |       |
| Premium amortization, net     | (75)                           | ) 43    | (109)                        | ) 15  |
| Realized (gain) loss, net     | (15)                           | ) 54    | (68)                         | ) 8   |
| Unrealized (gain) loss, net   | (1,324)                        | ) 647   | (1,294)                      | ) 567 |
| Other                         | (1)                            | ) 9     | 5                            | ) 11  |
| Total book to tax differences | (1,415)                        | ) 753   | (1,466)                      | ) 601 |

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|                                                                          |        |        |        |        |
|--------------------------------------------------------------------------|--------|--------|--------|--------|
| Estimated REIT taxable income                                            | 414    | 492    | 594    | 981    |
| Dividend on preferred stock                                              | 3      | 3      | 7      | 3      |
| Estimated REIT taxable income available to common shareholders           | \$411  | \$489  | \$587  | \$978  |
| Weighted average number of common shares outstanding - basic and diluted | 396.4  | 301.0  | 376.4  | 270.8  |
| Estimated REIT taxable income per common share - basic and diluted       | \$1.04 | \$1.62 | \$1.56 | \$3.61 |

42

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The decrease in our estimated taxable income is primarily a function of lower net interest spreads and a decline in estimated taxable net gains on our investments and hedging instruments.

During the three months ended June 30, 2013 and 2012, we declared common dividends of \$1.05 and \$1.25 per common share, respectively. During the six months ended June 30, 2013 and 2012, we declared common dividends of \$2.30 and \$2.50 per common share, respectively.

During the three months ended June 30, 2013 and 2012, we declared dividends on our Series A Preferred Stock of \$0.500 and \$0.556 per preferred share, respectively. During the six months ended June 30, 2013 and 2012, we declared dividends on our Series A Preferred Stock of \$1.000 and \$0.556 per preferred share, respectively.

As of June 30, 2013, we had distributed all of our 2012 taxable income under the available spill-back provision so that we will not be subject to federal or state corporate income tax for our 2012 tax year. As of June 30, 2013, we had an estimated \$425 million of current year undistributed taxable income, net of dividends declared. We expect to distribute all of our 2013 taxable income within the allowable time frame, including the available spill-back provision, so that we will not be subject to federal or state corporate income tax. However, as a REIT, we are still subject to a nondeductible federal excise tax of 4% to the extent that the sum of (i) 85% of our ordinary taxable income, (ii) 95% of our capital gains and (iii) any undistributed taxable income from the prior year, exceeds our dividends declared in such year and paid by January 31 of the subsequent year. For the three and six months ended June 30, 2012, we accrued a federal excise tax of \$2 million and \$4 million, respectively, which is included in our net income tax provision on our accompanying consolidated statements of comprehensive income. We did not accrue a federal excise tax for the three and six months ended June 30, 2013.

In addition, our TRS is subject to corporate federal and state income taxes at the combined federal and state corporate statutory tax rate of 39.5%. For the three months ended June 30, 2012, we recorded an income tax benefit of \$5 million, attributable to our TRS, which is included in our net income tax provision on our accompanying consolidated statements of comprehensive income. We did not accrue any income tax related to our TRS for the three months ended June 30, 2013. For the six months ended June 30, 2013 and 2012, we recorded an income tax provision of \$10 million and a benefit of \$5 million, respectively, attributable to our TRS, which is included in our net income tax provision on our accompanying consolidated statements of comprehensive income.

#### Other Comprehensive Income

The following table summarizes the components of our other comprehensive income for the three and six months ended June 30, 2013 and 2012 (in millions):

|                                                                                                                 | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|-----------------------------------------------------------------------------------------------------------------|--------------------------------|----------|------------------------------|----------|
|                                                                                                                 | 2013                           | 2012     | 2013                         | 2012     |
| Unrealized (loss) gain on AFS securities, net:                                                                  |                                |          |                              |          |
| Unrealized (loss) gain, net                                                                                     | \$ (2,796 )                    | \$ 1,106 | \$ (3,659 )                  | \$ 1,216 |
| Reversal of prior period unrealized (gain) loss, net, upon realization                                          | (17 )                          | (417 )   | 9                            | (633 )   |
| Unrealized (loss) gain on AFS securities, net:                                                                  | (2,813 )                       | 689      | (3,650 )                     | 583      |
| Unrealized gain on interest rate swaps designated as cash flow hedges:                                          |                                |          |                              |          |
| Reversal of prior period unrealized loss on interest rate swaps, net, upon reclassification to interest expense | 48                             | 52       | 97                           | 104      |
| Total other comprehensive (loss) income                                                                         | \$ (2,765 )                    | \$ 741   | \$ (3,553 )                  | \$ 687   |

#### LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of funds are borrowings under master repurchase agreements, equity offerings, asset sales and monthly principal and interest payments on our investment portfolio. Because the level of our borrowings can be adjusted on a daily basis, the level of cash and cash equivalents carried on the balance sheet is significantly less important than the potential liquidity available under our borrowing arrangements. We currently believe that we have

sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings, maintenance of any margin requirements and the payment of cash dividends as required for our continued qualification as a REIT. To qualify as a REIT, we must distribute annually at least 90% of our taxable income. To the extent that we annually distribute all of our taxable income in a timely manner, we will generally

not be subject to federal and state income taxes. We currently expect to distribute all of our taxable income in a timely manner so that we are not subject to federal and state income taxes. This distribution requirement limits our ability to retain earnings and thereby replenish or increase capital from operations.

#### Equity Capital

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

#### 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"). As of June 30, 2013, we have 3.1 million 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 Preferred Stock or designate additional shares of the Series A Preferred Stock and authorize the issuance of such shares.

#### Follow-on Common Stock Offering

In March 2013, we completed a public offering in which 57.5 million shares of our common stock were sold to the underwriters at a price of \$31.34 per share. Upon completion of the March offering, we received proceeds, net of offering expenses, of approximately \$1.8 billion. The underwriters in the offering sold the shares of our common stock in one or more transactions on the NASDAQ Global Select Market, in the over-the-counter market, through negotiated transactions or otherwise at market prices prevailing at the time of sale.

#### At-the-Market Offering Program

We have entered into sales agreements with sales agents to publicly offer and sell shares of our common stock in privately negotiated and/or at-the-market transactions from time to time. During the six months ended June 30, 2013, we had no sales under this program. As of June 30, 2013, 16.7 million shares remain available for issuance under these sales agreements. The sales agreements will remain in effect until all of the shares are sold under the agreements, subject to early termination rights.

#### Dividend Reinvestment and Direct Stock Purchase Plan

We sponsor a dividend reinvestment and direct stock purchase plan through which stockholders may purchase additional shares of our common stock by reinvesting some or all of the cash dividends received on shares of our common stock. Stockholders may also make optional cash purchases of shares of our common stock subject to certain limitations detailed in the plan prospectus. During the six months ended June 30, 2013, there were no shares issued under the plan. As of June 30, 2013, 21.7 million shares remain under the plan.

#### Common Stock Repurchase Program

In October 2012, our Board of Directors adopted a program that may provide for stock repurchases of up to \$500 million of our outstanding shares of common stock through December 31, 2013. 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 and Exchange Commission. 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 SEC Rule 10b-18, which sets certain restrictions on the method, timing, price and volume of stock repurchases. During the three and six months ended June 30, 2013, we made open market purchases of 0.3 million shares of our common stock at an average repurchase price of \$25.44 per share, or \$7 million. As of June 30, 2013, we had \$416 million remaining available for stock repurchases under the program.



## Debt Capital

As part of our investment strategy, we borrow against our investment portfolio pursuant to master repurchase agreements. We expect that our borrowings under such master repurchase agreements will generally have maturities ranging up to one year, but may have maturities up to five years or longer. Our leverage may vary periodically depending on market conditions and our Manager's assessment of risk and returns. We generally would expect our leverage to be within six to eleven times the amount of our stockholders' equity. However, under certain market conditions, we may operate at leverage levels outside of this range for extended periods of time. Our leverage ratio was 7.0 times the amount of our stockholders' equity as of June 30, 2013, including our agency MBS repurchase agreements, other debt and net payables/receivables for agency securities not yet settled. Our cost of borrowings under master repurchase agreements generally corresponds to LIBOR plus or minus a margin. As of June 30, 2013, our agency MBS repurchase agreements had a weighted average cost of funds of 0.45% and a weighted average original days-to-maturity of 188 days and a remaining weighted average days-to-maturity of 119 days. All measurements exclude amounts borrowed under U.S. Treasury repurchase agreements.

To limit our exposure to counterparty credit risk, we diversify our funding across multiple counterparties and by counterparty region. As of June 30, 2013, we had master repurchase agreements with 33 financial institutions, subject to certain conditions, located throughout North America, Europe and Asia. As of June 30, 2013, less than 3% of our stockholders' equity was at risk with any one repo counterparty, with the top five repo counterparties representing approximately 11% of our stockholders' equity. The table below includes a summary of our repurchase agreement funding by number of repo counterparties and counterparty region as of June 30, 2013. For further details regarding our borrowings under repurchase agreements and other debt as of June 30, 2013, please refer to Note 5 to our consolidated financial statements in this Quarterly Report on Form 10-Q.

| Counter-Party Region | June 30, 2013             |                                         |
|----------------------|---------------------------|-----------------------------------------|
|                      | Number of Counter-Parties | Percent of Repurchase Agreement Funding |
| North America        | 18                        | 58%                                     |
| Asia                 | 5                         | 11%                                     |
| Europe               | 10                        | 31%                                     |
|                      | 33                        | 100%                                    |

Amounts available to be borrowed under our repurchase agreements are dependent upon lender collateral requirements and the lender's determination of the fair value of the securities pledged as collateral, which fluctuates with changes in interest rates, credit quality and liquidity conditions within the investment banking, mortgage finance and real estate industries. In addition, our counterparties apply a "haircut" to our pledged collateral, which means our collateral is valued at slightly less than market value. This haircut reflects the underlying risk of the specific collateral and protects our counterparty against a change in its value, but conversely subjects us to counterparty risk and limits the amount we can borrow against our investment securities. Our master repurchase agreements do not specify the haircut; rather haircuts are determined on an individual repurchase transaction basis. Throughout the three months ended June 30, 2013, haircuts on our pledged collateral remained stable and as of June 30, 2013, our weighted average haircut was less than 5% of the value of our collateral.

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

required to act in good faith in making such valuation determinations. Our repurchase agreements generally provide that in the event of a margin call, we must provide additional securities or cash on the same business day that a margin call is made if the lender provides us notice prior to the margin notice deadline on such day.

As of June 30, 2013, we have met all of our margin requirements and we had unrestricted cash and cash equivalents of \$2.9 billion and unpledged securities of approximately \$3.1 billion, excluding unsettled purchases and sales of securities and including

securities pledged to us, available to meet margin calls on our repurchase agreements and derivative instruments and for other corporate purposes.

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

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

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

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

Excluding centrally cleared interest rate swaps, as of June 30, 2013, our amount at risk with any counterparty related to our interest rate swap and swaption agreements was less than 1% of our stockholders' equity.

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

#### TBA Dollar Roll Transactions

We may also enter into TBA dollar roll transactions as a means of investing in and financing agency securities. TBA dollar roll transactions represent a form of off-balance sheet financing and are accounted for as derivative instruments in our accompanying consolidated financial statements in this Quarterly Report on Form 10-Q. Inclusive of our net TBA position as of June 30, 2013, our total "at risk" leverage, net of unsettled securities, was 8.5 times our stockholders' equity.

Under certain market conditions, it may be uneconomical for us to roll our TBA contracts into future months and we may need to take physical delivery of the underlying securities. If we were required to take physical delivery, we would have to fund our total purchase commitment with cash or other financing sources and our liquidity position could be negatively impacted. As of June 30, 2013, the total cost basis (or forward purchase commitment) and the total market value of our net TBA position was \$15.3 billion and \$14.5 billion, respectively. Our TBA dollar roll contracts are also subject to margin requirements governed by the Mortgage-Backed Securities Division ("MBSD") of the Fixed Income Clearing Corporation and by our prime brokerage agreements, which may establish margin levels in excess of the MBSD. Such provisions require that we establish an initial margin based on the notional value of the TBA contract, which is subject to increase if the estimated fair value of our TBA contract or the estimated fair value of our collateral pledged declines. The MBSD has the sole discretion to determine the value of our TBA contracts and of the pledged collateral securing such contracts. In the event of a margin call, we must generally provide additional

collateral on the same business day.

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

#### Asset Sales and TBA Eligible Securities

We maintain a portfolio of highly liquid agency MBS securities. We may sell our agency MBS securities through the TBA market by delivering securities into TBA contracts for the sale of agency securities, subject to "good delivery" provisions promulgated by the Securities Industry and Financial Markets Association ("SIFMA"). We may alternatively sell agency MBS securities that have more unique attributes on a specified basis when such securities trade at a premium over generic TBA securities or if the securities are not otherwise eligible for TBA delivery. Since the TBA market is the second most liquid market (second to the U.S. Treasury market), maintaining a significant level of agency MBS securities eligible for TBA delivery enhances our liquidity profile and provides price support for our TBA eligible securities in a rising interest rate scenario at or above generic TBA prices. As of June 30, 2013, approximately 95% of our total agency MBS portfolio was eligible for TBA delivery.

#### Off-Balance Sheet Arrangements

As of June 30, 2013, we did not maintain any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, or special purpose or variable interest entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, as of June 30, 2013, we had not guaranteed any obligations of unconsolidated entities or entered into any commitment or intent to provide funding to any such entities.

#### FORWARD-LOOKING STATEMENTS

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

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

##### Interest Rate Risk

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

Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities, by affecting the spread between our interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates can also affect the rate of prepayments of our securities and the value of the agency securities that constitute our investment portfolio, which affects our net income and ability to realize gains from the sale of these assets and impacts our ability and the amount that we can borrow against these securities.

We may utilize a variety of financial instruments in order to limit the effects of changes in interest rates on our operations, including interest rate swap agreements, interest rate swaptions, interest rate cap or floor contracts and futures or forward contracts. We may also purchase or short TBA securities, U.S. Treasury securities and U.S. Treasury futures contracts, purchase or write put or call options on TBA securities or we may invest in other types of mortgage derivative securities, such as interest-only securities. When we use these types of derivatives to hedge our interest-earning assets or interest-bearing liabilities, we may be subject to certain risks, including the risk that losses on a hedge position will reduce the funds available for payments to holders of our common stock and that the losses may exceed the amount we invested in the instruments.

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

Primary measures of an instrument's price sensitivity to interest rate fluctuations are its duration and convexity. The duration of our investment portfolio changes with interest rates and tends to increase when rates rise and decrease when rates fall. This

"negative convexity" generally increases the interest rate exposure of our investment portfolio in excess of what is measured by duration alone.

We estimate the duration and convexity of our portfolio using both a third-party risk management system and market data. We review the duration estimates from the third-party model and may make adjustments based on our Manager's judgment. These adjustments are intended to, in our Manager's opinion, better reflect the unique characteristics and market trading conventions associated with certain types of securities. These adjustments generally result in shorter durations than what the unadjusted third-party model would otherwise produce. Without these adjustments, in rising rate scenarios, the longer unadjusted durations may underestimate price projections on certain securities with slower prepayment characteristics, such as HARP and lower loan balance securities, to a level below those of generic or TBA securities. However, in our Manager's judgment, because these securities are typically deliverable into TBA contracts, the price of these securities is unlikely to drop below the TBA price in rising rate scenarios. The accuracy of the estimated duration of our portfolio and projected agency security prices depends on our Manager's assumptions and judgments. Our Manager may discontinue making these duration adjustments in the future or may choose to make different adjustments. Other models could produce materially different results.

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

All changes in income and value in the table below are measured as percentage changes from the projected net interest income, investment portfolio value and net asset value at the base interest rate scenario. The base interest rate scenario assumes interest rates and prepayment projections as of June 30, 2013. We apply a floor of 0% for the down rate scenarios on our interest bearing liabilities and the variable leg of our interest rate swaps, such that any hypothetical interest rate decrease would have a limited positive impact on our funding costs beyond a certain level.

Actual results could differ materially from estimates, especially in the current market environment. To the extent that these estimates or other assumptions do not hold true, which is likely in a period of high price volatility, actual results will likely differ materially from projections and could be larger or smaller than the estimates in the table below. Moreover, if different models were employed in the analysis, materially different projections could result. Lastly, while the tables below reflect the estimated impact of interest rate increases and decreases on a static portfolio, we may from time to time sell any of our agency securities as a part of our overall management of our investment portfolio.

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

As of June 30, 2013

| Change in Interest Rate | Percentage Change in Projected     |                                           |                                    |
|-------------------------|------------------------------------|-------------------------------------------|------------------------------------|
|                         | Net Interest Income <sup>(2)</sup> | Portfolio Market Value <sup>(3) (4)</sup> | Net Asset Value <sup>(3) (5)</sup> |
| -100 Basis Points       | -2.5%                              | —%                                        | -0.2%                              |
| -50 Basis Points        | +2.9%                              | +0.2%                                     | +1.8%                              |
| +50 Basis Points        | +1.0%                              | -0.3%                                     | -2.8%                              |
| +100 Basis Points       | +1.3%                              | -0.7%                                     | -5.9%                              |

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

2. The estimated dollar change in net interest income expressed as a percent of net interest income based on asset yields and cost of funds as of June 30, 2013. It includes the effect of periodic interest costs on our interest rate swaps that are not designated as hedges under U.S. GAAP, but excludes costs associated with our other supplemental hedges, such as swaptions and short U.S. Treasury or TBA positions, and TBA dollar roll income. Base case scenario assumes interest rates and forecasted CPR of 7% as of June 30, 2013. Rate shock scenarios

assume a forecasted CPR of 6%, 6%, 8% and 9% for the +100 basis points, +50 basis points, - 50 basis points and -100 basis points scenarios, respectively. Estimated dollar change in net interest income does not include the one time impact of retroactive "catch-up" premium amortization benefit/cost due to an increase/decrease in the forecasted CPR. Down rate scenarios assume a floor of 0% for anticipated interest rates.

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

4. Estimated dollar change in investment portfolio value expressed as a percent of the total fair value of our investment portfolio as of June 30, 2013.

5. Estimated dollar change in portfolio value expressed as a percent of stockholders' equity, net of the Series A Preferred Stock liquidation preference, as of June 30, 2013.

#### Prepayment Risk

Premiums and discounts associated with the purchase of agency MBS are amortized or accreted into interest income over the projected lives of the securities, including contractual payments and estimated prepayments using the interest method. Changes

to the GSE's underwriting standards, further modifications to existing U.S. Government sponsored programs such as HARP, or the implementation of new programs could materially impact prepayment speeds. In addition, GSE buyouts of loans in imminent risk of default, loans that have been modified, or loans that have defaulted will generally be reflected as prepayments on agency securities and also increase the uncertainty around these estimates. Our policy for estimating prepayment speeds for calculating the effective yield is to evaluate published prepayment data for similar agency securities, market consensus and current market conditions. If the actual prepayment experienced differs from our estimate of prepayments, we will be required to make an adjustment to the amortization or accretion of premiums and discounts that would have an impact on future income.

#### Spread Risk

When the market spread widens between the yield on our agency securities and benchmark interest rates, our net book value could decline if the value of our agency securities fall by more than the offsetting fair value increases on our hedging instruments tied to the underlying benchmark interest rates. We refer to this as "spread risk" or "basis risk". The spread risk associated with our mortgage assets and the resulting fluctuations in fair value of these securities can occur independent of changes in benchmark interest rates and may relate to other factors impacting the mortgage and fixed income markets, such as actual or anticipated monetary policy actions by the Federal Reserve, market liquidity, or changes in required rates of return on different assets. Consequently, while we use interest rate swaps and other supplemental hedges to attempt to protect against moves in interest rates, such instruments typically will not protect our net book value against spread risk.

The table below quantifies the estimated changes in the fair value of our investment portfolio (including derivatives and other securities used for economic hedging purposes) and in our net asset value should spreads between our mortgage assets and benchmark interest rates go up or down by 10 and 25 basis points. The table assumes a spread duration of 5.7 years based on interest rates and MBS prices as of June 30, 2013; however, our portfolio's sensitivity of mortgage spread changes will vary with changes in interest rates and will generally increase as interest rates rise and prepayments slow, therefore, actual results could differ materially from our estimates, especially in the current market environment. Further, the estimated impact of spread changes included in the table below are in addition to our sensitivity to interest rate shocks included in the interest rate shock table included above.

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

As of June 30, 2013

| Change in MBS Spread | Percentage Change in Projected                  |                                       |
|----------------------|-------------------------------------------------|---------------------------------------|
|                      | Portfolio<br>Market<br>Value <sup>(2) (3)</sup> | Net Asset<br>Value <sup>(2) (4)</sup> |
| -25 Basis Points     | +1.4%                                           | +13%                                  |
| -10 Basis Points     | +0.6%                                           | +5%                                   |
| +10 Basis Points     | -0.6%                                           | -5%                                   |
| +25 Basis Points     | -1.4%                                           | -13%                                  |

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

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

3. Estimated dollar change in investment portfolio value expressed as a percent of the total fair value of our investment portfolio as of June 30, 2013.

4. Estimated dollar change in portfolio value expressed as a percent of stockholders' equity, net of the Series A

Preferred Stock liquidation preference, as of June 30, 2013.

#### Liquidity Risk

The primary liquidity risk for us arises from financing long-term assets with shorter-term borrowings through repurchase agreements. Our assets that are pledged to secure repurchase agreements are agency securities and cash. As of June 30, 2013, we had unrestricted cash and cash equivalents of \$2.9 billion and unpledged securities of approximately \$3.1 billion, excluding unsettled purchases and sales of securities and including securities pledged to us, available to meet margin calls on our repurchase agreements and derivative contracts and for other corporate purposes. However, should the value of our agency securities pledged as collateral or the value of our derivative instruments suddenly decrease, margin calls relating to our repurchase and derivative agreements could increase, causing an adverse change in our liquidity position. Further, there is no assurance that we will always be able to renew (or roll) our repurchase agreements. In addition, our counterparties have the option to increase our haircuts (margin requirements) on the assets we pledge, against repurchase agreements thereby reducing the amount that can be borrowed against an asset even if they agree to renew or roll the repurchase agreement. Significantly higher haircuts can reduce our ability to leverage

our portfolio or even force us to sell assets, especially if correlated with asset price declines or faster prepayment rates on our assets.

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

#### Extension Risk

The projected weighted-average life and the duration (or interest rate sensitivity) of our investments is based on our Manager's assumptions regarding the rate at which the borrowers will prepay the underlying mortgage loans. In general, we use interest rate swaps and swaptions to help manage our funding cost on our investments in the event that interest rates rise. These swaps (or swaptions) allow us to reduce our funding exposure on the notional amount of the swap for a specified period of time by establishing a fixed-rate to pay in exchange for receiving a floating rate that generally tracks our financing costs under our repurchase agreements.

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

#### Counterparty Credit Risk

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

#### Item 4. Controls and Procedures

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

We, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2013. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

**Changes in Internal Controls over Financial Reporting**

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

## PART II. - OTHER INFORMATION

### Item 1. Legal Proceedings

From time to time, we may be involved in various claims and legal actions arising in the ordinary course of business. As of June 30, 2013, we had no legal proceedings.

### Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012.

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

#### Stock Repurchase Program

The following table presents information with respect to purchases of our common stock made during the three months ended June 30, 2013 by us or any “affiliated purchaser” of us, as defined in Rule 10b-18(a)(3) under the Exchange Act (in millions, except per share amounts):

|              | Total Number<br>of Shares<br>Purchased <sup>(1)</sup> | Average Net<br>Price Paid Per<br>Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plans or<br>Programs <sup>(2)</sup> | Maximum Number<br>of Shares That May<br>Yet Be Purchased<br>Under the Publicly<br>Announced Plans or<br>Programs |
|--------------|-------------------------------------------------------|----------------------------------------|-------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------|
| June 4, 2013 | 0.3                                                   | \$25.44                                | 0.3                                                                                                         | N/A                                                                                                              |

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

In October 2012, our Board of Directors adopted a plan that may provide for stock repurchases of up to \$500 million of our outstanding shares of common stock through December 31, 2013. As of June 30, 2013, we had \$416 million remaining available for stock repurchases under the plan.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None.

### Item 6. Exhibits and Financial Statement Tables

(a) Exhibits

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

## Exhibit No. Description

|           |                                                                                                                                                                                                                                                                                           |
|-----------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| *3.1      | American Capital Agency Corp. Amended and Restated Certificate of Incorporation, as amended, incorporated herein by reference to Exhibit 3.1 of Form 10-Q for the quarter ended March 31, 2012 (File No. 001-34057), filed May 9, 2012.                                                   |
| *3.2      | American Capital Agency Corp. Second Amended and Restated Bylaws, as amended, incorporated herein by reference to Exhibit 3.2 of Form 10-K for the year ended December 31, 2011 (File No. 001-34057), filed February 23, 2012.                                                            |
| *3.3      | Certificate of Designations of 8.000% Series A Cumulative Redeemable Preferred Stock, incorporated herein by reference to Exhibit 3.1 of Form 8-K (File No 001-34057), filed April 3, 2012.                                                                                               |
| *4.1      | Instruments defining the rights of holders of securities: See Article IV of our Amended and Restated Certificate of Incorporation, as amended, incorporated herein by reference to Exhibit 3.1 of Form 10-Q for the quarter ended March 31, 2012 (File No. 001-34057), filed May 9, 2012. |
| *4.2      | Instruments defining the rights of holders of securities: See Article VI of our Second Amended and Restated Bylaws, as amended, incorporated herein by reference to Exhibit 3.2 of Form 10-K for the year ended December 31, 2011 (File No. 001-34057), filed February 23, 2012.          |
| *4.3      | Form of Certificate for Common Stock, incorporated herein by reference to Exhibit 4.1 to Amendment No. 4 to the Registration Statement on Form S-11 (Registration No. 333-149167), filed May 9, 2008.                                                                                     |
| *4.4      | Specimen 8.000% Series A Cumulative Redeemable Preferred Stock Certificate, incorporated herein by reference to Exhibit 4.1 of Form 8-K (File No. 001-34057), filed April 3, 2012.                                                                                                        |
| 12.1      | Computation of ratio of earnings to combined fixed charges and preferred stock dividends and ratio of earnings to fixed charges.                                                                                                                                                          |
| 31.1      | Certification of CEO Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                        |
| 31.2      | Certification of CFO Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                        |
| 32        | Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                   |
| 101.INS** | XBRL Instance Document                                                                                                                                                                                                                                                                    |
| 101.SCH** | XBRL Taxonomy Extension Schema Document                                                                                                                                                                                                                                                   |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase Document                                                                                                                                                                                                                                     |
| 101.LAB** | XBRL Taxonomy Extension Labels Linkbase Document                                                                                                                                                                                                                                          |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase Document                                                                                                                                                                                                                                    |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase Document                                                                                                                                                                                                                                      |

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\* Previously filed

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

(b) Exhibits

See the exhibits filed herewith.

(c) Additional financial statement schedules

NONE

SIGNATURES

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

AMERICAN CAPITAL AGENCY CORP.

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

Date: August 8, 2013