

ANNALY CAPITAL MANAGEMENT INC  
Form 10-Q  
May 08, 2014

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

---

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: MARCH 31, 2014

OR

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NUMBER: 1-13447

ANNALY CAPITAL MANAGEMENT, INC.  
(Exact name of Registrant as specified in its Charter)

MARYLAND  
(State or other jurisdiction of incorporation or  
organization)

22-3479661  
(IRS Employer Identification No.)

1211 AVENUE OF THE AMERICAS, SUITE 2902  
NEW YORK, NEW YORK  
(Address of principal executive offices)

10036  
(Zip Code)

(212) 696-0100  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate 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



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the last practicable date:

Class	Outstanding at April 30, 2014
Common Stock, \$.01 par value	947,503,334

ANNALY CAPITAL MANAGEMENT, INC.  
FORM 10-Q  
TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

	Page
<u>Item 1. Financial Statements</u>	
<u>Consolidated Statements of Financial Condition at March 31, 2014 (Unaudited) and December 31, 2013 (Derived from the audited consolidated financial statements at December 31, 2013)</u>	1
<u>Consolidated Statements of Comprehensive Income (Loss) (Unaudited) for the quarters ended March 31, 2014 and 2013</u>	2
<u>Consolidated Statements of Stockholders' Equity (Unaudited) for the quarters ended March 31, 2014 and 2013</u>	3
<u>Consolidated Statements of Cash Flows (Unaudited) for the quarters ended March 31, 2014 and 2013</u>	4
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	
<u>Note 1. Description of Business</u>	6
<u>Note 2. Basis of Presentation</u>	6
<u>Note 3. Significant Accounting Policies</u>	6
<u>Note 4. Agency Mortgage-backed Securities</u>	14
<u>Note 5. Acquisition of Crexus</u>	15
<u>Note 6. Commercial Real Estate Investments</u>	17
<u>Note 7. Fair Value Measurements</u>	19
<u>Note 8. Secured Financing</u>	22
<u>Note 9. Derivative Instruments</u>	22
<u>Note 10. Convertible Senior Notes</u>	26
<u>Note 11. Common Stock and Preferred Stock</u>	27
<u>Note 12. Goodwill</u>	28
<u>Note 13. Interest Income and Interest Expense</u>	28
<u>Note 14. Net Income (Loss) per Common Share</u>	29
<u>Note 15. Long-term Stock Incentive Plan</u>	30
<u>Note 16. Income Taxes</u>	30
<u>Note 17. Lease Commitments and Contingencies</u>	31
<u>Note 18. Risk Management</u>	31
<u>Note 19. RCap Regulatory Requirements</u>	32
<u>Note 20. Related Party Transactions</u>	32
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
<u>Special Note Regarding Forward-Looking Statements</u>	33
<u>Overview</u>	35
<u>Business Environment</u>	35
<u>Results of Operations</u>	36
<u>Financial Condition</u>	42
<u>Capital Management</u>	45
<u>Risk Management</u>	47

<u>Critical Accounting Policies</u>	55
<u>Glossary of Terms</u>	56
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	63
<u>Item 4. Controls and Procedures</u>	63
<u>PART II - OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	64
<u>Item 1A. Risk Factors</u>	64
<u>Item 6. Exhibits</u>	65
<u>SIGNATURES</u>	67

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(dollars in thousands, except per share data)

	March 31, 2014 (Unaudited)	December 31, 2013(1)
<b>ASSETS</b>		
Cash and cash equivalents	\$924,197	\$552,436
Reverse repurchase agreements	444,375	100,000
Securities borrowed	513,500	2,582,893
Investments, at fair value:		
U.S. Treasury securities (including pledged assets of \$0 and \$1,113,027, respectively)	-	1,117,915
Agency mortgage-backed securities (including pledged assets of \$66,110,869 and \$63,897,873, respectively)	75,350,388	70,388,949
Agency debentures (including pledged assets of \$2,368,493 and \$2,931,261, respectively)	2,408,259	2,969,885
Investment in affiliates	137,647	139,447
Commercial real estate debt and preferred equity(2)	1,640,206	1,583,969
Investments in commercial real estate	40,313	60,132
Corporate debt, held for investment	145,394	117,687
Receivable for investments sold	19,116	1,193,730
Accrued interest and dividends receivable	276,007	273,079
Receivable for investment advisory income (including from affiliates of \$6,498 and \$6,839, respectively)	6,498	6,839
Goodwill	94,781	94,781
Interest rate swaps, at fair value	340,890	559,044
Other derivatives, at fair value	40,105	146,725
Other assets	33,101	34,949
<b>Total assets</b>	<b>\$82,414,777</b>	<b>\$81,922,460</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
U.S. Treasury securities sold, not yet purchased, at fair value	\$-	\$1,918,394
Repurchase agreements	64,543,949	61,781,001
Securities loaned	513,510	2,527,668
Payable for investments purchased	1,898,507	764,131
Convertible Senior Notes	827,486	825,262
Securitized debt of consolidated VIE	260,700	-

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Mortgages payable	19,317	19,332
Participation sold	13,963	14,065
Accrued interest payable	170,644	160,921
Dividends payable	284,247	284,230
Interest rate swaps, at fair value	1,272,616	1,141,828
Other derivatives, at fair value	6,045	55,518
Accounts payable and other liabilities	39,081	25,055
<b>Total liabilities</b>	<b>69,850,065</b>	<b>69,517,405</b>
<b>Stockholders' Equity:</b>		
7.875% Series A Cumulative Redeemable Preferred Stock: 7,412,500 authorized, issued and outstanding	177,088	177,088
7.625% Series C Cumulative Redeemable Preferred Stock: 12,650,000 authorized, 12,000,000 issued and outstanding	290,514	290,514
7.50% Series D Cumulative Redeemable Preferred Stock: 18,400,000 authorized, issued and outstanding	445,457	445,457
Common stock, par value \$0.01 per share, 1,956,937,500 authorized, 947,488,945 and 947,432,862 issued and outstanding, respectively	9,475	9,474
Additional paid-in capital	14,770,553	14,765,761
Accumulated other comprehensive income (loss)	(2,088,479 )	(2,748,933 )
Accumulated deficit	(1,039,896 )	(534,306 )
<b>Total stockholders' equity</b>	<b>12,564,712</b>	<b>12,405,055</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$82,414,777</b>	<b>\$81,922,460</b>

(1) Derived from the audited consolidated financial statements at December 31, 2013.

(2) Includes senior securitized mortgages of consolidated VIE with a carrying value of \$398.1 million at March 31, 2014.

See notes to consolidated financial statements.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(dollars in thousands, except per share data)

(Unaudited)

	For the Quarter Ended	
	March 31, 2014	March 31, 2013
Net interest income:		
Interest income	\$ 655,901	\$ 737,217
Interest expense	124,971	177,590
Net interest income	530,930	559,627
Other income (loss):		
Realized gains (losses) on interest rate swaps(1)	(260,435 )	(225,476 )
Realized gains (losses) on termination of interest rate swaps	(6,842 )	(16,378 )
Unrealized gains (losses) on interest rate swaps	(348,942 )	325,734
Subtotal	(616,219 )	83,880
Investment advisory income	6,123	13,408
Net gains (losses) on disposal of investments	79,710	182,843
Dividend income from affiliates	13,045	6,431
Net gains (losses) on trading assets	(146,228 )	1,549
Net unrealized gains (losses) on interest-only Agency mortgage-backed securities	(20,793 )	80,127
Other income (loss)	1,460	132
Subtotal	(66,683 )	284,490
Total other income (loss)	(682,902 )	368,370
General and administrative expenses:		
Compensation and management fee	38,521	38,443
Other general and administrative expenses	8,857	13,469
Total general and administrative expenses	47,378	51,912
Income (loss) before income taxes	(199,350 )	876,085
Income taxes	4,001	5,807
Net income (loss)	(203,351 )	870,278
Dividends on preferred stock	17,992	17,992
Net income (loss) available (related) to common stockholders	\$ (221,343 )	\$ 852,286



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Net income (loss) per share available (related) to common stockholders:

Basic	\$	(0.23 )	\$	0.90
Diluted	\$	(0.23 )	\$	0.87

Weighted average number of common shares outstanding:

Basic	947,458,813	947,249,901
Diluted	947,458,813	994,815,169

Dividends Declared Per Share of Common Stock	\$	0.30	\$	0.45
--	----	------	----	------

Net income (loss)	\$	(203,351 )	\$	870,278
-------------------	----	------------	----	---------

Other comprehensive income (loss):

Unrealized gains (losses) on available-for-sale securities	741,172	(867,151 )		
Reclassification adjustment for net (gains) losses included in net income (loss)	(80,718 )	(182,843 )		
Other comprehensive income (loss)	660,454	(1,049,994 )		
Comprehensive income (loss)	\$	457,103	\$	(179,716 )

(1) Interest expense related to the Company's interest rate swaps is recorded in Realized gains (losses) on interest rate swaps.

See notes to consolidated financial statements.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(dollars in thousands, except per share data)

(Unaudited)

	7.875% Series A Cumulative Redeemable Preferred Stock	7.625% Series C Cumulative Redeemable Preferred Stock	7.50% Series D Cumulative Redeemable Preferred Stock	Common Stock Par Value	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
BALANCE, December 31, 2012	\$177,088	\$290,514	\$445,457	\$9,472	\$14,740,774	\$3,053,242	\$(2,792,103)	\$15,924,444
Net income (loss)	-	-	-	-	-	-	870,278	870,278
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	(867,151 )	-	(867,151 )
Reclassification adjustment for net (gains) losses included in net income (loss)	-	-	-	-	-	(182,843 )	-	(182,843 )
Exercise of stock options	-	-	-	-	265	-	-	265
Stock compensation expense	-	-	-	-	817	-	-	817
Net proceeds from direct purchase and dividend reinvestment	-	-	-	1	760	-	-	761
Contingent beneficial conversion feature on 4% Convertible Senior Notes	-	-	-	-	3,963	-	-	3,963
Preferred Series A dividends, declared \$0.492 per share	-	-	-	-	-	-	(3,648 )	(3,648 )

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Preferred Series C dividends, declared \$0.477 per share	-	-	-	-	-	-	(5,719 )	(5,719 )
Preferred Series D dividends, declared \$0.469 per share	-	-	-	-	-	-	(8,625 )	(8,625 )
Common dividends declared, \$0.45 per share	-	-	-	-	-	-	(426,173 )	(426,173 )
BALANCE, March 31, 2013	\$177,088	\$290,514	\$445,457	\$9,473	\$14,746,579	\$2,003,248	\$(2,365,990)	\$15,306,369
BALANCE, December 31, 2013	\$177,088	\$290,514	\$445,457	\$9,474	\$14,765,761	\$(2,748,933)	\$(534,306 )	\$12,405,055
Net income (loss)	-	-	-	-	-	-	(203,351 )	(203,351 )
Unrealized gains (losses) on available-for-sale securities	-	-	-	-	-	741,172	-	741,172
Reclassification adjustment for net (gains) losses included in net income (loss)	-	-	-	-	-	(80,718 )	-	(80,718 )
Net proceeds from direct purchase and dividend reinvestment	-	-	-	1	606	-	-	607
Contingent beneficial conversion feature on 4% Convertible Senior Notes	-	-	-	-	4,186	-	-	4,186
Preferred Series A dividends, declared \$0.492 per share	-	-	-	-	-	-	(3,648 )	(3,648 )
Preferred Series C dividends, declared \$0.477 per share	-	-	-	-	-	-	(5,719 )	(5,719 )
Preferred Series D dividends, declared \$0.469	-	-	-	-	-	-	(8,625 )	(8,625 )

per share

Common									
dividends									
declared, \$0.30									
per share	-	-	-	-	-	-	(284,247 )	(284,247 )	

BALANCE,

March 31, 2014	\$177,088	\$290,514	\$445,457	\$9,475	\$14,770,553	\$(2,088,479)	\$(1,039,896)	\$12,564,712	
----------------	-----------	-----------	-----------	---------	--------------	---------------	---------------	--------------	--

See notes to consolidated financial statements.

3

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

(Unaudited)

	For the Quarter Ended March	
	2014	2013
Cash flows from operating activities:		
Net income (loss)	\$(203,351 )	\$870,278
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization of Investment Securities premiums and discounts, net	118,988	421,057
Amortization of commercial real estate investment premiums and discounts, net	792	-
Amortization of intangibles	99	323
Amortization of deferred financing costs	2,813	2,038
Amortization of net origination fees and costs, net	(973 )	-
Amortization of contingent beneficial conversion feature and equity component of Convertible Senior Notes	6,410	3,324
Depreciation expense	292	-
Net gain on sale of commercial real estate	(1,213 )	-
Net (gains) losses on sales of Agency mortgage-backed securities and debentures	(80,718 )	(182,843 )
Stock compensation expense	-	817
Unrealized (gains) losses on interest rate swaps	348,942	(325,734 )
Net unrealized (gains) losses on interest-only Agency mortgage-backed securities	20,793	(80,127 )
Net (gains) losses on trading assets	146,228	14,829
Proceeds from repurchase agreements of RCap	329,649,937	237,569,485
Payments on repurchase agreements of RCap	(324,602,992)	(238,600,415)
Proceeds from reverse repurchase agreements	35,181,890	105,335,861
Payments on reverse repurchase agreements	(35,526,265 )	(108,458,231)
Proceeds from securities borrowed	19,993,580	53,799,157
Payments on securities borrowed	(17,924,187 )	(54,326,700 )
Proceeds from securities loaned	37,178,735	110,725,140
Payments on securities loaned	(39,192,893 )	(110,203,395)
Proceeds from U.S. Treasury securities	3,159,253	21,683,636
Payments on U.S. Treasury securities	(3,920,425 )	(22,157,117 )
Net payments on derivatives	(90,440 )	(1,490 )
Net change in:		
Due to / from brokers	8,596	-
Other assets	3,439	(14,779 )
Accrued interest and dividends receivable	(16,035 )	22,616
Receivable for investment advisory income	341	4,913
Accrued interest payable	25,032	(11,147 )
Accounts payable and other liabilities	13,801	26,250
Net cash provided by (used in) operating activities	4,300,469	(3,882,254 )

## Cash flows from investing activities:

Payments on purchases of Agency mortgage-backed securities and debentures	(9,367,034 )	(17,699,472 )
Proceeds from sales of Agency mortgage-backed securities and debentures	6,155,091	15,484,409
Principal payments on Agency mortgage-backed securities	1,675,575	8,514,074
Proceeds from Agency debentures called	-	847,205
Payments on purchases of corporate debt	(28,705 )	(3,483 )
Principal payments on corporate debt	1,051	911
Origination of commercial real estate investments, net	(125,949 )	-
Proceeds from sales of commercial real estate held for sale	20,740	-
Principal payments on commercial real estate investments	69,795	-
Proceeds from derivatives	-	7,465
Net cash provided by (used in) investing activities	(1,599,436 )	7,151,109

Statements continued on following page.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Financial Statements

Cash flows from financing activities:		
Proceeds from repurchase agreements	49,726,537	101,631,583
Principal payments on repurchase agreements	(52,010,534)	(103,063,408)
Proceeds from issuance of securitized debt	260,700	-
Payment of deferred financing cost	(4,288 )	-
Proceeds from exercise of stock options	-	265
Net proceeds from direct purchases and dividend reinvestments	607	761
Payments on participation sold	(72 )	-
Net payment on share repurchase	-	(141,149 )
Dividends paid	(302,222 )	(450,146 )
Net cash provided by (used in) financing activities	(2,329,272 )	(2,022,094 )
Net (decrease) increase in cash and cash equivalents	371,761	1,246,761
Cash and cash equivalents, beginning of period	552,436	615,789
Cash and cash equivalents, end of period	\$924,197	\$1,862,550
	-	-
Supplemental disclosure of cash flow information:		
Interest received	\$769,627	\$1,188,202
Dividends received	\$13,045	\$7,097
Investment advisory income received	\$6,464	\$18,321
Interest paid (excluding interest paid on interest rate swaps)	\$118,131	\$184,426
Net interest paid on interest rate swaps	\$250,571	\$226,463
Taxes paid	\$2,137	\$2,382
Noncash investing activities:		
Receivable for investments sold	\$19,116	\$1,292,478
Payable for investments purchased	\$1,898,507	\$3,203,461
Net change in unrealized gains (losses) on available-for-sale securities, net of reclassification adjustment	\$660,454	\$(1,049,994 )
Noncash financing activities:		
Dividends declared, not yet paid	\$284,247	\$426,173
Contingent beneficial conversion feature on 4% Convertible Senior Notes	\$4,186	\$3,963

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Notes to Consolidated Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

---

1. DESCRIPTION OF BUSINESS

Annaly Capital Management, Inc. (the “Company” or “Annaly”) is a Maryland corporation that commenced operations on February 18, 1997. The Company owns a portfolio of real estate related investments, including mortgage pass-through certificates, collateralized mortgage obligations, agency callable debentures, other securities representing interests in or obligations backed by pools of mortgage loans, commercial real estate assets and corporate loans. The Company’s principal business objective is to generate net income for distribution to its stockholders from its investments.

The Company’s business operations are primarily comprised of the following:

- Annaly, the parent company, which invests primarily in various types of Agency mortgage-backed securities and related derivatives to hedge these investments.
- Annaly Commercial Real Estate Group, Inc. (“ACREG,” formerly known as CreXus Investment Corp. (“CreXus”)), a wholly-owned subsidiary that was acquired during the second quarter of 2013 which specializes in acquiring, financing and managing commercial mortgage loans and other commercial real estate debt, commercial mortgage-backed securities and other commercial real estate-related assets.
- RCap Securities, Inc. (“RCap”), a wholly-owned subsidiary which operates as a broker-dealer, and is a member of the Financial Industry Regulatory Authority (“FINRA”).
- Fixed Income Discount Advisory Company (“FIDAC”), a wholly-owned subsidiary which manages an affiliated real estate investment trust (“REIT”) for which it earns fee income.
- Annaly Middle Market Lending LLC (formerly known as Charlesfort Capital Management LLC), a wholly-owned subsidiary which engages in corporate middle market lending transactions.

2. BASIS OF PRESENTATION

The accompanying consolidated financial statements and related notes of the Company have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”).

The accompanying consolidated financial statements and related notes are unaudited and should be read in conjunction with the audited consolidated financial statements included in the Company’s most recent annual report on Form 10-K. The consolidated financial information as of December 31, 2013 has been derived from audited consolidated financial statements not included herein.

In the opinion of management, all normal, recurring adjustments have been included for a fair statement of this interim financial information. Interim period operating results may not be indicative of the operating results for a full year.

3. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation – The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

The Company has evaluated all of its investments in legal entities in order to determine if they are variable interests in Variable Interest Entities (“VIEs”). A VIE is defined as an entity in which equity investors (i) do not have the characteristics of a controlling financial interest, and/or (ii) do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. A variable interest is an investment or other interest that



- Shannon Funding LLC (“Shannon”), a wholly-owned subsidiary which acquires residential mortgage loans and provides warehouse financing to residential mortgage originators in the United States.

The Company has elected to be taxed as a REIT as defined under the Internal Revenue Code of 1986, as amended, and regulations promulgated thereunder (the “Code”). The Company is externally managed by Annaly Management Company LLC (the “Manager”).

will absorb portions of a VIE's expected losses or receive portions of the entity's expected residual returns. A VIE is required to be consolidated by its primary beneficiary, which is defined as the party that (i) has the power to control the activities that most significantly impact the VIE's economic performance and (ii) has the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Notes to Consolidated Financial Statements

To assess whether the Company has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, the Company considers all facts and circumstances, including the Company's role in establishing the VIE and the Company's ongoing rights and responsibilities. This assessment includes first, identifying the activities that most significantly impact the VIE's economic performance; and second, identifying which party, if any, has power over those activities. In general, the parties that make the most significant decisions affecting the VIE or have the right to unilaterally remove those decision makers are deemed to have the power to direct the activities of a VIE.

To assess whether the Company has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, the Company considers all of the Company's economic interests, including debt and equity investments and other arrangements deemed to be variable interests in the VIE. This assessment requires that the Company applies judgment in determining whether these interests, in the aggregate, are considered potentially significant to the VIE. Factors considered in assessing significance include: the design of the VIE, including its capitalization structure; subordination of interests; payment priority; relative share of interests held across various classes within the VIE's capital structure; and the reasons why the interests are held by the Company.

The Company performs ongoing reassessments of whether changes in the facts and circumstances regarding the Company's involvement with a VIE causes the Company's consolidation conclusion regarding the VIE to change.

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand and cash held in money market funds on an overnight basis. RCap is a member of various clearing organizations with which it maintains cash required for the conduct of its day-to-day clearance activities. Cash and securities deposited with clearing organizations are carried at cost, which approximates fair value. The Company also maintains collateral in the form of cash on margin with counterparties to its interest

Revenue Recognition – The revenue recognition policy by asset class is discussed below.

Agency Mortgage-Backed Securities and Agency Debentures – The Company invests primarily in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans and certificates guaranteed by the Government National Mortgage Association (“Ginnie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”) or the Federal National Mortgage Association (“Fannie Mae”) (collectively, “Agency mortgage-backed securities”). These Agency mortgage-backed securities may include forward contracts for Agency mortgage-backed securities purchases or sales of a generic pool, on a to-be-announced basis (“TBA securities”). The Company also invests in Agency debentures issued by the Federal Home Loan Banks, Freddie Mac and Fannie Mae.

Agency mortgage-backed securities and Agency debentures are referred to herein as “Investment Securities.”

Although the Company generally intends to hold most of its Investment Securities until maturity, it may, from time to time, sell any of its Investment Securities as part of its overall management of its portfolio. Investment Securities are classified as available-for-sale and are reported at fair values estimated by management that are compared to independent sources for reasonableness, with unrealized gains and losses reported as a component of other comprehensive income (loss). Investment Securities transactions are recorded on trade date, including TBA securities that meet the regular-way securities scope exception from derivative accounting. Realized gains and losses on sales of Investment Securities are determined using the average cost method.

On April 1, 2011, the Company elected the fair value option for Agency interest-only mortgage-backed securities acquired on or after such date. Interest-only securities and inverse interest-only securities are collectively referred to as “interest-only securities.” These

rate swaps and other derivatives. Cash and securities deposited with clearing organizations and collateral held in the form of cash on margin with counterparties to its interest rate swaps and other derivatives totaled \$755.5 million and \$371.8 million at March 31, 2014 and December 31, 2013, respectively.

Fair Value Measurements – The Company carries various financial instruments at fair value. A complete discussion of the methodology utilized by the Company to estimate the fair value of certain financial instruments is included in the notes to these consolidated financial statements.

Agency interest-only mortgage-backed securities represent the Company's right to receive a specified proportion of the contractual interest flows of specific Agency mortgage-backed securities. Agency interest-only mortgage-backed securities acquired on or after April 1, 2011 are measured at fair value with changes in fair value recorded as Net unrealized gains (losses) on interest-only Agency mortgage-backed securities in the Company's Consolidated Statements of Comprehensive Income (Loss). The interest-only securities are included in Agency mortgage-backed securities at fair value on the accompanying Consolidated Statements of Financial Condition.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Notes to Consolidated Financial Statements

Interest income from coupon payments is accrued based on the outstanding principal amounts of the Investment Securities and their contractual terms. Premiums and discounts associated with the purchase of the Investment Securities are amortized or accreted into interest income over the projected lives of the securities using the interest method. The Company's policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, consensus prepayment speeds and current market conditions. Adjustments are made for actual prepayment activity.

**Corporate Debt** – The Company's investments in corporate debt are designated as held for investment, and are carried at their principal balance outstanding plus any premiums or discounts less allowances for loan losses. No allowance for loan losses was deemed necessary as of March 31, 2014 and December 31, 2013.

**Equity Securities** – The Company may invest in equity securities that are classified as available-for-sale or trading. Equity securities classified as available-for-sale are reported at fair value, based on market quotes, with unrealized gains and losses reported as a component of other comprehensive income (loss). Equity securities classified as trading are reported at fair value, based on market quotes, with unrealized gains and losses reported in the Consolidated Statements of Comprehensive Income (Loss) as Net gains (losses) on trading assets. Dividends are recorded in earnings based on the declaration date.

**Derivative Instruments** – The Company may use a variety of derivative instruments to economically hedge some of its exposure to market risks, including interest rate and prepayment risk. These instruments include, but are not limited to, interest rate swaps, options to enter into interest rate swaps ("swaptions"), TBA securities with the intent to net settle ("TBA derivatives"), options on TBA securities ("MBS options") and U.S. Treasury futures contracts. The Company may also 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. Derivatives are accounted for in accordance with the Financial

Some derivative agreements contain provisions that allow for netting or setting off by counterparty; however, beginning on September 30, 2013, the Company elected to present related assets and liabilities on a gross basis in the Consolidated Statements of Financial Condition. Prior to September 30, 2013, the Company presented in the Consolidated Statements of Financial Condition the fair value of interest rate swap contracts net, by counterparty, if the derivative agreements included netting provisions.

**Interest rate swap agreements** - Interest rate swaps are the primary instrument used to mitigate interest rate risk. In particular, the Company uses interest rate swaps to manage its exposure to changing interest rates on its repurchase agreements by economically hedging cash flows associated with these borrowings. Swap agreements may be over-the-counter ("OTC") agreements which are negotiated directly with a counterparty, or centrally cleared through a registered commodities exchange. OTC swaps are fair valued using internal pricing models and compared to the counterparty market values. Centrally cleared swaps are fair valued using internal pricing models and compared to the exchange market values.

**Interest rate swaptions** - Interest rate swaptions are purchased to mitigate the potential impact of increases or decreases in interest rates. Interest rate swaptions provide 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. They are not centrally cleared. The premium paid for interest rate swaptions is reported as an asset in the Consolidated Statement of Financial Position. The difference between the premium and the fair value of the swaption is reported in Net gain (loss) on trading assets in the Consolidated Statements of Comprehensive Income (Loss). If a swaption expires unexercised, the realized gain (loss) on the swaption would be equal to the premium paid. If the Company sells or exercises a swaption, the realized gain or loss on the swaption would be equal to the difference between the cash received or the fair value of the underlying interest rate swap received and the premium paid.

Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 815, Derivatives and Hedging, which requires recognition of all derivatives as either assets or liabilities at fair value in the Consolidated Statements of Financial Condition with changes in fair value recognized in the Consolidated Statements of Comprehensive Income (Loss).

The fair value of interest rate swaptions is estimated using internal pricing models and compared to the counterparty market value.

TBA Dollar Rolls - TBA dollar roll transactions are accounted for as a series of derivative transactions. The fair value of TBA derivatives is based on similar methods used to value Agency mortgage-backed securities with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Notes to Consolidated Financial Statements

**MBS Options** – MBS options are generally options on TBA contracts, which help manage mortgage market risks and volatility while providing the potential to enhance returns. MBS options are over-the-counter traded instruments and those written on current-coupon mortgage-backed securities are typically the most liquid. MBS options are fair valued using internal pricing models and compared to the counterparty market value at the valuation date with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

**U.S. Treasury Futures** - U.S. Treasury futures contracts are derivatives that track the prices of specific U.S. Treasury securities. Short sales of U.S. Treasury futures contracts help mitigate the potential impact of changes in interest rates on the portfolio performance. The Company maintains a margin account which is settled daily with Futures Commission Merchants (“FCMs”). The margin requirement varies based on the market value of the open positions and the equity retained in the account. Futures contracts are fair valued based on exchange pricing with gains and losses recorded in Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

**Other-Than-Temporary Impairment** – Management evaluates available-for-sale securities for other-than-temporary impairment at least quarterly, and more frequently when economic or market conditions warrant such evaluation. When the fair value of an available-for-sale security is less than its amortized cost the security is considered impaired. For securities that are impaired, the Company determines if it (1) has the intent to sell the security, (2) is more likely than not that it will be required to sell the security before recovery of its amortized cost basis, or (3) does not expect to recover the entire amortized cost basis of the security. Further, the security is analyzed for credit loss (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the Consolidated Statements of Comprehensive Income (Loss), while the balance of losses related to other factors will be recognized as a component of other comprehensive

**Repurchase Agreements** – The Company finances the acquisition of a significant portion of its Agency mortgage-backed securities with repurchase agreements. The Company examines each of the specified criteria in ASC 860, Transfers and Servicing, at the inception of each transaction and has determined that each of the financings meet the specified criteria in this guidance. None of the Company’s repurchase agreements are accounted for as components of linked transactions. As a result, the Company separately accounts for the financial assets and related repurchase financings in the accompanying consolidated financial statements.

**Reverse repurchase agreements and repurchase agreements with the same counterparty and the same maturity** are presented net in the Consolidated Statements of Financial Condition when the terms of the agreements permit netting. The Company reports cash flows on repurchase agreements as financing activities in the Consolidated Statements of Cash Flows. The Company reports cash flows on reverse repurchase and repurchase agreements entered into by RCap and Shannon as operating activities in the Consolidated Statements of Cash Flows.

**Goodwill and Intangible Assets** – The Company’s acquisitions of FIDAC, Merganser Capital Management, Inc. (“Merganser”) and CreXus were accounted for using the acquisition method. In October 2013, the Company sold the operations of Merganser. Under the acquisition method, net assets and results of operations of acquired companies are included in the consolidated financial statements from the date of acquisition. The costs of FIDAC, Merganser and CreXus were allocated to the assets acquired, including identifiable intangible assets, and the liabilities assumed based on their estimated fair values at the date of acquisition. The excess of purchase price over the fair value of the net assets acquired was recognized as goodwill.

The Company tests goodwill for impairment on an annual basis and at interim periods when events or circumstances may make it more likely than not that an impairment has occurred. If a qualitative analysis indicates that there may be an impairment, a quantitative analysis is performed. The quantitative impairment test

income (loss). There was no other-than-temporary impairment recognized for the quarters ended March 31, 2014 and December 31, 2013.

**Loan Loss Reserves** – To determine if loan loss allowances are required on investments in corporate debt, the Company reviews the monthly and/or quarterly financial statements of the borrowers to verify they meet the covenants of the loan documents. If based on the financial review it is deemed probable that the Company will be unable to collect contractual principal and interest amounts (e.g. financial performance and delinquencies), a loan loss provision would be recorded. No allowance for loan losses was deemed necessary as of March 31, 2014 and December 31, 2013.

for goodwill utilizes a two-step approach, whereby the Company compares the carrying value of each identified reporting unit to its fair value. If the carrying value of the reporting unit is greater than its fair value, the second step is performed, where the implied fair value of goodwill is compared to its carrying value. The Company recognizes an impairment charge for the amount by which the carrying amount of goodwill exceeds its fair value.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Notes to Consolidated Financial Statements

Intangible assets with an estimated useful life are amortized over the expected life.

Convertible Senior Notes – The Company records the 4% Convertible Senior Notes and 5% Convertible Senior Notes (collectively, the “Convertible Senior Notes”) at their contractual amounts, adjusted by the effects of a beneficial conversion feature and a contingent beneficial conversion feature (collectively, the “Conversion Features”). The Conversion Features’ intrinsic value is included in “Additional paid-in capital” on the Company’s Consolidated Statements of Financial Condition and reduces the recorded liability amount associated with the Convertible Senior Notes. A Conversion Feature may be recognized as a result of adjustments to the conversion price for dividends declared to common stockholders.

Stock Based Compensation – The Company is required to measure and recognize in the consolidated financial statements the compensation cost relating to share-based payment transactions. The Company recognizes compensation expense on a straight-line basis over the requisite service period for the entire award.

Income Taxes – The Company has elected to be taxed as a REIT and intends to comply with the provisions of the Code, with respect thereto. Accordingly, the Company will not be subjected to federal income tax to the extent of its distributions to stockholders and as long as certain asset, income and stock ownership tests are met. The Company and certain of its direct and indirect subsidiaries, including FIDAC, RCap and certain subsidiaries of ACREG, have made separate joint elections to treat these subsidiaries as taxable REIT subsidiaries (“TRS”). As such, each of these TRS is taxable as a domestic C corporation and subject to federal, state and local income taxes based upon their taxable income.

The provisions of ASC 740, Income Taxes, (“ASC 740”) clarify the accounting for uncertainty in income taxes recognized in financial statements and prescribe a recognition threshold and measurement attribute for

Commercial Real Estate Investments

Commercial Real Estate Loans – The Company's commercial real estate mortgages and loans are comprised of fixed-rate and adjustable-rate loans. Commercial real estate mortgages and loans are designated as held for investment and are carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less a reserve for estimated losses if necessary. Origination fees and costs, premiums and discounts are amortized or accreted into interest income over the estimated life of the loan. The difference between the principal amount of a loan and proceeds at acquisition is recorded as either a discount or premium.

Preferred Equity Interests Held for Investment – Preferred equity interests are designated as held for investment and are carried at their outstanding principal balance, net of unamortized origination fees and costs, premiums or discounts, less a reserve for estimated losses if necessary. Origination fees and costs, premiums and discounts are amortized or accreted into interest income over the estimated life of the investment.

Allowance for Losses – The Company evaluates the need for a loss reserve on its commercial real estate mortgages, loans and preferred equity interests held for investment (collectively referred to as “CRE Debt and Preferred Equity Investments”). A provision for losses related to CRE Debt and Preferred Equity Investments, including those accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, may be established when it is probable the Company will not collect amounts contractually due or all amounts previously estimated to be collectable. Management assesses the credit quality of the portfolio and adequacy of loan loss reserves on a quarterly basis, or more frequently as necessary. Significant judgment is required in this analysis. Depending on the expected recovery of its investment, the Company considers the estimated net recoverable value of the CRE Debt and Preferred Equity Investments as well as other factors, including but not limited to the fair value of any



uncertain tax positions taken or expected to be taken on a tax return. ASC 740 also requires that interest and penalties related to unrecognized tax benefits be recognized in the financial statements. The Company does not have any unrecognized tax benefits that would affect its financial position. Thus, no accruals for penalties and interest were necessary as of March 31, 2014 and December 31, 2013.

Use of Estimates – The preparation of the consolidated 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

collateral, the amount and the status of any senior debt, the prospects for the borrower and the competitive landscape where the borrower conducts business. Because this determination is based upon projections of future economic events, which are inherently subjective, the amounts ultimately realized may differ materially from the carrying value as of the reporting date.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

The Company may be exposed to various levels of credit risk depending on the nature of its investments and the nature and level of the assets underlying the investments and credit enhancements, if any, supporting its assets. The Company's core investment process includes procedures related to the initial approval of and periodic monitoring of credit risk and other risks associated with each investment. The Company's investment underwriting procedures include an evaluation of the borrower's ability to manage and operate the properties. Management reviews loan to value metrics upon either the origination or the acquisition of a new investment but generally does not update the loan to value metrics in the course of quarterly surveillance. Management generally reviews the most recent financial information produced by the borrower, which may include, but is not limited to net operating income ("NOI"), debt service coverage ratios, property debt yields (net cash flow or NOI divided by the amount of outstanding indebtedness), loan per unit and rent rolls relating to each of the Company's CRE Debt and Preferred Equity Investments, and may consider other factors management deems important. Management also reviews market pricing to determine the borrower's ability to refinance the asset at the maturity of the loan. Management also reviews economic trends, both macro as well as those directly affecting the property, and the supply and demand of competing projects in the sub-market in which the subject property is located.

In connection with the quarterly surveillance review process, loans are assigned an internal rating of Performing Loans, Watch List Loans or Workout Loans. Loans that are deemed Performing Loans meet all present contractual obligations. Watch List Loans are defined as performing or nonperforming loans for which the timing of cost recovery is under review. Workout Loans are defined as loans for which there is likelihood that we may not recover our cost basis.

Investments in Commercial Real Estate – Investments in commercial real estate are carried at historical cost less accumulated depreciation. Costs directly related to acquisitions deemed to be business combinations are expensed. Ordinary repairs and maintenance which are

Investments in real estate are depreciated using the straight-line method over the estimated useful lives of the assets, summarized as follows:

Category	Term
Building	35-40 years
Site improvements	2-7 years

The Company follows the acquisition method of accounting for acquisitions of operating real estate held for investment, where the purchase price of operating real estate is allocated to tangible assets such as land, building, site improvements and other identified intangibles such as above/below market and in-place leases.

The Company evaluates whether real estate acquired in connection with a foreclosure ("REO") or UCC/deed in lieu of foreclosure (herein collectively referred to as a foreclosure) constitutes a business and whether business combination accounting is applicable. Upon foreclosure of a property, the excess of the carrying value of a loan, if any, over the estimated fair value of the property, less estimated costs to sell, is charged to provision for loan losses.

Investments in commercial real estate, including REO, which do not meet the criteria to be classified as held for sale, are separately presented in the consolidated statements of financial condition as held for investment. Real estate held for sale is reported at the lower of its carrying value or its estimated fair value less estimated costs to sell. Once a property is determined to be held for sale, depreciation is no longer recorded. In addition, if considered material to the overall consolidated financial statements, the results of operations are reclassified to income (loss) from discontinued operations in the consolidated statements of comprehensive income (loss).

The Company's real estate portfolio (REO and real estate held for investment) is reviewed on a quarterly basis, or more frequently as necessary, to assess whether there are any indicators that the value of its operating real estate may be impaired or that its carrying value may not be recoverable. A property's value is considered

not reimbursed by the tenants are expensed as incurred. Major replacements and improvements that extend the useful life of the asset are capitalized and depreciated over their useful life.

impaired if the Company's estimate of the aggregate future undiscounted cash flows to be generated by the property is less than the carrying value of the property. In conducting this review, the Company considers U.S. macroeconomic factors, including real estate sector conditions, together with asset specific and other factors. To the extent impairment has occurred and is considered to be other than temporary, the loss will be measured as the excess of the carrying amount of the property over the calculated fair value of the property.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Notes to Consolidated Financial Statements

Revenue Recognition – Commercial Real Estate Investments - Interest income is accrued based on the outstanding principal amount of the CRE Debt and Preferred Equity Investments and their contractual terms. Premiums and discounts associated with the purchase of the CRE Debt and Preferred Equity Investments are amortized or accreted into interest income over the projected lives of the CRE Debt and Preferred Equity Investments using the interest method based on the estimated recovery value.

Broker Dealer Activities

In January 2014, RCap ceased its trading activity in U.S. Treasury securities, derivatives and certain securities borrowed and loaned transactions.

Reverse Repurchase Agreements – RCap enters into reverse repurchase agreements as part of its matched book trading activity. Reverse repurchase agreements are recorded on trade date at the contract amount and are collateralized by mortgage-backed or other securities. Margin calls are made by RCap as necessary based on the daily valuation of the underlying collateral as compared to the contract price. RCap generates income from the spread between what is earned on the reverse repurchase agreements and what is paid on the matched repurchase agreements. RCap's policy is to obtain possession of collateral with a market value in excess of the principal amount loaned under reverse repurchase agreements. To ensure that the market value of the underlying collateral remains sufficient, collateral is valued daily, and RCap will require counterparties to deposit additional collateral, when necessary. All reverse repurchase activities are transacted under master repurchase agreements that give RCap the right, in the event of default, to liquidate collateral held and in some instances, to offset receivables and payables with the same counterparty.

Securities Borrowed and Loaned Transactions – RCap records securities borrowed and loaned transactions as collateralized financings. Securities borrowed transactions require RCap to provide the counterparty with collateral in the form of cash, or other securities.

U.S. Treasury Securities – RCap traded in U.S. Treasury securities for its proprietary portfolio, which consisted of long and short positions on U.S. Treasury notes and bonds. U.S. Treasury securities were classified as trading investments and were recorded on the trade date at cost. Changes in fair value are reflected in Net gains (losses) on trading assets in the Company's Consolidated Statement of Comprehensive Income (Loss). Interest income or expense on U.S. Treasury notes and bonds was accrued based on the outstanding principal amount of those investments and their stated terms.

Derivatives - RCap entered primarily into U.S. Treasury, Eurodollar, federal funds, German government and U.S. equity index and currency futures and options contracts. RCap maintained a margin account which was settled daily with FCMs. Changes in the unrealized gains or losses on the futures and options contracts as well as any foreign exchange gains and losses are reflected in Net gains (losses) on trading assets in the Company's Consolidated Statements of Comprehensive Income (Loss). Unrealized gains (losses) are excluded from net income (loss) in arriving at cash flows from operating activities in the Consolidated Statements of Cash Flows.

A Summary of Recent Accounting Pronouncements Follows:

Presentation

Presentation of Financial Statements (ASC 205)/Property, Plant and Equipment (ASC 360)

On April 10, 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360) Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which raises the threshold for a disposal to be treated as discontinued operations. Under this update, the Company is required to report disposals that represent a strategic shift that has (or will have) a major effect on the Company's operations and financial results if the component of the Company or group of components meets the criteria to be accounted for as held for sale or the component of the

RCap receives collateral in the form of cash or other securities for securities loaned transactions. RCap monitors the fair value of the securities borrowed and loaned on a daily basis, with additional collateral obtained or refunded as necessary. Securities borrowed and securities loaned transactions are recorded at contract value. For these transactions, the rebates accrued by RCap are recorded as interest income or expense.

Company or group of components is disposed of by sale. The ASU removes requirements that operations and cash flows have been (or will be eliminated) from the ongoing operations and that the Company will not have any significant continuing involvement with the component in order to be reported as discontinued operations. Additionally, ASU 2014-08 also eliminates a number of scope exceptions and requires additional disclosures for transactions that meet the definition of a discontinued operations and significant items that are disposed of or held for sale that do not meet the discontinued operations criteria. The ASU is effective for reporting periods beginning after December 15, 2014 with early adoption permitted. Adoption is not expected to have a significant impact on the consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Notes to Consolidated Financial Statements

Balance Sheet (ASC 210)

On December 23, 2011, the FASB released ASU 2011-11, Balance Sheet: Disclosures about Offsetting Assets and Liabilities. Under this update, the Company is required to disclose both gross information and net information about both instruments and transactions eligible for offset in the Company's Consolidated Statements of Financial Condition and transactions subject to an agreement similar to a master netting arrangement. The scope includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements and securities borrowing and securities lending arrangements. This disclosure is intended to enable financial statement users to understand the effect of such arrangements on the Company's financial position. In January 2013, the FASB released ASU 2013-01 Balance Sheet: Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities, which served solely to clarify the scope of financial instruments included in ASU 2011-11 as there was concern about diversity in practice. The objective of these updates is to support further convergence of GAAP and IFRS requirements. The updates are effective for annual reporting periods beginning on or after January 1, 2013 and did not have a significant impact on the consolidated financial statements.

Comprehensive Income (ASC 220)

On December 23, 2011, the FASB issued ASU 2011-12, Comprehensive Income: Deferral of Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU No. 2011-05, which defers those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. This was done to allow the FASB time to re-deliberate the presentation on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. No other requirements under ASU 2011-05 are affected by ASU 2011-12. The FASB tentatively decided not to require

In February 2013, the FASB issued ASU 2013-02, Comprehensive Income: Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This update addresses the disclosure issue left open at the deferral under ASU 2011-12. This update requires the provision of information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, it requires presentation, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, a cross-reference must be provided to other disclosures required under GAAP that provide additional detail about those amounts. This update is effective for reporting periods beginning after December 15, 2012. Adoption of ASU 2013-02 did not have a significant impact on the consolidated financial statements.

Assets

Receivables – Troubled Debt Restructurings by Creditors (ASC 310-40)

In January 2014, the FASB issued ASU 2014-04, Receivables–Troubled Debt Restructurings by Creditors, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure, which clarifies that an in substance repossession or foreclosure has occurred, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, when the creditor obtains legal title to the property upon completion of a foreclosure or the borrower conveys all interest in the property to the creditor through a deed in lieu of foreclosure or similar arrangement. ASU 2014-04 also requires disclosure of the amount of foreclosed residential real estate held by the creditor and the

presentation of reclassification adjustments out of accumulated other comprehensive income on the face of the financial statements and to propose new disclosures instead.

recorded investment in mortgage loans collateralized by residential real estate property in the process of foreclosure. The update is effective for reporting periods beginning after December 15, 2014. Adoption is not expected to have a significant impact on the consolidated financial statements.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

## Broad Transactions

## Financial Services – Investment Companies (ASC 946)

In June 2013, the FASB finalized ASU 2013-08 amending the scope, measurement and disclosure requirements under Topic 946 – Financial Services-Investment Companies. In January 2014, the FASB has officially removed the Investment Companies: Real

Estate Property Investments and the Investment Properties projects from its agenda. As stated in ASC 946-10-15-3, the guidance in Topic 946 does not apply to REITs, and thus has no effect on the Company's consolidated financial statements.

## 4. AGENCY MORTGAGE-BACKED SECURITIES

The following tables present the Company's available-for-sale Agency mortgage-backed securities portfolio as of March 31, 2014 and December 31, 2013 which were carried at their fair value:

March 31, 2014	Freddie Mac	Fannie Mae	Ginnie Mae	Total
	(dollars in thousands)			
Principal outstanding	\$ 24,875,914	\$ 47,149,481	\$ 113,744	\$ 72,139,139
Unamortized premium	1,697,704	3,367,828	22,465	5,087,997
Unamortized discount	(9,446 )	(11,341 )	(380 )	(21,167 )
Amortized cost	26,564,172	50,505,968	135,829	77,205,969
Gross unrealized gains	205,409	381,265	8,650	595,324
Gross unrealized losses	(1,013,503 )	(1,433,916 )	(3,486 )	(2,450,905 )
Estimated fair value	\$ 25,756,078	\$ 49,453,317	\$ 140,993	\$ 75,350,388

	Fixed Rate	Adjustable Rate	Total
	(dollars in thousands)		
Amortized cost	\$ 73,655,761	\$ 3,550,208	\$ 77,205,969
Gross unrealized gains	455,048	140,276	595,324
Gross unrealized losses	(2,435,557 )	(15,348 )	(2,450,905 )
Estimated fair value	\$ 71,675,252	\$ 3,675,136	\$ 75,350,388

December 31, 2013	Freddie Mac	Fannie Mae	Ginnie Mae	Total
	(dollars in thousands)			
Principal outstanding	\$ 24,458,925	\$ 43,564,657	\$ 120,739	\$ 68,144,321
Unamortized premium	1,627,966	2,970,813	27,085	4,625,864
Unamortized discount	(9,533 )	(11,568 )	(383 )	(21,484 )



Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Amortized cost	26,077,358	46,523,902	147,441	72,748,701
Gross unrealized gains	227,423	456,057	9,845	693,325
Gross unrealized losses	(1,267,106 )	(1,781,683 )	(4,288 )	(3,053,077 )
Estimated fair value	\$ 25,037,675	\$ 45,198,276	\$ 152,998	\$ 70,388,949

	Fixed Rate	Adjustable Rate (dollars in thousands)	Total
Amortized cost	\$ 68,784,424	\$ 3,964,277	\$ 72,748,701
Gross unrealized gains	538,556	154,769	693,325
Gross unrealized losses	(3,040,153 )	(12,924 )	(3,053,077 )
Estimated fair value	\$ 66,282,827	\$ 4,106,122	\$ 70,388,949

Actual maturities of Agency mortgage-backed securities are generally shorter than stated contractual maturities because actual maturities of Agency mortgage-backed securities are affected by periodic payments and prepayments of principal on the underlying mortgages. The following table summarizes the Company's Agency

mortgage-backed securities as of March 31, 2014 and December 31, 2013, according to their estimated weighted average life classifications:

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

Weighted Average Life	March 31, 2014		December 31, 2013	
	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost
	(dollars in thousands)			
Less than one year	\$ 66,051	\$ 65,248	\$ 65,584	\$ 64,561
Greater than one year through five years	46,192,942	47,553,922	50,046,013	51,710,059
Greater than five years through ten years	22,833,176	23,099,356	14,915,716	15,292,973
Greater than ten years	6,258,219	6,487,443	5,361,636	5,681,108
Total	\$ 75,350,388	\$ 77,205,969	\$ 70,388,949	\$ 72,748,701

The weighted average lives of the Agency mortgage-backed securities at March 31, 2014 and December 31, 2013 in the table above are based upon principal prepayment rates for each security provided through subscription-based financial information services. The prepayment model considers current yield, forward yield, steepness of the yield curve, current mortgage rates, mortgage rate of the outstanding loans, loan age, margin, volatility and other factors. The actual weighted average lives of the Agency mortgage-backed securities could be longer or shorter than estimated.

The following table presents the gross unrealized losses and estimated fair value of the Company's Agency mortgage-backed securities by length of time that such securities have been in a continuous unrealized loss position at March 31, 2014 and December 31, 2013.

	March 31, 2014			December 31, 2013		
	Estimated Fair Value	Gross Unrealized Losses	Number of Securities	Estimated Fair Value	Gross Unrealized Losses	Number of Securities
	(dollars in thousands)					
Less than 12 Months	\$ 50,079,785	\$ (2,046,126)	642	\$ 47,677,197	\$ (2,569,474)	583
12 Months or More	6,055,285	(404,779 )	50	6,102,283	(483,603 )	55
Total	\$ 56,135,070	\$ (2,450,905)	692	\$ 53,779,480	\$ (3,053,077)	638

The decline in value of these securities is solely due to market conditions and not the quality of the assets. Substantially all of the Agency mortgage-backed securities are "AAA" rated or carry an implied "AAA" rating. The investments are not considered to be other-than-temporarily impaired because the Company currently has the ability and intent to hold the investments to maturity or for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investments, and it is not more likely than not that the Company will be required to sell the

Agency interest-only mortgage-backed securities represent the right to receive a specified portion of the contractual interest flows of the underlying outstanding principal balance of specific Agency mortgage-backed securities. Agency interest-only mortgage-backed securities in the Company's portfolio as of March 31, 2014 and December 31, 2013 had net unrealized gains of \$57.3 million and \$78.1 million and an amortized cost of \$1.1 billion and \$1.0 billion, respectively.

## 5. ACQUISITION OF CREXUS

investments before recovery of the amortized cost bases, which may be maturity. Also, the Company is guaranteed payment of the principal amount of the securities by the respective issuing government agency.

During the quarter ended March 31, 2014, the Company disposed of \$4.3 billion of Agency mortgage-backed securities, resulting in a net realized gain of \$129.5 million. During the quarter ended March 31, 2013, the Company sold \$16.3 billion of Agency mortgage-backed securities, resulting in a net realized gain of \$182.8 million. Average cost is used as the basis on which the realized gain or loss on sale is determined.

On April 17, 2013, the Company, through its wholly-owned subsidiary CXS Acquisition Corporation, obtained control of CreXus pursuant to the merger agreement dated January 30, 2013. CreXus owned a portfolio of commercial real estate assets which are now owned by the Company. Following the acquisition, CXS Acquisition Corporation was renamed Annaly Commercial Real Estate Group, Inc.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

The business combination was accounted for under the acquisition method of accounting in accordance with ASC 805, Business Combinations, (“ASC 805”). Accordingly, goodwill was measured as the excess of the aggregate of the acquisition-date fair value of the consideration transferred and the acquisition-date fair value of the Company’s previously held equity interest in CreXus over the fair value, at acquisition date, of the

identifiable assets acquired net of assumed liabilities. The following table summarizes the aggregate consideration and preliminary fair value of the assets acquired and liabilities assumed at the acquisition date:

	April 17, 2013 (dollars in thousands)
Cash consideration transferred	\$ 876,267
Fair value of equity interest in CreXus held before the business combination	106,521
	\$ 982,788
<b>Recognized amounts of identifiable assets acquired and liabilities assumed</b>	
Cash and cash equivalents	\$ 151,843
Commercial real estate investments	796,950
Accrued interest receivable	3,485
Other assets	5,617
Mortgages payable	(19,376 )
Participation sold	(14,352 )
Accounts payable and accrued expenses	(12,729 )
<b>Total identifiable net assets</b>	<b>911,438</b>
Goodwill	71,350
	\$ 982,788

The Company recorded \$71.4 million of goodwill during the second quarter of 2013 associated with the acquisition of CreXus in the Consolidated Statements of Financial Condition. The Company recorded a \$0.4 million adjustment to goodwill during the second half of 2013. The final goodwill recorded on the Consolidated Statements of Financial Condition may differ from that reflected herein as a result of future measurement period adjustments. In management’s opinion, the goodwill represents the synergies that will result from integrating CreXus’ commercial real estate platform into the Company, which the Company believes is complementary to its existing business and return profile.

The acquisition-date fair value of the previously held equity interest in CreXus excluded the estimated fair

value of the control premium that resulted from the merger transaction. The Company recognized a loss of \$18.9 million during the second quarter of 2013 as a result of remeasuring the fair value of its equity interest in CreXus held before the business combination.

Under ASC 805, merger-related transactions costs (such as advisory, legal, valuation and other professional fees) are not included as components of consideration transferred but are expensed in the periods in which the costs are incurred. Transaction costs of \$7.3 million were incurred during 2013 and were included in other general and administrative expenses in the Consolidated Statements of Comprehensive Income (Loss).



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

## 6. COMMERCIAL REAL ESTATE INVESTMENTS

At March 31, 2014 and December 31, 2013, commercial real estate investments were composed of the following:

## CRE Debt and Preferred Equity Investments

	March 31, 2014			December 31, 2013		
	Outstanding Principal (dollars in thousands)	Carrying Value(1)	Percentage of Loan Portfolio(2)	Outstanding Principal (dollars in thousands)	Carrying Value(1)	Percentage of Loan Portfolio(2)
Senior mortgages	\$ 337,845	\$ 336,845	20.5 %	\$ 669,512	\$ 667,299	42.2 %
Senior securitized mortgages(3)	399,541	398,113	24.3 %	-	-	0.0 %
Subordinate notes	15,965	16,049	1.0 %	41,059	41,408	2.6 %
Mezzanine loans	641,253	641,887	39.0 %	626,883	628,102	39.5 %
Preferred equity	249,769	247,312	15.2 %	249,769	247,160	15.7 %
Total	\$ 1,644,373	\$ 1,640,206	100 %	\$ 1,587,223	\$ 1,583,969	100 %

(1) Net carrying value includes unamortized origination fees of \$4.9 million.

(2) Based on outstanding principal.

(3) Assets of consolidated VIE.

	March 31, 2014					
	Senior Mortgages	Senior Securitized Mortgages(1)	Subordinate Notes	Mezzanine Loans	Preferred Equity	Total
Beginning balance	\$ 667,299	\$ -	\$ 41,408	\$ 628,102	\$ 247,160	\$ 1,583,969
Originations & advances (principal)	67,946	-	-	59,000	-	126,946
Principal payments	(72 )	-	(25,094 )	(44,630 )	-	(69,796 )
Sales (principal)	-	-	-	-	-	-
Amortization & accretion of (premium) discounts	(36 )	-	(265 )	(617 )	28	(890 )
Net (increase) decrease in origination fees	(1,012 )	-	-	15	1	(996 )
	698	135	-	17	123	973

Amortization of net origination fees						
Transfers	(397,978 )	397,978	-	-	-	-
Allowance for loan losses	-	-	-	-	-	-
Net carrying value	\$ 336,845	\$ 398,113	\$ 16,049	\$ 641,887	\$ 247,312	\$ 1,640,206

(1) Assets of consolidated VIE.

	December 31, 2013					
	Senior Mortgages	Senior Securitized Mortgages(1)	Subordinate Notes	Mezzanine Loans	Preferred Equity	Total
	(dollars in thousands)					
Beginning balance	\$ 429,229	\$ -	\$ 41,571	\$ 568,759	\$ 187,623	\$ 1,227,182
Originations & advances (principal)	240,150	-	-	136,040	60,000	436,190
Principal payments	(388 )	-	(90 )	(64,035 )	-	(64,513 )
Sales (principal)	(13,750 )	-	-	-	-	(13,750 )
Amortization & accretion of (premium) discounts	(37 )	-	(73 )	(192 )	31	(271 )
Net (increase) decrease in origination fees	(1,106 )	-	-	14	(601 )	(1,693 )
Amortization of net origination fees	701	-	-	16	107	824
Transfers	12,500	-	-	(12,500 )	-	-
Allowance for loan losses	-	-	-	-	-	-
Net carrying value	\$ 667,299	\$ -	\$ 41,408	\$ 628,102	\$ 247,160	\$ 1,583,969

(1) Assets of consolidated VIE.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

## Internal CRE Debt and Preferred Equity Investment Ratings

Investment Type	Outstanding Principal	Percentage of CRE Debt and Preferred Equity Portfolio	March 31, 2014		Internal Ratings		
			Performing (dollars in thousands)	Watch List Loans	Workout Loans		
Senior mortgages	\$ 337,845	20.5 %	\$ 312,372	\$ 25,473	(2)	\$ -	
Senior securitized mortgages(1)	399,541	24.3 %	399,541	-		-	
Subordinate notes	15,965	1.0 %	15,965	-		-	
Mezzanine loans	641,253	39.0 %	635,253	6,000		-	
Preferred equity	249,769	15.2 %	249,769	-		-	
	\$ 1,644,373	100 %	\$ 1,612,900	\$ 31,473		\$ -	

(1) Assets of consolidated VIE.

(2) Includes approximately \$13 million related to one loan on non accrual status.

Investment Type	Outstanding Principal	Percentage of CRE Debt and Preferred Equity Portfolio	December 31, 2013		Internal Ratings		
			Performing (dollars in thousands)	Watch List Loans	Workout Loans		
Senior mortgages	\$ 669,512	42.2 %	\$ 644,039	\$ 25,473	(1)	\$ -	
Subordinate notes	41,059	2.6 %	41,059	-		-	
Mezzanine loans	626,883	39.5 %	620,883	6,000		-	
Preferred equity	249,769	15.7 %	249,769	-		-	
	\$ 1,587,223	100 %	\$ 1,555,750	\$ 31,473		\$ -	

(1) Includes approximately \$13 million related to one loan on non accrual status.

## Total Commercial Real Estate Investment

	March 31, 2014 (dollars in thousands)	December 31, 2013 (dollars in thousands)
Real estate held for investment, at amortized cost		
Land	\$ 6,639	\$ 6,639
Buildings and improvements	31,100	31,100
Subtotal	37,739	37,739



Less: accumulated depreciation	(1,170 )	(877 )
Total real estate held for investment at amortized cost, net	36,569	36,862
Real estate held for sale at fair value	3,744	23,270
Total investment in commercial real estate, net	40,313	60,132
Net carrying value of CRE Debt and Preferred Equity Investments	1,640,206	1,583,969
Total commercial real estate investments	\$ 1,680,519	\$ 1,644,101

#### Securitizations and VIEs

In January 2014, the Company closed NLY Commercial Mortgage Trust 2014-FL1 (the "Trust"), a \$399.5 million securitization financing transaction which provides permanent, non-recourse financing collateralized by floating-rate first mortgage debt investments originated or purchased by the Company and is not subject to margin calls. A total of \$260.7 million of investment grade bonds were issued by the

Trust, representing an advance rate of 65.3% at a weighted average coupon of LIBOR plus 1.74%. The Company is using the proceeds to originate commercial real estate investments. The Company retained bonds rated below investment grade and the only interest-only bond issued by the Trust, which are referred to as the subordinate bonds.

The Company incurred approximately \$4.3 million of costs in connection with the securitization that have been capitalized and are being amortized to interest expense. Deferred financing costs are included in Other assets in the accompanying consolidated statements of financial condition.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 1. Notes to Consolidated Financial Statements

The Trust is structured as a pass through entity that receives principal and interest on the underlying collateral and distributes those payments to the certificate holders. The Trust is a VIE and the Company is the primary beneficiary as a result of its ability to replace the special servicer without cause through its ownership interest in the subordinate bonds. The Company's exposure to the obligations of the VIE is generally limited to the Company's investment in the Trust. Assets of the Trust may only be used to settle obligations of the Trust. Creditors of the Trust have no recourse to the general credit of the Company. The Company is not contractually required to provide and has not provided any form of financial support to the Trust. No gain or loss was recognized upon initial consolidation of the Trust.

As of March 31, 2014 the carrying value of the Trust's assets was \$398.1 million, net of \$1.4 million of unamortized origination fees, which are included in Commercial real estate debt and preferred equity investments in the accompanying Consolidated Statements of Financial Condition. As of March 31, 2014, the carrying value of the Trust's liabilities was \$260.7 million, classified as Securitized debt in the accompanying Consolidated Statements of Financial Condition.

#### 7. FAIR VALUE MEASUREMENTS

The Company follows fair value guidance in accordance with GAAP to account for its financial instruments. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

GAAP requires classification of the instruments into a three-level hierarchy based on the priority of the inputs to the valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the

Level 1– inputs to the valuation methodology are quoted prices (unadjusted) for identical assets and liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to overall fair value.

The Company designates its financial instruments as available for sale or trading depending upon the type of instrument and the Company's intent and ability to hold such instrument to maturity. Instruments classified as available for sale and trading are reported at fair value on a recurring basis.

The following is a description of the valuation methodologies used for instruments carried at fair value. These methodologies are applied to assets and liabilities across the three level fair value hierarchy, with the observability of inputs determining the appropriate level.

U.S. Treasury securities and investment in affiliates are valued using quoted prices for identical instruments in active markets. Agency mortgage-backed securities, Agency debentures, interest rate swaps, swaptions and other derivatives are valued using quoted prices, including dealer quotes, or internally estimated prices for similar assets using internal models. The Company incorporates common market pricing methods, including a spread measurement to the Treasury curve as well as underlying characteristics of the particular security including coupon, prepayment speeds, periodic and life caps, rate reset period and expected life of the security in its estimates of fair value. Management reviews the fair values generated by the internal models to determine whether prices are reflective of the current market. Management indirectly corroborates its estimates of the fair value derived using internal models by comparing its results to independent prices provided by dealers in the securities and/or third party pricing services. Certain liquid asset classes, such as Agency fixed-rate

categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. Financial assets and liabilities recorded at fair value on the Consolidated Statements of Financial Condition or disclosed in the related notes are categorized based on the inputs to the valuation techniques as follows:

pass-throughs, may be priced using independent sources such as quoted prices for TBA securities.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

The Agency mortgage-backed securities, interest rate swap and swaption markets are considered to be active markets such that participants transact with sufficient frequency and volume to provide transparent pricing information on an ongoing basis. The liquidity of the Agency mortgage-backed securities, interest rate swaps and swaptions markets and the similarity of the Company's securities to those actively traded enable the Company to observe quoted prices in the market and utilize those prices as a basis for formulating fair

value measurements. Consequently, the Company has classified Agency mortgage-backed securities, interest rate swaps, swaptions, TBA derivatives and MBS options as Level 2 inputs in the fair value hierarchy.

The following table presents the estimated fair values of financial instruments measured at fair value on a recurring basis.

March 31, 2014	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
<b>Assets:</b>				
Agency mortgage-backed securities	\$ -	\$ 75,350,388	\$ -	\$ 75,350,388
Agency debentures	-	2,408,259	-	2,408,259
Investment in affiliates	137,647	-	-	137,647
Interest rate swaps	-	340,890	-	340,890
Other derivatives	-	40,105	-	40,105
<b>Total Assets</b>	<b>\$ 137,647</b>	<b>\$ 78,139,642</b>	<b>\$ -</b>	<b>\$ 78,277,289</b>
<b>Liabilities:</b>				
Interest rate swaps	\$ -	\$ 1,272,616	\$ -	\$ 1,272,616
Other derivatives	-	6,045	-	6,045
<b>Total Liabilities</b>	<b>\$ -</b>	<b>\$ 1,278,661</b>	<b>\$ -</b>	<b>\$ 1,278,661</b>
At December 31, 2013	Level 1	Level 2	Level 3	Total
	(dollars in thousands)			
<b>Assets:</b>				
U.S. Treasury securities	\$ 1,117,915	\$ -	\$ -	\$ 1,117,915
Agency mortgage-backed securities	-	70,388,949	-	70,388,949
Agency debentures	-	2,969,885	-	2,969,885
Investment in affiliates	139,447	-	-	139,447
Interest rate swaps	-	559,044	-	559,044
Other derivatives	3,487	143,238	-	146,725
<b>Total Assets</b>	<b>\$ 1,260,849</b>	<b>\$ 74,061,116</b>	<b>\$ -</b>	<b>\$ 75,321,965</b>
<b>Liabilities:</b>				
U.S. Treasury securities sold, not yet purchased	1,918,394	-	-	1,918,394
Interest rate swaps	-	1,141,828	-	1,141,828
Other derivatives	439	55,079	-	55,518
<b>Total Liabilities</b>	<b>\$ 1,918,833</b>	<b>\$ 1,196,907</b>	<b>\$ -</b>	<b>\$ 3,115,740</b>

GAAP requires disclosure of fair value information about financial instruments, whether or not recognized in the financial statements, for which it is practical to estimate the value. In cases where quoted market prices

The carrying value of short term instruments, including cash and cash equivalents, reverse repurchase agreements and repurchase agreements whose term is less than twelve months, and securities borrowed and

are not available, fair values are based upon discounted cash flows using market yields or other valuation methodologies. Considerable judgment is necessary to interpret market data and develop estimated fair values. Accordingly, fair values are not necessarily indicative of the amount the Company would realize on disposition of the financial instruments. The use of different market assumptions or estimation methodologies could have a material effect on the estimated fair value amounts.

securities loaned, generally approximates fair value due to the short term nature of the instruments.

Instruments held-for-investment are recorded at their principal balance outstanding, plus any premiums or less discounts that are amortized or accreted over the estimated life of the instrument.

The estimated fair value of commercial real estate debt and preferred equity investments takes into consideration changes in credit spreads and interest rates from the date of origination or purchase to the reporting date. The fair value also reflects consideration of asset-specific maturity dates and other items that could have an impact on the fair value as of the reporting date.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

Estimates of fair value of corporate debt require the use of judgments and inputs including, but not limited to, the enterprise value of the borrower (i.e., an estimate of the total fair value of the borrower's debt and equity), the nature and realizable value of any collateral, the borrower's ability to make payments when due and its earnings history. Management also considers factors that affect the macro and local economic markets in which the borrower operates.

The fair value of repurchase agreements with remaining maturities greater than one year or with embedded optionality are valued as structured notes, with term to maturity, LIBOR rates and the Treasury curve being primary determinants of estimated fair value.

The fair value of mortgages payable is calculated using the estimated yield of a new par loan to value the

remaining terms in place. A par loan is created using the identical terms of the existing loan; however, the coupon is derived by using the original spread against the interpolated Treasury. The fair value of mortgages payable also reflects consideration of the value of the underlying collateral and changes in credit risk from the time the debt was originated.

The carrying value of participation sold is based on the loan's amortized cost less an allowance for loan losses, if necessary. The fair value of participation sold is based on the fair value of the underlying related commercial loan.

The fair value of convertible senior notes is determined using end of day quoted prices in active markets.

The fair value of securitized debt of consolidated VIE is determined using the average of external vendor pricing services.

The following table summarizes the estimated fair value for all financial assets and liabilities as of March 31, 2014 and December 31, 2013.

	Level in Fair Value Hierarchy	March 31, 2014		December 31, 2013	
		Carrying Value	Fair Value	Carrying Value	Fair Value
(dollars in thousands)					
<b>Financial assets:</b>					
Cash and cash equivalents	1	\$924,197	\$924,197	\$552,436	\$552,436
Reverse repurchase agreements	1	444,375	444,375	100,000	100,000
Securities borrowed	1	513,500	513,500	2,582,893	2,582,893
U.S. Treasury securities	1	-	-	1,117,915	1,117,915
Agency mortgage-backed securities	2	75,350,388	75,350,388	70,388,949	70,388,949
Agency debentures	2	2,408,259	2,408,259	2,969,885	2,969,885
Investment in affiliates	1	137,647	137,647	139,447	139,447
Commercial real estate debt and preferred equity	3	1,640,206	1,649,239	1,583,969	1,581,836
Corporate debt	2	145,394	145,912	117,687	118,362
Interest rate swaps	2	340,890	340,890	559,044	559,044
Other derivatives	1,2	40,105	40,105	146,725	146,725
<b>Financial liabilities:</b>					
U.S. Treasury securities sold, not yet purchased	1	\$-	\$-	\$1,918,394	\$1,918,394

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

Repurchase agreements	1,2	64,543,949	64,856,432	61,781,001	62,134,133
Securities loaned	1	513,510	513,510	2,527,668	2,527,668
Convertible Senior Notes	1	827,486	883,946	825,262	870,199
Securitized debt of consolidated VIE	2	260,700	262,105	-	-
Mortgages payable	2	19,317	19,240	19,332	19,240
Participation sold	3	13,963	13,882	14,065	14,050
Interest rate swaps	2	1,272,616	1,272,616	1,141,828	1,141,828
Other derivatives	1,2	6,045	6,045	55,518	55,518

21

---

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

## 8. SECURED FINANCING

The Company had outstanding \$64.5 billion and \$61.8 billion of repurchase agreements with weighted average borrowing rates of 2.43% and 2.33%, after giving effect to the Company's interest rate swaps, and weighted average remaining maturities of 187 days and 204 days as of March 31, 2014 and December 31, 2013, respectively. Investment Securities and U.S. Treasury securities pledged as collateral under these repurchase agreements and interest rate swaps had an estimated fair value and accrued interest of \$68.5

billion and \$227.0 million, respectively, at March 31, 2014 and \$67.9 billion and \$222.1 million, respectively, at December 31, 2013.

At March 31, 2014 and December 31, 2013, the repurchase agreements had the following remaining maturities and weighted average rates:

	March 31, 2014			December 31, 2013		
	Repurchase Agreements	Weighted Average Rate		Repurchase Agreements	Weighted Average Rate	
			(dollars in thousands)			
1 day	\$ 6,065,530	0.29 %		\$ -	0.00 %	
2 to 29 days	12,308,123	0.34 %		21,171,574	0.36 %	
30 to 59 days	17,122,926	0.43 %		13,373,921	0.43 %	
60 to 89 days	3,842,791	0.42 %		3,592,266	0.44 %	
90 to 119 days	6,941,938	0.55 %		4,010,334	0.52 %	
Over 120 days(1)	18,262,641	1.26 %		19,632,906	1.29 %	
Total	\$ 64,543,949	0.65 %		\$ 61,781,001	0.68 %	

(1) Approximately 14% of the total repurchase agreements have a remaining maturity over 1 year.

Repurchase agreements and reverse repurchase agreements with the same counterparty and the same maturity are presented net in the Consolidated Statements of Financial Condition when the terms of the agreements permit netting. The following table summarizes the gross amounts of reverse repurchase

agreements and repurchase agreements, amounts offset in accordance with netting arrangements and net amounts of repurchase agreements and reverse repurchase agreements as presented in the Consolidated Statements of Financial Condition as of March 31, 2014 and December 31, 2013.

	March 31, 2014		December 31, 2013	
	Reverse Repurchase Agreements	Repurchase Agreements	Reverse Repurchase Agreements	Repurchase Agreements
			(dollars in thousands)	
Gross Amounts	\$ 1,766,563	\$ 65,866,137	\$ 2,524,980	\$ 64,205,981
Amounts Offset	(1,322,188 )	(1,322,188 )	(2,424,980 )	(2,424,980 )
Netted Amounts	\$ 444,375	\$ 64,543,949	\$ 100,000	\$ 61,781,001

## 9. DERIVATIVE INSTRUMENTS



In connection with the Company's investment/market rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts, which include interest rate swaps, swaptions and U.S. Treasury futures contracts. The Company also enters into TBA derivatives and MBS options to economically hedge its exposure to market risks. The purpose of using derivatives is to manage overall portfolio risk with the potential to generate additional income for distribution to stockholders. These derivatives are subject to changes in market value resulting from changes in interest rates, volatility, Agency mortgage-backed security spreads to U.S. Treasuries and market liquidity. The use of derivatives

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

also creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the stated contract. Additionally, the Company may have to pledge cash or assets as collateral for the derivative transactions, the amount which may vary based on the market value, notional amount and remaining term of the derivative contract. In the event of a default by the counterparty, the Company could have difficulty obtaining its Investment Securities

pledged as collateral as well as receiving payments in accordance with the terms of the derivative contracts. None of the Company's derivative transactions have been designated as hedging instruments for accounting purposes.

The table below summarizes fair value information about our derivative assets and liabilities as of March 31, 2014 and December 31, 2013:

Derivatives Instruments	Balance Sheet Location	March 31, 2014	December 31, 2013
Assets:			
(dollars in thousands)			
Interest rate swaps	Interest rate swaps, at fair value	\$ 340,890	\$ 559,044
Interest rate swaptions	Other derivative contracts, at fair value	36,965	110,361
TBA derivatives	Other derivative contracts, at fair value	3,140	20,693
MBS options	Other derivative contracts, at fair value	-	12,184
U.S. Treasury futures	Other derivative contracts, at fair value	-	3,487
		\$ 380,995	\$ 705,769
Liabilities:			
Interest rate swaps	Interest rate swaps, at fair value	\$ 1,272,616	1,141,828
Interest rate swaptions	Other derivative contracts, at fair value	-	24,662
TBA derivatives	Other derivative contracts, at fair value	6,045	13,779
MBS options	Other derivative contracts, at fair value	-	16,638
U.S. Treasury futures	Other derivative contracts, at fair value	-	439
		\$ 1,278,661	\$ 1,197,346

The following table summarizes certain characteristics of the Company's interest rate swaps at March 31, 2014 and December 31, 2013:

Maturity	March 31, 2014			
	Current Notional(1)	Weighted Average Pay Rate(2)(3)	Weighted Average Receive Rate(2)(4)	Weighted Average Years to Maturity(2)

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

(dollars in thousands)							
0 - 3 years	\$	24,516,550	1.78	%	0.17	%	1.84
3 - 6 years		8,723,500	2.07	%	0.19	%	4.60
6 - 10 years		17,179,700	2.49	%	0.23	%	7.83
Greater than 10 years		6,290,000	3.66	%	0.18	%	21.09
Total / Weighted Average	\$	56,709,750	2.16	%	0.19	%	5.31

(1) Notional amount includes \$3.1 billion in forward starting pay fixed swaps, offset by \$1.4 billion in forward starting receive fixed swaps.

(2) Excludes forward starting swaps.

(3) Weighted average fixed rate on forward starting pay fixed swaps was 3.00%.

(4) Weighted average fixed rate on forward starting pay receive swaps was 1.18%.

December 31, 2013

Maturity	Current Notional	Weighted Average Pay Rate	Weighted Average Receive Rate	Weighted Average Years to Maturity
(dollars in thousands)				
0 - 3 years	\$ 24,286,000	1.83 %	0.18 %	1.98
3 - 6 years	8,865,410	2.02 %	0.19 %	4.19
6 - 10 years	15,785,500	2.37 %	0.23 %	7.66
Greater than 10 years	3,490,000	3.62 %	0.20 %	19.93
Total / Weighted Average	\$ 52,426,910	2.14 %	0.20 %	5.26

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

The following table summarizes certain characteristics of the Company's interest rate swaptions at March 31, 2014 and December 31, 2013:

March 31, 2014 (dollars in thousands)	Current Underlying Notional	Weighted Average Underlying Pay Rate	Weighted Average Underlying Receive Rate	Weighted Average Underlying Years to Maturity	Weighted Average Months to Expiration
Long	\$ 4,100,000	3.14%	3M LIBOR	10.04	4.70
Short	\$ -	-	-	-	-

December 31, 2013 (dollars in thousands)	Current Underlying Notional	Weighted Average Underlying Pay Rate	Weighted Average Underlying Receive Rate	Weighted Average Underlying Years to Maturity	Weighted Average Months to Expiration
Long	\$ 5,150,000	3.07%	3M LIBOR	10.10	4.26
Short	\$ 1,000,000	3M LIBOR	2.83%	5.96	23.71

The following table summarizes certain characteristics of the Company's TBA derivatives as of March 31, 2014 and December 31, 2013:

Purchase and sale contracts for derivative TBAs	March 31, 2014			
	Notional	Cost Basis (dollars in thousands)	Market Value	Net Carrying Value
Purchase contracts	\$ 1,500,000	\$ 1,569,331	\$ 1,568,184	\$ (1,147 )
Sale contracts	(2,125,000 )	(2,127,773 )	(2,129,531 )	(1,758 )
Net TBA derivatives	\$ (625,000 )	\$ (558,442 )	\$ (561,347 )	\$ (2,905 )

Purchase and sale contracts for derivative TBAs	December 31, 2013			
	Notional	Cost Basis (dollars in thousands)	Market Value	Net Carrying Value
Purchase contracts	\$ 2,625,000	\$ 2,733,682	\$ 2,722,324	\$ (11,357 )
Sale contracts	(3,875,000 )	(3,923,213 )	(3,904,941 )	18,271
Net TBA derivatives	\$ (1,250,000 )	\$ (1,189,531 )	\$ (1,182,617 )	\$ 6,914

Derivative contracts may contain legally enforceable provisions that allow for netting or setting off receivables and payables with each counterparty. Beginning on September 30, 2013, the Company elected to present derivative contracts on a gross basis on the Consolidated Statements of Financial Condition. Prior to September 30, 2013, the Company presented

the fair value of derivative contracts net, by counterparty. The following tables present information about our derivative assets and liabilities that are subject to such provisions and can potentially be offset on our Consolidated Statements of Financial Condition as of March 31, 2014 and December 31, 2013, respectively.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

March 31, 2014	Gross Amounts	Amounts Eligible for Offset	Net Amounts
Assets:			
		(dollars in thousands)	
Interest rate swaps, at fair value	\$ 340,890	\$ (311,264 )	\$ 29,626
Interest rate swaptions, at fair value	36,965	-	36,965
TBA derivatives, at fair value	3,140	(1,304 )	1,836
Liabilities:			
Interest rate swaps, at fair value	1,272,616	(311,264 )	961,352
Interest rate swaptions, at fair value	-	-	-
TBA derivatives, at fair value	6,045	(1,304 )	4,741

December 31, 2013	Gross Amounts	Amounts Eligible for Offset	Net Amounts
Assets:			
		(dollars in thousands)	
Interest rate swaps, at fair value	\$ 559,044	\$ (408,553 )	\$ 150,491
Interest rate swaptions, at fair value	110,361	(24,662 )	85,699
TBA derivatives, at fair value	20,693	(9,775 )	10,918
MBS options, at fair value	12,184	(3,292 )	8,892
U.S. Treasury futures, at fair value	3,487	(439 )	3,048
Liabilities:			
Interest rate swaps, at fair value	1,141,828	(408,553 )	733,275
Interest rate swaptions, at fair value	24,662	(24,662 )	-
TBA derivatives, at fair value	13,779	(9,775 )	4,004
MBS options, at fair value	16,638	(3,292 )	13,346
U.S. Treasury futures, at fair value	439	(439 )	-

The effect of interest rate swaps on the Consolidated Statements of Comprehensive Income (Loss) is as follows:

	Location on Consolidated Statements of Comprehensive Income (Loss)		
	Realized Gains (Losses) on Interest Rate Swaps(1)	Realized Gains (Losses) on Termination of Interest Rate Swaps (dollars in thousands)	Unrealized Gains (Losses) on Interest Rate Swaps
For the Quarter Ended:			
March 31, 2014	\$ (260,435 )	\$ (6,842 )	\$ (348,942 )
March 31, 2013	\$ (225,476 )	\$ (16,378 )	\$ 325,734

(1) Interest expense related to the Company's interest rate swaps is recorded in Realized gains (losses) on interest rate swaps on the Consolidated Statements of Comprehensive Income (Loss).

As of March 31, 2014, the swap portfolio, excluding forward starting swaps, had a weighted average pay rate

The effect of other derivative contracts on the Company's Consolidated Statements of Comprehensive

of 2.16% and a weighted average receive rate of 0.19%. Income (Loss) is as follows:  
 The weighted average pay rate at December 31, 2013 was 2.14% and the weighted average receive rate was 0.20%.

Three Months Ended March 31, 2014

Derivative Instruments	Realized Gain (Loss) (dollars in thousands)	Unrealized Gain (Loss)	Amount of Gain/(Loss) Recognized in Net Gains (Losses) on Trading Assets
Net TBA derivatives (1)	\$ (37,837 )	\$ (11,410 )	\$ (49,247 )
Net interest rate swaptions	\$ (40,943 )	\$ (52,917 )	\$ (93,860 )
U.S. Treasury futures	\$ (5,669 )	\$ (3,048 )	\$ (8,717 )
			\$ (151,824 )

(1) Includes options on TBA securities.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

Three Months Ended March 31, 2013

Derivative Instruments	Realized Gain (Loss)	Unrealized Gain (Loss)	Amount of Gain/(Loss) Recognized in Net Gains (Losses) on Trading Assets
(dollars in thousands)			
Net TBA derivatives	\$ 9,340	\$ (1,875 )	\$ 7,465
Net interest rate swaptions	\$ -	\$ -	\$ -
U.S. Treasury futures	\$ 12,702	\$ (12,458 )	\$ 244
			\$ 7,709

Certain of the Company's derivative contracts are subject to International Swaps and Derivatives Association Master Agreements ("ISDA") which may contain provisions that grant counterparties certain rights with respect to the applicable ISDA upon the occurrence of certain events such as (i) negative performance that results in a decline in net assets in excess of specified thresholds or dollar amounts over set periods of time, (ii) the Company's failure to maintain its REIT status, (iii) the Company's failure to comply with limits on the amount of leverage, and (iv) the Company's stock being delisted from the New York Stock Exchange (NYSE). Upon the occurrence of any one of items (i) through (iv), the counterparty to the applicable ISDA has a right to terminate the ISDA in accordance with its provisions. The aggregate fair value of all derivative instruments with the aforementioned features that are in a net liability position at March 31, 2014 is approximately \$898 million, which represents the maximum amount the Company would be required to pay upon termination. This amount is fully collateralized.

#### 10. CONVERTIBLE SENIOR NOTES

In 2010, the Company issued \$600.0 million in aggregate principal amount of its 4% convertible senior notes due 2015 ("4% Convertible Senior Notes") for net proceeds of approximately \$582.0 million. The Company has repurchased \$492.5 million in aggregate principal amount of its 4% Convertible Senior Notes as of March 31, 2014. Interest on the 4% Convertible Senior Notes is paid semi-annually at a rate of 4% per year and the 4% Convertible Senior Notes will mature

The intrinsic value of the contingent beneficial conversion feature was \$97.4 million and \$93.2 million at March 31, 2014 and December 31, 2013, respectively, which is reflected in Additional paid-in capital on the Company's Consolidated Statements of Financial Condition, and reduces the recorded liability on the 4% Convertible Senior Notes. The unamortized contingent beneficial conversion feature of the 4% Convertible Senior Notes at March 31, 2014 and December 31, 2013 of \$25.7 million and \$26.9 million, respectively, is recognized in interest expense over the remaining life of the notes.

In May 2012, the Company issued \$750.0 million in aggregate principal amount of its 5% convertible senior notes due 2015 ("5% Convertible Senior Notes") for net proceeds of approximately \$727.5 million. Interest on the 5% Convertible Senior Notes is paid semi-annually at a rate of 5% per year and the 5% Convertible Senior Notes will mature on May 15, 2015 unless repurchased or converted earlier. The 5% Convertible Senior Notes are convertible into shares of Common Stock at a conversion rate for each \$1,000 principal amount of 5% Convertible Senior Notes. The initial conversion rate and conversion rate at March 31, 2014 was 52.7969, which was equivalent to an initial conversion price of approximately \$18.94 per share of Common Stock, subject to adjustment in certain circumstances. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of Common Stock or a combination of cash and shares of Common Stock, at the Company's sole discretion. There is no limit on the total number of shares of Common Stock that the Company would be



on February 15, 2015 unless repurchased or converted earlier. The 4% Convertible Senior Notes are convertible into shares of Common Stock at a conversion rate for each \$1,000 principal amount of 4% Convertible Senior Notes. The initial conversion rate was 46.6070, which was equivalent to an initial conversion price of approximately \$21.4560 per share of Common Stock. The conversion rate at March 31, 2014 was 81.9145, which is equivalent to a conversion price of approximately \$12.2079 per share of Common Stock. The conversion rate is subject to adjustment in certain circumstances. There is no limit on the total number of shares of Common Stock that the Company would be required to issue upon a conversion.

required to issue upon a conversion.

At issuance, the Company determined that the 5% Convertible Senior Notes included an equity component of \$11.7 million, which is reflected in Additional paid-in capital on the Company's Consolidated Statements of Financial Condition, and reduces the recorded liability on the 5% Convertible Senior Notes. The \$11.7 million discount to the principal amount of the Convertible Senior Notes is recognized in interest expense over the remaining life of the notes. At March 31, 2014 and December 31, 2013, \$4.4 million and \$5.4 million, respectively, of the unamortized discount had not been reflected in interest expense.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Notes to Consolidated Financial Statements

The 4% Convertible Senior Notes due 2015 and the 5% Convertible Senior Notes due 2015 rank pari-passu with each other. They are each a general corporate obligation and therefore rank junior to collateralized debt of the Company with respect to secured collateral.

The 4% Convertible Senior Notes and the 5% Convertible Senior Notes rank senior to the 7.875% Series A Cumulative Redeemable Preferred Stock, 7.625% Series C Cumulative Redeemable Preferred Stock and 7.50% Series D Cumulative Redeemable Preferred Stock. The 7.875% Series A Cumulative Redeemable Preferred Stock, 7.625% Series C Cumulative Redeemable Preferred Stock and 7.50% Series D Cumulative Redeemable Preferred Stock rank pari-passu with each other.

The 7.875% Series A Cumulative Redeemable Preferred Stock, 7.625% Series C Cumulative Redeemable Preferred Stock and 7.50% Series D Cumulative Redeemable Preferred Stock rank senior to the common stock of the Company.

11. COMMON STOCK AND PREFERRED STOCK

The Company's authorized shares of capital stock, par value of \$0.01 per share, consists of 1,956,937,500 shares classified as common stock, 7,412,500 shares classified as 7.875% Series A Cumulative Redeemable Preferred Stock, 4,600,000 shares classified as 6.00% Series B Cumulative Convertible Preferred Stock, 12,650,000 shares classified as 7.625% Series C Cumulative Redeemable Preferred Stock and 18,400,000 shares classified as 7.50% Series D Cumulative Redeemable Preferred Stock.

(A) Common Stock

At March 31, 2014 and December 31, 2013, the Company had issued and outstanding 947,488,945 and 947,432,862 shares of common stock, with a par value of \$0.01 per share.

No options were exercised during the quarter ended March 31, 2014. During the quarter ended March 31, 2013, 20,000 options were exercised for an aggregate

During the quarter ended March 31, 2014, the Company raised \$0.6 million, by issuing 56,000 shares, through the Direct Purchase and Dividend Reinvestment Program. During the quarter ended March 31, 2013, the Company raised \$0.8 million, by issuing 50,000 shares, through the Direct Purchase and Dividend Reinvestment Program.

In October 2012, the Company announced that its board of directors ("Board of Directors") had authorized the repurchase of up to \$1.5 billion of its outstanding common shares over a 12 month period. All common shares purchased were part of a publicly announced plan in open-market transactions. The repurchase plan expired in October 2013. There were no purchases made by the Company under this repurchase plan during the quarter ended March 31, 2013.

In March 2012, the Company entered into six separate Distribution Agency Agreements ("Distribution Agency Agreements") with each of Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse Securities (USA) LLC, Goldman, Sachs & Co., J.P. Morgan Securities LLC, Morgan Stanley & Co. LLC and RCap Securities, Inc. (together, the Agents). Pursuant to the terms of the Distribution Agency Agreements, the Company may sell from time to time through the Agents, as its sales agents, up to 125,000,000 shares of the Company's common stock. The Company did not make any sales under the Distribution Agency Agreements during the quarters ended March 31, 2014 and 2013.

(B) Preferred Stock

At March 31, 2014 and December 31, 2013, the Company had issued and outstanding 7,412,500 shares of Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock"), with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series A Preferred Stock is entitled to a dividend at a rate of 7.875% per year based on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series A Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not declared)

exercise price of \$0.3 million.

exclusively at the Company's option commencing on April 5, 2009 (subject to the Company's right under limited circumstances to redeem the Series A Preferred Stock earlier in order to preserve its qualification as a REIT). Through March 31, 2014, the Company had declared and paid all required quarterly dividends on the Series A Preferred Stock.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 1. Notes to Consolidated Financial Statements

At March 31, 2014 and December 31, 2013, the Company had issued and outstanding 12,000,000 shares of Series C Preferred Stock, with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series C Preferred Stock is entitled to a dividend at a rate of 7.625% per year based on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series C Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on May 16, 2017 (subject to the Company's right under limited circumstances to redeem the Series C Preferred Stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change of control of the Company). Through March 31, 2014, the Company had declared and paid all required quarterly dividends on the Series C Preferred Stock.

At March 31, 2014 and December 31, 2013, the Company had issued and outstanding 18,400,000 shares of Series D Preferred Stock, with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series D Preferred Stock is entitled to a dividend at a rate of 7.50% per year based on the \$25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series D Preferred Stock is redeemable at \$25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on September 13, 2017 (subject to the Company's right under limited circumstances to redeem the Series D Preferred Stock earlier in order to preserve its qualification as a REIT or under limited circumstances related to a change of control of the Company). Through March 31, 2014, the Company had declared and paid all required quarterly dividends on the Series D Preferred Stock.

(C) Distributions to Stockholders

During the quarter ended March 31, 2014, the Company declared dividends to common stockholders totaling \$284.2 million, or \$0.30 per common share, paid to common stockholders on April 30, 2014. During the quarter ended March 31, 2014, the Company declared dividends to Series A Preferred stockholders totaling approximately \$3.6 million, or \$0.492 per share, Series C Preferred stockholders totaling approximately \$5.7 million, or \$0.477 per share, Series D Preferred stockholders totaling approximately \$8.6 million, or \$0.469 per share, which were paid to preferred stockholders on March 31, 2014.

During the quarter ended March 31, 2013, the Company declared dividends to common stockholders totaling \$426.2 million or \$0.45 per share, which were paid to common stockholders on April 29, 2013. During the quarter ended March 31, 2013, the Company declared dividends to Series A Preferred stockholders totaling approximately \$3.6 million or \$0.492 per share, Series C Preferred stockholders totaling approximately \$5.7 million or \$0.477 per share and Series D Preferred stockholders totaling approximately \$8.6 million or \$0.469 per share.

12. GOODWILL

At March 31, 2014 and December 31, 2013, goodwill totaled \$94.8 million.

13. INTEREST INCOME AND INTEREST EXPENSE

The table below presents the components of the Company's interest income and interest expense for the quarters ended March 31, 2014 and 2013.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

	For the quarters ended	
	March 31, 2014	March 31, 2013
Interest income:		
Investment Securities	\$ 614,419	\$ 723,750
Commercial investment portfolio(1)	39,486	1,070
U.S. Treasury securities	1,329	5,996
Securities loaned	114	2,612
Reverse repurchase agreements	500	3,636
Other	53	153
Total interest income	655,901	737,217
Interest expense:		
Repurchase agreements	103,131	157,064
Convertible Senior Notes	18,897	15,813
U.S. Treasury securities sold, not yet purchased	1,076	2,788
Securities borrowed	95	1,925
Securitized debt of consolidated VIE	1,611	-
Participation sold	161	-
Total interest expense	124,971	177,590
Net interest income	\$ 530,930	\$ 559,627

(1) Includes commercial real estate debt and preferred equity and corporate debt.

## 14. NET INCOME (LOSS) PER COMMON SHARE

The following table presents a reconciliation of net income and shares used in calculating basic and diluted earnings per share for the quarters ended March 31, 2014 and 2013.

	For the Quarter Ended	
	March 31, 2014	March 31, 2013
	(dollars in thousands, except per share data)	
Net income (loss)	\$ (203,351 )	\$ 870,278
Less: Preferred stock dividends	17,992	17,992
Net income (loss) available to common shareholders, prior to adjustment for dilutive potential common shares, if necessary	(221,343 )	852,286
Add: Interest on Convertible Senior Notes, if dilutive	-	10,450
Net income (loss) available to common shareholders, as adjusted	(221,343 )	862,736
Weighted average shares of common stock outstanding-basic	947,458,813	947,249,901
Add: Effect of dilutive stock options and Convertible Senior Notes, if dilutive	-	47,565,268
Weighted average shares of common stock outstanding-diluted	947,458,813	994,815,169
Net income (loss) per share available (related) to common share:		
Basic	\$ (0.23 )	\$ 0.90

Diluted	\$ (0.23 )	\$ 0.87
---------	------------	---------

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

Options to purchase 3.2 million and 3.4 million shares of common stock were outstanding and considered anti-dilutive as their exercise price and option expense exceeded the average stock price for the quarters ended March 31, 2014 and 2013, respectively.

## 15. LONG-TERM STOCK INCENTIVE PLAN

The Company adopted the 2010 Equity Incentive Plan (the "Plan"), which authorizes the Compensation Committee of the Board of Directors to grant options, stock appreciation rights, dividend equivalent rights, or other share-based awards, including restricted shares up to an aggregate of 25,000,000 shares, subject to adjustments as provided in the 2010 Equity Incentive Plan. The Company had previously adopted a long term stock incentive plan for executive officers, key employees and non-employee directors (the "Prior Plan"). The Prior Plan authorized the Compensation Committee of the Board of Directors to grant awards, including non-qualified options as well as incentive stock options as defined under Section 422 of the Code. The Prior Plan authorized the granting of options or other awards for an aggregate of the greater of 500,000 shares or 9.5% of the diluted outstanding

shares of the Company's common stock, up to a ceiling of 8,932,921 shares. No further awards will be made under the Prior Plan, although existing awards remain effective.

Stock options were issued at the market price on the date of grant, subject to an immediate or four year vesting in four equal installments with a contractual term of 5 or 10 years.

The following table sets forth activity related to the Company's stock options awarded under the Plan as of March 31, 2014:

	For the Quarter Ended March 31, 2014	
	Number of Shares	Weighted Average Exercise Price
Options outstanding at the beginning of period	3,581,752	\$ 15.44
Granted	-	\$ -
Exercised	-	\$ -
Forfeited	(353,417 )	\$ 14.94
Expired	-	\$ -
Options outstanding at the end of period	3,228,335	\$ 15.49
Options exercisable at the end of the period	3,228,335	\$ 15.49

The weighted average remaining contractual term was approximately 3.5 years for stock options outstanding and exercisable as of March 31, 2014.

As of March 31, 2014, there was no unrecognized compensation cost related to nonvested share-based compensation awards.

Section 162(m) of the Code ("Section 162(m)"). As a result of the externalization of management effective as of July 1, 2013, the Company does not expect to be subject to the Section 162(m) disallowance.

The state and local tax jurisdictions for which the Company is subject to tax-filing obligations recognize the Company's status as a REIT, and therefore, the

16. INCOME TAXES

For the quarter ended March 31, 2014 the Company was qualified to be taxed as a REIT under Code Sections 856 through 860. As a REIT, the Company is not subject to federal income tax to the extent that it distributes its taxable income to its stockholders. To maintain qualification as a REIT, the Company must distribute at least 90% of its annual REIT taxable income to its stockholders and meet certain other requirements such as assets it may hold, income it may generate and its stockholder composition. It is generally the Company's policy to distribute 100% of its REIT taxable income. To the extent there is any undistributed REIT taxable income at the end of a year, the Company distributes such shortfall within the next year as permitted by the Code. For years prior to 2013, the Company retained the amount of taxable income attributable to certain employee remuneration deductions disallowed for tax purposes pursuant to

Company generally does not pay income tax in such jurisdictions. The Company may, however, be subject to certain minimum state and local tax filing fees and the Company's TRSs are subject to federal, state and local taxes.

During the quarter ended March 31, 2014, the Company recorded \$4.0 million of income tax expense for income attributable to its TRSs. During the quarter ended March 31, 2013, the Company's TRSs recorded \$1.9 million of income tax expense for income attributable to those subsidiaries, and the portion of earnings retained based on Code Section 162(m) limitations. During the quarter ended March 31, 2013, the Company recorded \$3.9 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations.

The Company's 2012, 2011 and 2010 federal, state and local tax returns remain open for examination.



## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 1. Notes to Consolidated Financial Statements

## 17. LEASE COMMITMENTS AND CONTINGENCIES

## Commitments

The Company has a non-cancelable lease for office space which commenced in May 2002 and expires in

December 2014. FIDAC has a lease for office space which commenced in October 2010 and expires in February 2016. The lease expense for the quarters ended March 31, 2014 and 2013 were \$0.4 million and \$0.6 million, respectively. The Company's aggregate future minimum lease payments total \$1.9 million. The following table details the lease payments.

Year Ending December 31,	Lease Commitments (dollars in thousands)
2014 (remaining)	\$ 1,721
2015	159
2016	27
2017	-
2018	-
Later years	-
	\$ 1,907

The Company had no material unfunded loan commitments as of March 31, 2014 and December 31, 2013.

## Contingencies

From time to time, the Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Company's consolidated financial statements. No accrual for contingencies was required as of March 31, 2014 and December 31, 2013.

## 18. RISK MANAGEMENT

The primary risks to the Company are liquidity and investment/market risk. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond the Company's control. Changes in the general level of interest rates can affect net interest income, which is the difference between the interest income earned on interest earning assets and the interest expense incurred in connection with the interest bearing liabilities, by affecting the spread between the interest earning assets and interest bearing liabilities. Changes in

The Company may seek to mitigate the potential financial impact by entering into interest rate agreements such as interest rate swaps, interest rate swaptions and other hedges. As of March 31, 2014 and December 31, 2013, the Company entered into interest rate swaps to pay a fixed rate and receive a floating rate of interest, with a total notional amount of \$58.1 billion and \$52.4 billion, respectively. As of March 31, 2014 the Company entered into interest rate swaps to receive a fixed rate and pay a floating rate of interest, with a total notional amount of \$1.4 billion. The Company was not party to any receive fixed-rate interest rate swaps at December 31, 2013

Weakness in the mortgage market, the shape of the yield curve and changes in the expectations for the volatility of future interest rates may adversely affect the performance and market value of the Company's investments. This could negatively impact the Company's book value. Furthermore, if many of the Company's lenders are unwilling or unable to provide additional financing, the Company could be forced to sell its Investment Securities at an inopportune time when prices are depressed. The Company has established policies and procedures for mitigating risks, including conducting scenario analyses and utilizing a range of hedging strategies.

the level of interest rates can also affect the value of the interest earning assets and the Company's ability to realize gains from the sale of these assets. A decline in the value of the interest earning assets pledged as collateral for borrowings under repurchase agreements and derivative contracts could result in the counterparties demanding additional collateral pledges or liquidation of some of the existing collateral to reduce borrowing levels.

The payment of principal and interest on the Freddie Mac and Fannie Mae Agency mortgage-backed securities are guaranteed by those respective agencies and the payment of principal and interest on Ginnie Mae Agency mortgage-backed securities are backed by the full faith and credit of the U.S. government. Principal and interest on Agency debentures are guaranteed by the agency issuing the debenture. Substantially all of the Company's Investment Securities have an actual or implied "AAA" rating.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 1. Notes to Consolidated Financial Statements

The Company faces credit risk on the portions of its portfolio which are not Agency mortgage-backed securities, Agency debentures or U.S. Treasury securities. The Company is exposed to credit risk on CRE Debt and Preferred Equity Investments and corporate debt. The Company is exposed to risk of loss if an issuer, borrower or counterparty fails to perform its obligations under contractual terms. The Company has established policies and procedures for mitigating credit risk, including reviewing and establishing limits for credit exposure, limiting transactions with specific counterparties, maintaining qualifying collateral and continually assessing the creditworthiness of counterparties, borrowers and issuers.

#### 19. RCAP REGULATORY REQUIREMENTS

RCap is subject to regulations of the securities business that include but are not limited to trade practices, use and safekeeping of funds and securities, capital structure, recordkeeping and conduct of directors, officers and employees.

As a self-clearing, registered broker dealer, RCap is required to maintain minimum net capital by FINRA. As of March 31, 2014 RCap had a minimum net capital requirement of \$0.3 million. RCap consistently operates with capital in excess of its regulatory capital requirements. RCap's regulatory net capital as defined by SEC Rule 15c3-1, as of March 31, 2014 was \$397.2 million with excess net capital of \$396.9 million.

#### 20. RELATED PARTY TRANSACTIONS

##### Investment in Affiliate, Available-For-Sale Equity Security

At March 31, 2014, the Company's available-for-sale equity securities represented shares of Chimera Investment Corporation ("Chimera"), which are reported at fair value. The Company owned approximately 45.0 million shares of Chimera at a fair value of approximately \$137.6 million at March 31, 2014 and approximately 45.0 million shares of Chimera at a fair value of approximately \$139.4 million at December 31, 2013. At March 31, 2014 and December 31, 2013, the

##### Advisory fees

For the quarter ended March 31, 2014, the Company recorded advisory fees from Chimera totaling \$6.1 million. For the quarter ended March 31, 2013, the Company recorded advisory fees from Chimera and CreXus totaling \$9.3 million. At March 31, 2014 and December 31, 2013, the Company had amounts receivable from Chimera of \$6.5 million and \$6.8 million, respectively.

##### Management Agreement

In June 2013, the Company and the Manager entered into a Management Agreement (the "Management Agreement"), effective as of July 1, 2013 and applicable for the entire 2013 calendar year, pursuant to which the Company's management is conducted by the Manager through the authority delegated to it in the Management Agreement and pursuant to the policies established by the Board of Directors (the "Externalization"). Pursuant to the terms of the Management Agreement, the Company pays the Manager a monthly management fee in an amount equal to 1/12th of 1.05% of stockholders' equity, as defined in the Management Agreement, for its management services.

Effective July 1, 2013, a majority of the Company's employees were terminated by the Company and were hired by the Manager. The Company has a limited number of employees following the Externalization, all of whom are employees of the Company's subsidiaries for regulatory or corporate efficiency reasons. All compensation expenses associated with such retained employees reduce the management fee. Pursuant to a pro forma calculation that computed the management fee as though it was in effect beginning January 1, 2013, the Company paid the Manager an amount equal to the pro forma calculation minus the actual compensation paid to the Company's and its subsidiaries' employees from January 1, 2013 to June 30, 2013.

The Management Agreement may be amended or modified by agreement between the Company and the Manager. The initial term of the Management Agreement expires on December 31, 2014 and will be

investment in Chimera had an unrealized loss of \$1.2 million and an unrealized gain of \$0.6 million, respectively.

The Company evaluates the near-term prospects of its current investment in Chimera in relation to the severity and length of time of impairment. As of March 31, 2014, management determined that its investment in Chimera was not considered to be other-than-temporarily impaired as the Company had the intent and ability to retain its investments for a period of time sufficient to allow for any anticipated recovery in market value. As of December 31, 2013, the Company's investment in Chimera was in an unrealized gain position.

automatically renewed for a one year term each anniversary date thereafter unless previously terminated pursuant to the terms of the Management Agreement. There is no termination fee for a termination of the Management Agreement by either the Company or the Manager.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Special Note Regarding Forward-Looking Statements

Certain statements contained in this quarterly report, and certain statements contained in our future filings with the Securities and Exchange Commission (the SEC or the Commission), in our press releases or in our other public or stockholder communications may not be based on historical facts and are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements, which are based on various assumptions, (some of which are beyond our control) may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "anticipate," "continue," or similar terms or variations on those terms, or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, changes in interest rates, changes in the yield curve, changes in prepayment rates, the availability of mortgage-backed securities and other securities for purchase, the availability of financing, and, if available, the terms of any financing, changes in the market value of our assets, changes in business conditions and the general economy, our ability to grow the commercial mortgage business, credit risks related to our investments in commercial real estate assets and corporate debt, our ability to consummate any contemplated investment

opportunities and other corporate transactions, changes in governmental regulations affecting our business, our ability to maintain our classification as a real estate investment trust (or REIT) for federal income tax purposes, our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended (or Investment Company Act), and risks associated with the business of our subsidiaries, including the investment advisory businesses of our subsidiary, and risks associated with the broker dealer business of our subsidiary. For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, see the information under the caption "Risk Factors" contained in our most recent annual report on Form 10-K. We do not undertake and specifically disclaim any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our most recent annual report on Form 10-K. All references to "Annaly," "we," "us" or "our" mean Annaly Capital Management, Inc. and all entities owned by us, except where it is made clear that the term means only the parent company. Refer to the Glossary of Terms for definitions of commonly used terms in this quarterly report on Form 10-Q.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management’s Discussion and Analysis

INDEX TO ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

	Page
<u>Overview</u>	35
<u>Business Environment</u>	35
<u>Economic Environment</u>	35
<u>Financial Regulatory Reform</u>	36
<u>Results of Operations</u>	36
<u>Net Income (Loss) Summary</u>	36
<u>Non-GAAP Financial Measures</u>	37
<u>Core Earnings Summary</u>	38
<u>Economic Interest Expense and Economic Net Interest Income</u>	38
<u>Interest Income and Average Earning Asset Yield</u>	39
<u>Economic Interest Expense and the Cost of Interest-Bearing Liabilities</u>	39
<u>Economic Net Interest Income</u>	40
<u>Other Income</u>	40
<u>General and Administrative Expenses</u>	41
<u>Unrealized Gains and Losses</u>	42
<u>Net Income (Loss) and Return on Average Equity</u>	42
<u>Financial Condition</u>	42
<u>Investment Securities</u>	43
<u>Contractual Obligations</u>	44
<u>Off-Balance Sheet Arrangements</u>	45
<u>Capital Management</u>	45
<u>Stockholders’ Equity</u>	46
<u>Common and Preferred Stock</u>	46
<u>Distributions to Stockholders</u>	47
<u>Leverage and Capital</u>	47
<u>Risk Management</u>	47
<u>Risk Appetite</u>	47
<u>Governance</u>	48
<u>Description of Risks</u>	48
<u>Liquidity Risk Management</u>	49
<u>Funding</u>	49
<u>Excess Liquidity</u>	50
<u>Maturity Profile</u>	51
<u>Stress Testing</u>	52
<u>Liquidity Management Policies</u>	52
<u>Investment/Market Risk Management</u>	52
<u>Credit and Counterparty Risk Management</u>	53
<u>Operational Risk Management</u>	54
<u>Compliance, Regulatory and Legal Risk Management</u>	55
<u>Critical Accounting Policies</u>	55
<u>Valuation of Financial Instruments</u>	55
<u>Agency Mortgage-backed Securities and Debentures</u>	55
<u>Interest Rate Swaps</u>	55

<u>Revenue Recognition</u>	55
<u>Use of Estimates</u>	55
<u>Glossary of Terms</u>	56

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management’s Discussion and Analysis

Overview

We are a leading mortgage REIT that is externally managed by Annaly Management Company LLC (or Manager). Our common stock is listed on the New York Stock Exchange under the symbol “NLY.” Since our founding in 1997, we have strived to generate net income for distribution to our stockholders through the prudent selection and management of our investments.

We own a portfolio of real estate related investments. We use our capital coupled with borrowed funds to invest in real estate related investments, earning the spread between the yield on our assets and the cost of our borrowings and hedging activities.

We are primarily organized around the following operations:

Annaly, the parent company

Invests primarily in various types of Agency mortgage-backed securities and related derivatives to hedge these investments.

Annaly Commercial Real Estate Group, Inc. (or ACREG) (formerly known as CreXus Investment Corp. (or CreXus))

Wholly-owned subsidiary that was acquired during the second quarter of 2013 and specializes in acquiring, financing and managing commercial mortgage loans and other commercial real estate debt, commercial mortgage-backed securities and other commercial real estate-related assets.

RCap Securities, Inc.

Wholly-owned subsidiary that operates as a broker-dealer, and is a member of the Financial Industry Regulatory Authority.

Fixed Income Discount Advisory Company (or FIDAC)

Wholly-owned subsidiary that manages an affiliated REIT for which it earns fee income.

Annaly Middle Market Lending LLC

Wholly-owned subsidiary that engages in corporate middle market lending transactions.

Shannon Funding LLC

Wholly-owned subsidiary that acquires residential mortgage loans and provides warehouse financing to residential mortgage originators in the United States.

Our asset portfolio totaled \$79.5 billion as of March 31, 2014, which includes \$398.1 million of commercial real estate securitized loans held in a consolidated trust, compared to \$75.1 billion as of December 31, 2013, reflecting an increase in Investment Securities. ACREG represented approximately 2.1% of our asset portfolio as of March 31, 2014.

We recorded a net loss of \$203.4 million, or \$0.23 per average basic common share, for the quarter ended March 31, 2014 compared to net income of \$870.3 million, or \$0.90 per basic share, for the same period in 2013. Leverage at March 31, 2014 and December 31, 2013 was 5.2:1 and 5.0:1, respectively. At March 31, 2014 and December 31, 2013 the Company’s capital ratio was 15.2% and 15.1%, respectively. At March 31, 2014

Business Environment

We have begun selectively adding Agency mortgage-backed securities to our portfolio in the first quarter of 2014. We remain somewhat cautious as the Federal Reserve (or Fed) has begun to wind down their purchases of Agency MBS. Additionally, further financial and housing regulatory reform is likely, and its effect on our business is unclear.

Economic Environment

Economic growth, as measured by real gross domestic product (or GDP), increased slightly by 0.1 percent on a seasonally-adjusted annualized rate in the first quarter of 2014. The decline in pace of growth is likely partially



and December 31, 2013, the Company had a common stock book value per share of \$12.30 and \$12.13, respectively.

due to unusually harsh weather conditions throughout the United States, with the recent trend of 1-3 percent growth intact. Employment growth was also steady throughout the quarter though similarly impacted by weather, averaging just below the recent trend of 200,000 jobs added per month, as measured by the Bureau of Labor Services. The annual growth in the

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

Fed's preferred price measure, or core PCE which is defined as personal consumption expenditure prices excluding food and energy prices, continued to run below expectations at 1.1 percent in February 2014. The Federal Open Market Committee (FOMC or the Committee) continues to note that "inflation persistently below its 2 percent objective could pose risks to economic performance," but expects that inflation will eventually trend back towards its objective.

Noting the cumulative progress toward maximum employment and an improving labor market outlook, on January 29, 2014, the Fed announced that beginning in February 2014, it will add to its holdings of longer-term U.S. Treasury securities at a pace of \$35 billion per month rather than \$40 billion per month, and will add to its holdings of Agency mortgage-backed securities at a pace of \$30 billion per month rather than \$35 billion per month. The FOMC continued the slowing of their pace of asset purchases in their March 18-19, 2014 meeting, reducing their purchases of U.S. Treasuries to \$30 billion per month, and Agency mortgage-backed securities to \$25 billion per month. In their April 30 meeting, the FOMC elected to further reduce their purchases of U.S. Treasuries to \$25 billion per month, and Agency mortgage-backed securities to \$20 billion per month. In a further modification to their policy rate guidance, the FOMC removed the language surrounding a specific unemployment rate threshold altogether at their March meeting, in favor of a broader assessment of "a wide range of information." In addition, they provided guidance on the expected future path of their federal funds rate target, saying they anticipate "even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run." In her first post-FOMC press conference Chairman Yellen reiterated the Committee's commitment to accommodative monetary policy after a "series of years in which growth has proven disappointing" and a "shallower glide path" to the first federal funds increase. The 10-year Treasury, which closed to yield 3.03 percent on December 31, 2013 correspondingly fell to yield 2.72 percent on March 31, 2014. Volatility, as measured by the Merrill Lynch MOVE index, similarly

coupon and the 10-year U.S. Treasury, which had widened amidst volatility during the second quarter of 2013, steadied through the end of the year and first quarter of 2014. The higher level of mortgage rates resulted in decreased prepayment speeds and lower mortgage originations.

#### Financial Regulatory Reform

Uncertainty remains surrounding financial regulatory reform and its impact on the markets and the broader economy. In particular, the government is attempting to change its involvement through the Agencies in the mortgage market. There have been numerous legislative initiatives introduced regarding the Agencies, and it is unclear which approach, if any, may become law. In addition, regulators remain focused on the wholesale funding markets, bank capital levels and shadow banking. It is difficult to predict the ultimate legislative and other regulatory outcomes of these efforts. We continue to monitor these legislative and regulatory developments and evaluate their potential impact on our business.

#### Results of Operations

The results of our operations are affected by various factors, many of which are beyond our control. Certain of such risks and uncertainties are described herein (see "Special Note Regarding Forward-Looking Statements") and in Part I, Item 1A. "Risk factors" of our most recent annual report on Form 10-K.

#### Net Income (Loss) Summary

For the quarter ended March 31, 2014, we recorded a net loss of \$203.4 million, or \$0.23 per average basic common share, as compared to net income of \$870.3 million, or \$0.90 per average basic common share, for the quarter ended March 31, 2013. We attribute the majority of the change in net income (loss) for the quarter ended March 31, 2014 from the quarter ended March 31, 2013 to the change in unrealized gains (losses) on interest rate swaps, which resulted in an unrealized loss of \$348.9 million for the quarter ended March 31, 2014 compared to an unrealized gain of

declined during the same period from 73.55 to 61.81.

In response to the Fed's taper decision and improved economic outlook, long-term rates, benchmarked by the 10-year U.S. Treasury, initially rose through the end of the year before steadying in the first quarter of 2014. The mortgage basis, or spread between the 30-year Agency mortgage-backed securities current

\$325.7 million for the same period in 2013. The change in the fair value of interest rate swaps was primarily attributable to the downtrend in forward interest rates experienced during the quarter ended March 31, 2014 compared to rising interest rates during the same period in 2013. In addition, net gains (losses) on trading assets resulted in a loss of \$146.2 million for the quarter ended March 31, 2014 compared to a gain of \$1.5 million for the same period in 2013, net gains on

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

disposal of investments decreased \$103.1 million for the same comparative period and the change in unrealized gains (losses) on interest-only Agency mortgage-backed securities resulted in an unrealized loss of 20.8 million for the quarter ended March 31,

2014 compared to an unrealized gain of \$80.1 million for the same period in 2013.

The following table presents our net income (loss) summary for the quarters ended March 31, 2014 and 2013.

	For the Quarter Ended March 31,	
	2014	2013
	(dollars in thousands, except per share data)	
Interest income	\$ 655,901	\$ 737,217
Interest expense	124,971	177,590
Net interest income	530,930	559,627
Other income (loss)	(682,902 )	368,370
General and administrative expenses	47,378	51,912
Income (loss) before income taxes	(199,350 )	876,085
Income taxes	4,001	5,807
Net income (loss)	(203,351 )	870,278
Dividends on preferred stock	17,992	17,992
Net income (loss) available (related) to common stockholders	\$ (221,343 )	\$ 852,286
Net income (loss) per share available (related) to common stockholders:		
Basic	\$ (0.23 )	\$ 0.90
Diluted	\$ (0.23 )	\$ 0.89
Weighted average number of common shares outstanding:		
Basic	947,458,813	947,249,901
Diluted	947,458,813	994,815,169
Other information:		
Average total assets	\$ 82,168,619	\$ 129,477,076
Average equity	\$ 12,484,884	\$ 15,615,407
Return on average total assets	(0.99 %)	2.69 %
Return on average equity	(6.52 %)	22.29 %

We use daily balances to calculate average Interest Earning Assets and Interest Bearing Liabilities. For the purpose of computing net interest income and ratios relating to cost of funds measures throughout this report, interest expense includes interest expense on interest rate swaps, which is recorded in the Consolidated Statements of Comprehensive Income (Loss) as Realized gains (losses) on interest rate swaps.

## Non-GAAP Financial Measures

Core earnings is defined as net income (loss) excluding gains or losses on disposals of investments and termination of interest rate swaps, unrealized gains or losses on interest rate swaps and Agency interest-only mortgage-backed securities and net gains and losses on trading assets.

We believe that core earnings, core earnings per average basic common share, economic interest expense and economic net interest income provide meaningful information to consider, in addition to the respective amounts prepared in accordance with GAAP. The

This Management Discussion and Analysis section contains analysis and discussion of non-GAAP measurements. The non-GAAP measurements include the following:

- core earnings;
- core earnings per average basic common share;
- economic interest expense; and
- economic net interest income.

non-GAAP measures help us to evaluate our financial position and performance without the effects of certain transactions and GAAP adjustments that are not necessarily indicative of our current investment portfolio and operations.

Our presentation of the economic value of our investment strategy has important limitations. Other market participants may calculate core earnings, core earnings per average basic common share, economic interest expense and economic net interest income differently than we calculate them, making comparative analysis difficult.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

Although we believe that the calculation of the economic value of our investment strategy described above helps evaluate and measure our financial position and performance without the effects of certain transactions, it is of limited usefulness as an analytical tool. Therefore, the economic value of our investment strategy should not be viewed in isolation and is not a substitute for net income (loss), net income (loss) per basic share available (related) to common stockholders, interest expense and net interest income computed in accordance with GAAP.

## Core Earnings Summary

Our core earnings were \$239.7 million, or \$0.23 per average basic common share, for the quarter ended

March 31, 2014 compared to \$296.4 million, or \$0.29 per average basic common share, for the same period in 2013. We attribute the majority of the decrease in core earnings for the quarter ended March 31, 2014 from the quarter ended March 31, 2013 to a decline in economic net interest income of \$63.7 million for the quarter ended March 31, 2014 compared to the same period in 2013, primarily attributable to a decline in average Interest Earning Assets to \$81.9 billion from \$124.4 billion.

The following table provides GAAP measures of net income (loss) and net income (loss) per basic share available to common stockholders for the quarters ended March 31, 2014 and 2013 and details with respect to reconciling the aforementioned line items on a non-GAAP basis:

	For the Quarter Ended March 31,	
	2014	2013
	(dollars in thousands, except per share data)	
GAAP net income (loss)	\$ (203,351 )	\$ 870,278
Adjustments:		
Realized (gains) losses on termination of interest rate swaps	6,842	16,378
Unrealized (gains) losses on interest rate swaps	348,942	(325,734 )
Net (gains) losses on disposal of investments	(79,710 )	(182,843 )
Net (gains) losses on trading assets	146,228	(1,549 )
Net unrealized (gains) losses on interest-only Agency mortgage-backed securities	20,793	(80,127 )
Core earnings	\$ 239,744	\$ 296,403
GAAP net income per average basic common share	\$ (0.23 )	\$ 0.90
Core earnings per average basic common share	\$ 0.23	\$ 0.29

## Economic Interest Expense and Economic Net Interest Income

We believe the economic value of our investment strategy is depicted by the economic net interest income we earn. We calculate economic net interest income by determining our GAAP net interest income and reducing it by interest expense on interest rate swaps. Our economic interest expense, which is

composed of interest expense on our Interest Bearing Liabilities plus interest expense on interest rate swaps, reflects total contractual interest payments.

The following table provides GAAP measures of interest expense and net interest income and details with respect to reconciling the aforementioned line items on a non-GAAP basis for each respective period:

Economic	GAAP Net
----------	----------

Edgar Filing: ANNALY CAPITAL MANAGEMENT INC - Form 10-Q

	GAAP Interest Expense	Add: Realized Losses on Interest Rate Swaps (1)	Interest Expense	Interest Income	Less: Realized Losses on Interest Rate Swaps (1)	Economic Net Interest Income
For the Quarter Ended:						
			(dollars in thousands)			
March 31, 2014	\$ 124,971	\$ 260,435	\$ 385,406	\$ 530,930	\$ 260,435	\$ 270,495
March 31, 2013	\$ 177,590	\$ 225,476	\$ 403,066	\$ 559,627	\$ 225,476	\$ 334,151

(1) Economic interest expense includes interest expense on interest rate swaps.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

## Interest Income and Average Earning Asset Yield

Prepayment speeds, as reflected by the Constant Prepayment Rate, or CPR, and interest rates vary according to the type of investment, conditions in financial markets, competition and other factors, none of which can be predicted with any certainty. In general, as prepayment speeds on our Agency mortgage-backed securities portfolio increase, related purchase premium amortization increases, thereby reducing the yield on such assets. The following table presents the CPR experienced on our Agency mortgage-backed securities portfolio for the periods presented.

Quarter Ended	CPR
March 31, 2014	6%
March 31, 2013	19%

Our interest income for the quarters ended March 31, 2014 and 2013 was \$655.9 million and \$737.2 million, respectively. We had average Interest Earning Assets of \$81.9 billion and \$124.4 billion, and the yield on our average Interest Earning Assets was 3.21% and 2.37% for the quarters ended March 31, 2014 and 2013, respectively. The decline in interest income of \$81.3 million for the quarter ended March 31, 2014 compared to the quarter ended March 31, 2013 was primarily due to a \$42.6 billion decrease in average Interest Earning Assets for the quarter ended March 31, 2014 compared to the same period in 2013.

## Economic Interest Expense and the Cost of Interest Bearing Liabilities

Our largest expense is the cost of Interest Bearing Liabilities and interest expense on interest rate swaps, which is recorded in realized gains (losses) on interest rate swaps on the Consolidated Statements of Comprehensive Income (Loss). We had average Interest Bearing Liabilities of \$66.9 billion and \$110.7 billion for the quarters ended March 31, 2014 and 2013, respectively. Our total economic interest expense was \$385.4 million, which included \$260.4 million in interest expense on interest rate swaps, and \$403.1 million, which included \$225.5 million in interest expense on interest rate swaps, for the quarters ended March 31, 2014 and 2013, respectively. Our cost of funds on average Interest Bearing Liabilities was 2.31% and 1.46%, including interest expense on interest rate swaps, for the quarters ended March 31, 2014 and 2013, respectively. Economic interest expense, including interest expense on interest rate swaps, for the quarter ended March 31, 2014 decreased by \$17.7 million when compared to the quarter ended March 31, 2013, primarily due to the \$43.9 billion decline in average Interest Bearing Liabilities for the quarter ended March 31, 2014 compared to the same period in 2013, partially offset by a 85 basis point increase in the cost of Interest Bearing Liabilities, largely attributable to increased swap expense.

The table below shows our average Interest Bearing Liabilities and cost of funds on average Interest Bearing Liabilities as compared to average one-month and average six month LIBOR for the periods presented.

Average Interest Bearing Liabilities	Interest Bearing Liabilities at Period End	Economic Interest Expense(1)	Average	Average	Average	Average	Average	Average
			Cost of Interest Bearing Liabilities	Cost of One-Month LIBOR	Cost of Six-Month LIBOR	Relative to Average One-Month LIBOR	Relative to Average Six-Month LIBOR	
			(dollars in thousands)					

For the  
Quarter



Ended:

March

31, 2014	\$66,870,534	\$66,159,608	\$385,406	2.31 %	0.16 %	0.33 %	(0.17 %)	2.15 %	1.98 %
----------	--------------	--------------	-----------	--------	--------	--------	----------	--------	--------

March

31, 2013	\$110,722,615	\$104,089,071	\$403,066	1.46 %	0.20 %	0.47 %	(0.27 %)	1.26 %	0.99 %
----------	---------------	---------------	-----------	--------	--------	--------	----------	--------	--------

(1) Economic interest expense includes interest expense on interest rate swaps.

We do not manage our portfolio to have a pre-designated amount of borrowings at quarter or year end. Our borrowings at period end are a snapshot of our borrowings as of a date, and this number should be expected to differ from average borrowings over the period for a number of reasons. The mortgage-backed securities we own pay principal and interest towards the end of each month and the mortgage-backed securities we purchase are typically settled during the beginning of the month. As a result, depending on the amount of mortgage-backed securities we have committed to purchase, we may retain the principal and

interest we receive in the prior month, or we may use it to pay down our borrowings. Moreover, we use interest rate swaps, swaptions and other derivative instruments to hedge our portfolio and as we pledge or receive collateral under these agreements, our borrowings on any given day may be increased or decreased. Our average borrowings during a quarter will differ from period end borrowings as we implement our portfolio management strategies and risk management strategies over changing market conditions by increasing or decreasing leverage. Additionally, these numbers will differ during periods when we conduct capital raises, as

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

in certain instances we may purchase additional assets and increase leverage with the expectation of a successful capital raise. Since our average borrowings and period end borrowings can be expected to differ, we believe our average borrowings during a period provide a more accurate representation of our exposure to the risks associated with leverage.

As of March 31, 2014 and December 31, 2013, 98% and 99%, respectively, of our debt consisted of borrowings collateralized by a pledge of our Investment Securities. These borrowings appear on our Consolidated Statements of Financial Condition as Repurchase Agreements. All of our Agency mortgage-backed securities and debentures are currently accepted as collateral for these borrowings. However, we limit our borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and thus increase the liquidity and strength of our balance sheet. As of March 31, 2014, the term to maturity of our repurchase agreements ranged from one day to five years. Additionally, we have entered into borrowings giving the counterparty the right to call the balance prior to maturity. At March 31, 2014 and December 31, 2013, the weighted average cost of funds for all of our borrowings was 2.46% and 2.37%, respectively,

including the effect of the interest rate swaps, 4% Convertible Senior Notes due 2015 and 5% Convertible Senior Notes due 2015 (collectively, the Convertible Senior Notes), and the weighted average days to maturity was 189 days and 208 days, respectively.

## Economic Net Interest Income

Our economic net interest income, including interest paid on interest rate swaps, totaled \$270.5 million and \$334.2 million for the quarters ended March 31, 2014 and 2013, respectively. The decline for the quarter ended March 31, 2014 compared to the same period in 2013 was primarily due to lower interest income, as our average Interest Earning Assets decreased by \$42.6 billion.

The table below shows our average Interest Earning Assets, total interest income, yield on average Interest Earning Assets, average Interest Bearing Liabilities, economic interest expense, average cost of Interest Bearing Liabilities, economic net interest income and net interest rate spread for the periods presented.

	Average Interest Earning Assets(1)	Total Interest Income	Yield on Average Interest Earning Assets	Average Interest Bearing Liabilities	Economic Interest Expense(2)	Average Cost of Interest Bearing Liabilities	Economic Net Interest Income(3)	Net Interest Rate Spread
For the Quarter Ended:	(dollars in thousands)							
March 31, 2014	\$ 81,852,609	\$ 655,901	3.21 %	\$ 66,870,534	\$ 385,406	2.31 %	\$ 270,495	0.90 %
March 31, 2013	\$ 124,414,754	\$ 737,217	2.37 %	\$ 110,722,615	\$ 403,066	1.46 %	\$ 334,151	0.91 %

(1) Does not reflect unrealized gains/ (losses) or premium/ (discount).

(2) Economic interest expense includes interest expense on interest rate swaps.

(3) Economic net interest income includes interest expense on interest rate swaps.

## Other Income

Other income is largely comprised of net gains or losses on interest rate swaps, gains or losses from trading assets, net gains or losses on sales of Agency mortgage-backed securities and other investments, net unrealized gains (losses) on interest-only Agency mortgage-backed securities, dividend income from available-for-sale equity securities and investment advisory fees.

The aggregate net gain (loss) on interest rate swaps was a loss of \$616.2 million and a gain of \$83.9 million for the quarters ended March 31, 2014 and 2013, respectively. The change in the aggregate net gain (loss) on interest rate swaps for the quarter ended March 31, 2014 as compared to the same period in

2013 was primarily attributable to the downward trend in forward interest rates experienced in the first quarter of 2014, coupled with a larger notional balance of swaps outstanding in the first quarter of 2014 compared to the same period in 2013.

Our net loss from trading assets was \$146.2 million for the quarter ended March 31, 2014 compared to a net gain of \$1.5 million for the same period in 2013. The change for the quarter ended March 31, 2014 as compared to the same period in 2013 was primarily attributable to net losses from interest rate swaptions and TBA derivatives.

For the quarters ended March 31, 2014 and 2013, we disposed of Investments Securities with a carrying value of \$5.0 billion and \$17.2 billion for an aggregate

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

net gain of \$80.7 million and \$182.8 million, respectively. We may from time to time sell existing assets to acquire new assets, which our management believes might have higher risk-adjusted returns, or to manage our balance sheet as part of our asset/liability management strategy.

Our net unrealized loss on interest-only Agency mortgage-backed securities was \$20.8 million for the quarter ended March 31, 2014 compared to a net gain of \$80.1 million for the same period in 2013. The change was primarily attributable to the downward trend in forward interest rates experienced in the first quarter of 2014 compared to rising interest rates during the same period in 2013.

Dividend income from our investments in Chimera Investment Corporation (or Chimera) totaled \$13.0 million for the quarter ended March 31, 2014. Dividend income from our investment in Chimera and CreXus (we held shares prior to our acquisition of CreXus, which closed during the second quarter of 2013), totaled \$6.4 million for the quarter ended March 31, 2013. The increase in dividend income for the quarter ended March 31, 2014 compared to the same period in 2013 was due to a \$9.0 million special dividend from our investment in Chimera recognized during the first quarter of 2014, partially offset by CreXus declaring a dividend during the first quarter of 2013 but not during the same period in 2014 as a result of its acquisition. Chimera is and CreXus was managed by our wholly-owned subsidiary FIDAC.

FIDAC is a registered investment advisor specializing in managing fixed income securities. In October 2013, we sold the net assets and operations of Merganser Capital Management, Inc., a registered investment advisor specializing in managing fixed income securities, to a third party. Investment advisory income for the quarters ended March 31, 2014 and 2013 totaled \$6.1 million and \$13.4 million, respectively, net of fees paid to third parties pursuant to distribution service agreements for facilitating and promoting distribution of shares or units to FIDAC's clients. The decline in investment advisory income for the quarter ended March 31, 2014 compared to the same period in 2013 was due to lower advisory fees from affiliates and the sale of Merganser in October 2013.

## General and Administrative Expenses

General and administrative (or G&A) expenses consists of compensation expense, the management fee and other expenses. G&A expenses were \$47.4 million and \$51.9 million for the quarters ended March 31, 2014 and 2013, respectively. For the quarter ended March 31, 2014, any compensation expense incurred by us reduced the amount of the management fee by the same amount. G&A expenses as a percentage of average total assets was 0.23% and 0.16% for the quarters ended March 31, 2014 and 2013, respectively. The decrease in G&A expenses of \$4.5 million for the quarter ended March 31, 2014 compared to the same period in 2013 was the result of lower other general and administrative expenses, primarily lower professional fees and brokerage expenses.

The table below shows our total G&A expenses as compared to average total assets and average equity for the periods presented.

## G&amp;A Expenses and Operating Expense Ratios

	Total G&A Expenses	Total G&A Expenses/Average Assets	Total G&A Expenses/Average Equity
For the Quarter Ended:	(dollars in thousands)		
March 31, 2014	\$ 47,378	0.23%	1.52%
March 31, 2013	\$ 51,912	0.16%	1.33%

Unrealized Gains and Losses

With our “available-for-sale” accounting treatment, unrealized fluctuations in market values of assets do not impact our GAAP or taxable income but rather are reflected on our balance sheet by changing the carrying value of the asset and stockholders’ equity under Accumulated Other Comprehensive Income (Loss). As

a result of this fair value accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used historical amortized cost accounting. As a result, comparisons with companies that use historical cost accounting for some or all of their balance sheet may not be meaningful.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

The table below shows cumulative unrealized gains and losses on our available-for-sale investments reflected in the Consolidated Statements of Financial Condition.

	Unrealized Gains and Losses	
	March 31, 2014	December 31, 2013
	(dollars in thousands)	
Unrealized gain	\$ 519,935	\$ 600,034
Unrealized loss	(2,608,414 )	(3,348,967 )
Net unrealized gain (loss)	\$ (2,088,479 )	\$ (2,748,933 )

Unrealized changes in the estimated fair value of available-for-sale investments may have a direct effect on our potential earnings and dividends: positive changes will increase our equity base and allow us to increase our borrowing capacity while negative changes tend to limit borrowing capacity under our investment policy. A very large negative change in the net fair value of our available-for-sale investment securities might impair our liquidity position, requiring us to sell assets with the likely result of realized losses upon sale.

The fair value of these securities being below amortized cost for the quarter ended March 31, 2014 is solely due to market conditions and not the quality of the assets. Substantially all of the Agency mortgage-backed securities are "AAA" rated or carry an implied "AAA" rating. The investments are not considered to be other-than-temporarily impaired because we currently have the ability and intent to hold the

investments to maturity or for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investments, and it is not more likely than not that we will be required to sell the investments before recovery of the amortized cost bases, which may be maturity. Also, we are guaranteed payment of the principal amount of the securities by the respective issuing government agency.

## Net Income (Loss) and Return on Average Equity

We recorded a net loss of \$203.4 million and net income of \$870.3 million for the quarters ended March 31, 2014 and 2013, respectively. Our return (loss) on average equity was (6.52%) and 22.29% for the quarters ended March 31, 2014 and 2013, respectively.

The table below shows the components of our return on average equity for the periods presented.

## Components of Return of Average Equity

For the Quarter Ended:	Components of Return of Average Equity													
	Economic Net Interest Income/Average Equity(1)		Net Investment Advisory Fees/Average Equity		Realized and Unrealized Gains and Losses/Average Equity		Other Income (Loss)/Average Equity(2)		G&A Expenses/Average Equity		Income Taxes/Average Equity		Return on Average Equity	
March 31, 2014	8.67	%	0.20	%	(14.20	%)	0.46	%	(1.52	%)	(0.13	%)	(6.52	%)
	8.56	%	0.35	%	14.70	%	0.16	%	(1.33	%)	(0.15	%)	22.29	%

March 31,  
2013

(1) Economic net interest income includes interest expense on interest rate swaps.

(2) Other income (loss) includes dividend income from affiliates, impairment of goodwill, loss on previously held equity interest in CreXus and other income (loss).

#### Financial Condition

Total assets were \$82.4 billion and \$81.9 billion as of March 31, 2014 and December 31, 2013, respectively. The change was primarily due to a \$4.4 billion increase in Investments Securities partially offset by decreases in securities borrowed and U.S. Treasury securities as

RCap, our broker-dealer subsidiary, ceased its trading activity in U.S. Treasury securities, derivatives and certain securities borrowed and loaned transactions activities during the first quarter of 2014.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

## Investment Securities

Substantially all of our Agency mortgage-backed securities at March 31, 2014 and December 31, 2013 were backed by single-family mortgage loans. Substantially all of the mortgage assets underlying these mortgage-backed securities were secured with a first lien position on the underlying single-family properties. Our mortgage-backed securities were largely Freddie Mac, Fannie Mae or Ginnie Mae pass through certificates or CMOs, which carry an actual or implied "AAA" rating. We carry all of our Agency mortgage-backed securities at fair value on the Consolidated Statements of Financial Condition.

We accrete discount balances as an increase to interest income over the expected life of the related Interest Earning Assets and we amortize premium balances as a decrease to interest income over the expected life of the related Interest Earning Assets. At March 31, 2014 and December 31, 2013 we had on our Consolidated Statements of Financial Condition a total of \$24.3 million and \$25.7 million, respectively, of unamortized discount (which is the difference between the remaining principal amount and current amortized cost of our Investment Securities acquired at a price below principal value) and a total of \$5.1 billion and \$4.6 billion, respectively, of unamortized premium (which

is the difference between the remaining principal value and the current amortized cost of our Investment Securities acquired at a price above principal amount).

We received mortgage principal repayments of \$1.7 billion and \$8.5 billion for the quarters ended March 31, 2014 and 2013, respectively. The average prepayment speed for the quarters ended March 31, 2014 and 2013 was 6% and 19%, respectively. Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our mortgage-backed securities, all other factors being equal, our net interest income would decrease during the life of these mortgage-backed securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our mortgage-backed securities, all other factors being equal, our net interest income would increase during the life of these mortgage-backed securities as we would amortize our net premium balance over a longer time period.

The table below summarizes certain characteristics of our Agency mortgage-backed securities and Agency debentures, excluding interest-only securities, as of the dates presented.

## Agency Mortgage-Backed Securities and Agency Debentures

	Principal Amount	Net Premium	Amortized Cost	Amortized Cost/Principal Amount	Carrying Value	Carrying Value/Principal Amount	Weighted Average Coupon Rate	Weighted Average Yield
At March 31, 2014	\$ 74,724,887	\$ 3,921,391	\$ 78,646,278	105.25 %	\$ 76,559,004	102.45 %	3.68 %	2.96 %
At December 31, 2013	\$ 71,430,069	\$ 3,558,168	\$ 74,988,237	104.98 %	\$ 72,238,708	101.13 %	3.62 %	2.89 %

The tables below summarize certain characteristics of our Agency mortgage-backed securities and Agency debentures and interest-only securities, as of the dates presented. The index level for adjustable-rate Agency mortgage-backed securities and Agency debentures is the weighted average rate of the various short-term interest rate indices, which determine the coupon rate.



Adjustable-Rate Agency Mortgage-Backed Securities and Agency Debentures

	Principal Amount	Weighted Average Term to Next Adjustment	Weighted Average Lifetime Cap (dollars in thousands)	Weighted Average Coupon Rate	Weighted Average Asset Yield	Principal Amount at Period End as % of Total Investment Securities
At March 31, 2014	\$ 5,485,600	32 months	7.65 %	2.79 %	2.67 %	7.34 %
At December 31, 2013	\$ 6,719,599	33 months	6.44 %	2.81 %	2.80 %	9.41 %

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

## Fixed-Rate Agency Mortgage-Backed Securities and Agency Debentures Characteristics

	Principal Amount	Weighted Average Coupon Rate (dollars in thousands)	Weighted Average Asset Yield (dollars in thousands)	Principal Amount at Period End as % of Total Investment Securities
At March 31, 2014	\$ 69,239,287	3.75 %	2.98 %	92.66 %
At December 31, 2013	\$ 64,710,470	3.71 %	2.90 %	90.59 %

## Agency Interest-Only Mortgage-Backed Securities

	Notional Amount	Net Premium	Amortized Cost	Amortized Cost/Notional Amount (dollars in thousands)	Carrying Value	Carrying Value/Notional Amount	Weighted Average Coupon Rate	Weighted Average Asset Yield
At March 31, 2014	\$ 7,751,109	\$ 1,142,301	\$ 1,142,301	14.74 %	\$ 1,199,643	15.48 %	3.92 %	11.99 %
At December 31, 2013	\$ 7,374,675	\$ 1,041,990	\$ 1,041,990	14.13 %	\$ 1,120,126	15.19 %	3.82 %	9.00 %

At March 31, 2014 and December 31, 2013, we held Agency mortgage-backed securities and Agency debentures, excluding interest-only securities, with coupons linked to various indices. The following tables detail the portfolio characteristics by index.

## Adjustable-Rate Agency Mortgage-Backed Securities and Agency Debentures by Index

March 31, 2014

	Six- Month Libor	Twelve Month Libor	12- Month Moving Average	11th District Cost of Funds	1-Year Treasury Index	Other Indices(1)
Weighted average term to next adjustment	3 mo.	40 mo.	1 mo.	1 mo.	16 mo.	29 mo.
Weighted average annual period cap	1.70%	2.00%	0.00%	0.00%	2.00%	0.00%
Weighted average lifetime cap at March 31, 2014	11.22%	9.87%	9.16%	10.79%	10.70%	4.66%
Investment principal value as percentage of	0.22%	3.36%	0.16%	0.21%	0.16%	3.23%

Investment Securities  
at March 31, 2014

(1) Combination of indices that account for less than 0.05% of total or adjust over time, without a reset index.

Adjustable-Rate Agency Mortgage-Backed Securities and Agency Debentures by Index  
December 31, 2013

	Six Month Libor	Twelve Month Libor	12- Month Moving Average	11th District Cost of Funds	1-Year Treasury Index	Other Indices(1)
Weighted average term to next adjustment	4 mo.	40 mo.	1 mo.	1 mo.	18 mo.	34 mo.
Weighted average annual period cap	1.78%	2.00%	0.00%	0.00%	2.00%	0.00%
Weighted average lifetime cap at December 31, 2013	11.20%	9.81%	7.36%	10.80%	10.74%	2.36%
Investment principal value as percentage of Investment Securities at December 31, 2013	0.40%	4.04%	0.28%	0.23%	0.18%	4.28%

(1) Combination of indices that account for less than 0.05% of total or adjust over time, without a reset index.

Contractual Obligations

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for repurchase agreements, Convertible Senior Notes, interest expense on repurchase agreements and

Convertible Senior Notes, the non-cancelable office leases and employment agreements as of March 31, 2014. The table does not include the effect of net interest rate payments under our interest rate swap agreements. The net swap payments will fluctuate based on monthly changes in the receive rate. As of

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

March 31, 2014, the interest rate swaps had a net negative fair value of \$931.7 million.

	Within One Year	One to Three Years	Three to Five Years	More than Five Years	Total
	(dollars in thousands)				
Repurchase agreements	\$ 55,528,949	\$ 7,286,338	\$ 1,728,662	\$ -	\$ 64,543,949
Interest expense on repurchase agreements, based on rates at March 31, 2014	239,666	273,574	21,583	-	534,823
Convertible Senior Notes	107,541	750,000	-	-	857,541
Securitized debt of consolidated VIE	84,180	176,520	-	-	260,700
Mortgages payable	178	19,139	-	-	19,317
Participation sold	-	-	13,963	-	13,963
Interest expense on Convertible Senior Notes	41,264	4,688	-	-	45,952
Long-term operating lease obligations	1,748	159	-	-	1,907
Employment contracts of our subsidiaries	1,888	-	-	-	1,888
Total	\$ 56,005,414	\$ 8,510,418	\$ 1,764,208	\$ -	\$ 66,280,040

We had no material unfunded loan commitments issued as of March 31, 2014.

In the coming periods, we expect to continue to finance our Agency mortgage-backed securities in a manner that is largely consistent with our current operations via repurchase agreements. We also intend to consider using Federal Home Loan Bank of Des Moines (FHLB Des Moines) advances, securitization structures or other term financing structures to finance certain of our assets. During the quarter ended March 31, 2014, we received \$1.7 billion from principal repayments and \$6.2 billion in cash from disposal of Investment Securities. During the quarter ended March 31, 2013, we received \$8.5 billion from principal repayments and \$16.3 billion in cash from disposal of Investment Securities.

## Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often

strategy. A strong and robust capital position is essential to executing our investment strategy. The firm's capital strategy is predicated on a strong capital position, which enables us to execute our investment strategy regardless of the market environment.

Our Internal Capital Adequacy Assessment Program (or ICAAP) framework supports capital and business performance measurement, and is integrated within the overall risk governance framework. The ICAAP framework is designed to align capital measurement with the firm's risk appetite.

The firm's objective is to maintain an active ICAAP that reflects sound governance, requires active assessment and reporting of internal capital adequacy, incorporates stress testing based on internal and external factors and identifies potential capital actions to ensure the firm's capital and available financial resources remain in excess of internal capital requirements.

referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities. As such, we are not materially exposed to any market, credit, liquidity or financing risk that could arise if we had engaged in such relationships.

#### Capital Management

Maintaining a strong balance sheet that can support the business even in times of economic stress and market volatility is of critical importance to our business

The capital policy defines the parameters and principles supporting a comprehensive capital management practice, including processes that effectively identify, measure and monitor risks impacting capital adequacy. The capital assessment process considers the precision in risk measures as well as the volatility of exposures and the relative activities producing risk. Parameters used in modeling economic capital must align with the firm's risk appetite.

Economic capital is our internal quantification of the risks inherent in our business and considers the amount of capital our firm needs as a buffer to protect against risk. It is considered the capital needed to remain solvent under extreme scenarios. It is a probabilistic

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

measure of potential future losses at a given confidence level over a given time horizon.

The major risks impacting capital applicable to us are liquidity, investment/market, credit, counterparty, operational, and other risks such as compliance, legal and regulatory risks. For further discussion of the risks the firm is subject to, please see Part I, Item 1A. "Risk Factors" of our most recent annual report on Form 10-K.

Capital requirements are based on maintaining levels above approved limits, ensuring the quality of our capital appropriately reflects our asset mix, market and funding structure. As such we use a complement of capital metrics and related threshold levels to measure and analyze our capital from a magnitude and composition perspective. Our policy is to maintain an appropriate amount of available financial resources over the aggregate economic capital requirements.

Available Financial Resources (or AFR) is the actual capital held to protect against the unexpected losses measured in our capital management process and may include:

- Common and preferred equity
- Other forms of equity-like capital
- Surplus credit reserves over expected losses
- Other loss absorption instruments

In the event we fall short of our internal limits we will take appropriate actions which may include asset sales, changes in asset mix, reductions in asset purchases or originations, issuance of capital or other capital enhancing or risk reduction strategies.

## Stockholders' Equity

The following table provides a summary of total stockholders' equity as of March 31, 2014 and December 31, 2013:

	March 31, 2014	December 31, 2013
	(dollars in thousands)	
Stockholders' Equity:		
7.875% Series A Cumulative Redeemable Preferred Stock	\$ 177,088	\$ 177,088
7.625% Series C Cumulative Redeemable Preferred Stock	290,514	290,514
7.50% Series D Cumulative Redeemable Preferred Stock	445,457	445,457
Common stock	9,475	9,474
Additional paid-in capital	14,770,553	14,765,761
Accumulated other comprehensive income (loss)	(2,088,479 )	(2,748,933 )
Accumulated deficit	(1,039,896 )	(534,306 )
Total stockholders' equity	\$ 12,564,712	\$ 12,405,055

## Common and Preferred Stock

Our authorized shares of capital stock, par value of \$0.01 per share, consists of 1,956,937,500 shares classified as common stock, 7,412,500 shares classified as 7.875% Series A Cumulative Redeemable Preferred Stock, 4,600,000 shares classified as 6.00% Series B Cumulative Convertible Preferred Stock, 12,650,000 shares classified as 7.625% Series C Cumulative Redeemable Preferred Stock and 18,400,000 shares classified as 7.50% Series D Cumulative Redeemable Preferred Stock.

In October 2012, we announced that our board of directors authorized the repurchase of up to \$1.5 billion of our outstanding common shares over a 12 month period. All common shares purchased were part of a publicly announced plan in open-market transactions. The repurchase plan expired in October 2013. We did not repurchase any shares of our outstanding common stock under this repurchase plan during the quarter ended March 31, 2013.

In March 2012, we entered into six separate Distribution Agency Agreements (or Distribution Agency Agreements) with each of Merrill Lynch, Pierce, Fenner

During the quarter ended March 31, 2014, the Company raised \$0.6 million, by issuing 56,000 shares, through the Direct Purchase and Dividend Reinvestment Program. During the quarter ended March 31, 2013, the Company raised \$0.8 million, by issuing 50,000 shares, through the Direct Purchase and Dividend Reinvestment Program.

& Smith Incorporated, Credit Suisse Securities (USA) LLC, Goldman, Sachs & Co., J.P. Morgan Securities LLC, Morgan Stanley & Co. LLC and RCap (together, the Agents). Pursuant to the terms of the Distribution Agency Agreements, we may sell from time to time through the Agents, as our sales agents, up to 125,000,000 shares of our common stock. We did not make any sales under the Distribution Agency Agreements during the quarters ended March 31, 2014 and 2013.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

#### Distributions to Stockholders

During the quarter ended March 31, 2014, we declared dividends to common stockholders totaling \$284.2 million, or \$0.30 per common share, which were paid to stockholders on April 30, 2014. During the quarter ended March 31, 2014, we declared dividends to Series A Preferred stockholders totaling approximately \$3.6 million or \$0.492 per share, Series C Preferred stockholders totaling approximately \$5.7 million or \$0.477 per share, Series D Preferred stockholders totaling approximately \$8.6 million or \$0.469 per share which were paid to preferred stockholders on March 31, 2014.

During the quarter ended March 31, 2013, we declared dividends to common stockholders totaling \$426.2 million or \$0.45 per share, which were paid to stockholders on April 29, 2013. During the quarter ended March 31, 2013, we declared dividends to Series A Preferred stockholders totaling approximately \$3.6 million or \$0.492 per share, Series C Preferred stockholders totaling approximately \$5.7 million or \$0.477 per share and Series D Preferred stockholders totaling approximately \$8.6 million or \$0.469 per share which were paid to preferred stockholders on April 1, 2013.

Our policy is to distribute 100% of our REIT taxable income. To the extent there is any undistributed REIT taxable income at the end of a year, we distribute such shortfall within the next year as permitted by the Code.

#### Leverage and Capital

We believe that it is prudent to maintain a conservative debt-to-equity ratio as there continues to be volatility in the mortgage and credit markets. Our capital policy governs our capital and leverage position including setting limits. Based on the guidelines, we generally expect to maintain a ratio of debt-to-equity of less than 12:1. Our actual leverage ratio varies from time to time based upon various factors, including our management's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity, the availability of credit, over-collateralization

assessment of domestic and international market conditions.

Our debt-to-equity ratio at March 31, 2014 (including securitized debt of consolidated VIE, loan participation sold and mortgages payable which are non-recourse to us) and December 31, 2013 was 5.2:1 and 5.0:1, respectively. Our capital ratio, which represents our ratio of stockholders' equity to total assets, was 15.2% and 15.1% at March 31, 2014 and December 31, 2013, respectively. Our net capital ratio was 15.4% and 15.9% at March 31, 2014 and December 31, 2013, respectively. Our net capital ratio represents our ratio of stockholders' equity to total assets, adjusted to reflect net balances of U.S. Treasury securities and U.S. Treasury securities sold, not yet purchased, reverse repurchase agreements and repurchase agreements, and securities borrowed and securities loaned.

#### Risk Management

We are subject to a variety of risks in the ordinary conduct of our business. The effective management of these risks is of critical importance to the overall success of the firm. The objective of our risk management framework is to measure, monitor and manage these risks. Our risk management framework is intended to facilitate a holistic, enterprise wide view of risk. We have built a strong and collaborative risk culture throughout the firm focused on awareness which ensures the key risks are understood and managed appropriately. Each employee is accountable for monitoring and managing risk within their area of responsibility.

#### Risk Appetite

We maintain a firm-wide risk appetite statement which defines the types and levels of risk we are willing to take in order to achieve our business objectives, and reflects our risk management philosophy. Fundamentally, we will only engage in risk activities based on our core expertise that enhance value for our stockholders. Our activities focus on capital preservation and income generation through proactive portfolio management, supported by a conservative liquidity and leverage



levels required by lenders when we pledge assets to secure borrowings and our

posture.

The risk appetite statement asserts the following key parameters to guide our risk management activities.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

Portfolio composition	We will maintain a high quality asset portfolio with (1) at least 75% of the portfolio to be high quality mortgage-backed securities and short term investments (equivalency rating of AA+ or better) and (2) an aggregate weighted average equivalency rating of single "A" or better.
Leverage	We will operate at a debt-to-equity ratio no greater than 12:1.
Capital buffer	We will maintain an excess capital buffer, of which at least 25% will be invested in AAA rated mortgage-backed securities (or assets of similar or better liquidity characteristics), to meet the liquidity needs of the firm.
Interest rate risk	We will seek to manage interest rate risk to protect the portfolio from adverse rate movements.
Hedging	We will use swaps and other derivatives to hedge market risk, targeting both income and capital preservation.
Capital preservation	We will seek to protect our capital base through disciplined risk management practices.
Compliance	We will comply with regulatory requirements needed to maintain our REIT status and our exemption from registration under the Investment Company Act.

## Governance

Risk management begins with our board of directors, through the review and oversight of the risk management framework, and executive management, through the ongoing formulation of risk management practices and related execution in managing risk. The board of directors exercises its oversight of risk management primarily through the Board Risk Committee (or BRC) and Board Audit Committee (or BAC). The BRC is responsible for oversight of our risk governance structure, risk management and risk assessment guidelines and policies, our risk tolerance and our capital, liquidity and funding. The BAC is responsible for oversight of the quality and integrity of our accounting, internal controls and financial reporting practices, including independent auditor selection, evaluation and review, and oversight of the internal audit function.

Risk assessment and risk management are the responsibility of our management. A series of management committees have oversight or decision-making responsibilities for risk management activities. Memberships of these committees are reviewed

regularly to ensure the appropriate personnel are engaged in the risk management process. Three primary management committees have been established to provide a comprehensive framework for risk management. The management committees responsible for risk management of the firm include the Enterprise Risk Committee, Asset and Liability Committee and the Financial Reporting and Disclosure Committee.

Audit Services is an independent function with reporting lines to the BAC. Audit Services is responsible for performing our internal audit activities, which includes independently assessing and validating key controls within the risk management framework.

## Description of Risks

We are subject to a variety of risks due to the business we operate. Risk categories are an important component of a robust enterprise wide risk management framework. We have identified the following primary categories that are utilized throughout the firm to identify, assess, measure and monitor risk.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

Risk	Description
Liquidity Risk	Risk to earnings, capital or business arising from our inability to meet our obligations when they come due without incurring unacceptable losses because of inability to liquidate assets or obtain adequate funding.
Investment/Market Risk	Risk to earnings, capital or business resulting in the decline in value of our assets or an increase in the costs of financing caused from changes in market variables, such as interest rates, which affect the values of invested securities and other investment instruments.
Credit and Counterparty Risk	Risk to earnings, capital or business, resulting from an obligor's or counterparty's failure to meet the terms of any contract or otherwise failure to perform as agreed. This risk is present in lending, investing, funding and hedging activities.
Operational Risk	Risk to earnings, capital, reputation or business arising from inadequate or failed internal processes or systems, human factors or external events. Model risk is included in operational risk.
Compliance, Regulatory and Legal Risk	Risk to earnings, capital, reputation or conduct of business arising from violations of, or nonconformance with internal and external applicable rules and regulations, losses resulting from lawsuits or adverse judgments, or from changes in the regulatory environment that may impact our business model.

## Liquidity Risk Management

Our liquidity risk management strategy is designed to ensure the availability of sufficient resources to support

our business and meet our financial obligations under both normal and adverse market and business environments. Our liquidity risk management practices consist of the following primary elements:

Funding	Availability of diverse and stable sources of funds.
Excess Liquidity	Excess liquidity primarily in the form of unencumbered assets.
Maturity Profile	Diversity and tenor of liabilities and modest use of leverage.
Stress Testing	Scenario modeling to measure the resiliency of our liquidity position.
Liquidity Management Policies	Comprehensive policies including monitoring, risk limits and a contingent funding plan (CFP).

## Funding

Our primary financing sources are repurchase agreements and various forms of equity. Through the judicious use of leverage, we maintain excess liquidity through investing in high quality unencumbered assets, which serve as our capital buffer.

Repurchase agreements are our primary source of debt financing. We conservatively manage our repurchase agreement (or repo) funding position through a variety of methods including diversity, breadth and depth of counterparties and maintaining a staggered and longer-term maturity profile. We have not at the present time entered into any commitment agreements under which the lender would be required to enter into new

repurchase agreements could result, causing an adverse change in our liquidity position.

At March 31, 2014, we had total pledged collateral for repurchase agreements and interest rate swaps of \$68.5 billion. The weighted average haircut was approximately 4% on repurchase agreements. The quality and character of the Agency mortgage-backed securities that we pledge as collateral under the repurchase agreements and interest rate swaps did not materially change during the quarter ended March 31, 2014 compared to the quarter ended December 31, 2013, and our counterparties did not materially alter any requirements, including required haircuts, related to the collateral we pledge under repurchase agreements and interest rate swaps during the quarter ended March 31, 2014.

repurchase agreements during a specified period of time.

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. Should prepayment speeds on the mortgages underlying our Agency mortgage-backed securities and/or market interest rates suddenly increase or market values decrease, margin calls on our

We had repurchase agreements outstanding of \$64.5 billion with a weighted average borrowing rate of 0.65% and weighted average remaining maturities of 187 days as of March 31, 2014.

At March 31, 2014 the repurchase agreements had the following remaining maturities and weighted average rates:

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

	Repurchase Agreements	March 31, 2014 Weighted Average Rate (dollars in thousands)		% of Total	
1 day	\$ 6,065,530	0.29	%	9.4	%
2 to 29 days	12,308,123	0.34	%	19.0	%
30 to 59 days	17,122,926	0.43	%	26.5	%
60 to 89 days	3,842,791	0.42	%	6.0	%
90 to 119 days	6,941,938	0.55	%	10.8	%
Over 120 days(1)	18,262,641	1.26	%	28.3	%
Total	\$ 64,543,949	0.65	%	100.0	%

(1) Approximately 14% of the total repurchase agreements have a remaining maturity over 1 year.

During the first quarter of 2014, a wholly-owned insurance subsidiary attained membership to the FHLB Des Moines. Such membership is anticipated to provide an additional funding source for us. Such borrowing capacity is at the sole discretion and subject to conditions of FHLB Des Moines. Eligible collateral may include residential and commercial real estate debt securities.

## Excess Liquidity

Our primary source of liquidity is the availability of unencumbered assets which may be provided as

collateral to support additional funding needs. We target minimum thresholds of available, unencumbered assets to maintain excess liquidity. The following table illustrates our asset portfolio and those which are available to support potential collateral obligations and funding needs. Assets are considered encumbered if pledged as collateral against an existing liability, and therefore no longer available to support additional funding. An asset is considered unencumbered if it has not been pledged or securitized. The following table provides the carrying amount of our encumbered and unencumbered financial assets as of March 31, 2014:

	Encumbered	Unencumbered (dollars in thousands)	Total
Financial Assets:			
Cash and cash equivalents	\$ 755,528	\$ 168,669	\$ 924,197
Investments, at fair value:			
Agency mortgage-backed securities	66,110,869	7,292,483	73,403,352
Agency debentures	2,368,493	39,766	2,408,259
Commercial real estate debt and preferred equity	398,113	1,242,093	1,640,206
Corporate debt	-	145,394	145,394
Total financial assets	\$ 69,633,003	\$ 8,888,405	\$ 78,521,408

The amounts reflected in the table above are on a settlement date basis and may differ from the total positions reported on the Consolidated Statements of Financial Condition.

We maintain liquid assets in order to satisfy our current and future obligations in normal and stressed operating environments. These are held as the primary means of

into cash, through liquidation or used as collateral in financing arrangements. Our balance sheet also generates liquidity on an on-going basis through

liquidity risk mitigation. The composition of our liquid assets is considered as well and is subject to certain parameters. The composition is monitored for concentration risk, asset type and ratings. We believe the assets we consider liquid can be readily converted

mortgage principal and interest repayments and net earnings held prior to payment of dividends. Carrying value represents the market value of assets. The following table presents our liquid assets as a percentage of total assets as of March 31, 2014.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

Liquid Assets	Carrying Value (dollars in thousands)	
Cash and cash equivalents	\$	924,197
Investment Securities		77,758,647
Total liquid assets	\$	78,682,844
Percentage of liquid assets to total assets		95.47 %

## Maturity Profile

We consider the profile of our assets, liabilities and derivatives when managing both liquidity risk as well as investment/market risk employing a measurement of both the maturity gap and interest rate gap.

We determine the amount of liquid assets that are required to be held by monitoring several liquidity metrics. We utilize several modeling techniques to analyze our current and potential obligations including the expected cash flows from our assets, liabilities and derivatives. The following table illustrates the expected maturities and cash flows of our assets, liabilities and derivatives. The table is based on a static portfolio and assumes no reinvestment of asset cash flows and no future liabilities are entered into. In assessing the maturity of our assets, liabilities and off balance sheet obligations we typically use the stated maturities or prepayment expectations for assets that exhibit prepayment characteristics. Cash and cash equivalents are included in the 'within 3 months' maturity bucket, and not the contractual maturity as they are typically held for a short period of time.

When measuring our maturity gap it is considered negative when the amount of liabilities exceeds assets in any given period. A negative gap increases our liquidity risk as we must enter into future liabilities.

Our interest rate sensitivity gap is the difference between Interest Earning Assets and Interest Bearing

Liabilities maturing or re-pricing within a given time period. The effect of interest rate swaps is reflected in our interest rate gap. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if an institution were perfectly matched in each maturity category. The amount of assets and liabilities utilized to compute our interest rate sensitivity gap was determined in accordance with the contractual terms of the assets and liabilities, except adjustable-rate loans and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature. The effects of interest rate swaps, which effectively lock in our financing costs for a longer term is also reflected in our interest rate sensitivity gap. The interest rate sensitivity of our assets and liabilities in the table could vary substantially based on actual prepayment experience.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

	Less than 3 Months	3-12 Months	More than 1 Year to 3 Years	3 Years and Over	Total
(dollars in thousands)					
<b>Financial Assets:</b>					
Cash and cash equivalents	\$ 924,197	\$ -	\$ -	\$ -	\$ 924,197
Reverse repurchase agreements	444,375	-	-	-	444,375
Securities borrowed	513,500	-	-	-	513,500
Agency Mortgage-backed securities (principal)	298	62,654	1,569,462	70,506,725	72,139,139
Agency debentures (principal)	-	-	319,950	2,265,798	2,585,748
Corporate debt (principal)	-	-	12,043	134,330	146,373
Commercial real estate debt and preferred equity (principal)	12,973	377,199	717,315	536,886	1,644,373
<b>Total financial assets</b>	<b>\$ 1,895,343</b>	<b>\$ 439,853</b>	<b>\$ 2,618,770</b>	<b>\$ 73,443,739</b>	<b>\$ 78,397,705</b>
<b>Financial Liabilities:</b>					
Repurchase agreements	\$ 39,339,370	\$ 16,189,579	\$ 7,286,338	\$ 1,728,662	\$ 64,543,949
Securities loaned	513,510	-	-	-	513,510
Convertible Senior Notes (principal)	-	107,541	750,000	-	857,541
Securitized debt of consolidated VIE	-	84,180	176,520	-	260,700
Participations Sold	-	-	-	13,963	13,963
<b>Total financial liabilities</b>	<b>\$ 39,852,880</b>	<b>\$ 16,381,300</b>	<b>\$ 8,212,858</b>	<b>\$ 1,742,625</b>	<b>\$ 66,189,663</b>
<b>Maturity gap</b>	<b>\$ (37,957,537)</b>	<b>\$ (15,941,447)</b>	<b>\$ (5,594,088 )</b>	<b>\$ 71,701,114</b>	<b>\$ 12,208,042</b>
<b>Cumulative maturity gap</b>	<b>\$ (37,957,537)</b>	<b>\$ (53,898,984)</b>	<b>\$ (59,493,072)</b>	<b>\$ 12,208,042</b>	
<b>Interest rate sensitivity gap</b>	<b>\$ 20,521,154</b>	<b>\$ (17,415,022)</b>	<b>\$ (29,311,404)</b>	<b>\$ 38,413,316</b>	<b>\$ 12,208,044</b>
<b>Cumulative rate sensitivity gap</b>	<b>\$ 20,521,154</b>	<b>\$ 3,106,132</b>	<b>\$ (26,205,272)</b>	<b>\$ 12,208,044</b>	
<b>Cumulative rate sensitivity gap as a %</b>	<b>26.18 %</b>	<b>3.96 %</b>	<b>(33.43 %)</b>	<b>15.57 %</b>	



of total rate sensitive  
assets

The methodologies we employ for evaluating interest rate risk include an analysis of our interest rate “gap,” measurement of the duration and convexity of our portfolio and sensitivities to interest rates and spreads.

#### Stress Testing

We utilize liquidity stress testing to ensure we have sufficient liquidity under a variety of scenarios and stresses. These stress tests are considered and assist with the management of our pool of liquid assets, and influence our current and future funding plans. Our stress tests are modeled over both short term and longer time horizons. The stresses applied include market-wide and firm-specific stresses.

#### Liquidity Management Policies

We utilize a comprehensive liquidity policy structure to inform our liquidity risk management practices including monitoring and measurement, along with well-defined key limits. Both quantitative and qualitative targets are utilized to measure the ongoing stability and condition of the liquidity position, and include the level and composition of unencumbered assets, as well as both short-term and long-term sustainability of the funding composition under stress conditions.

We also monitor early warning metrics designed to measure the quality and depth of liquidity sources based upon both company-specific and macro environmental conditions. The metrics assess both the short-term and long-term liquidity conditions and are integrated into our CFP, with various liquidity ratings influencing management actions with respect to contingency planning and potential related actions.

#### Investment/Market Risk Management

One of the primary risks we are subject to is interest rate risk. Changes in the level of interest rates can affect our net interest income, which is the difference between the income we earn on our Interest Earning Assets and the interest expense incurred from Interest Bearing Liabilities and derivatives. Changes in the level of interest rates can also affect the value of our securities and our ability to realize gains from the sale of these assets. We may utilize a variety of financial instruments, including interest rate swaps, swaptions, options, futures and other hedges, in order to limit the effects of interest rates on our results. Our portfolio and the value of our portfolio, including derivatives, may be adversely affected as a result of changing interest rates and spreads.

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

We simulate a wide variety of interest rate scenarios in evaluating our risk. Scenarios are run to capture our sensitivity to interest rates, spreads and the shape of the yield curve. We also consider assumptions affecting our analysis such as prepayments. In addition to predefined interest rate scenarios, we utilize Value-at-Risk measures to estimate potential losses in the portfolio over various time horizons utilizing various confidence levels. The following tables estimate the potential changes in economic net interest income over a twelve month period and the immediate effect on our portfolio market value, should interest rates increase or

decrease by 25, 50 or 75 basis points, and mortgage option adjusted spreads increase or decrease by 5, 15 or 25 basis points, assuming the shocks will be parallel and instantaneous. All changes to income and portfolio market value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at March 31, 2014 and various estimates regarding prepayments and all activities are made at each level of rate shock. Actual results could differ significantly from these estimates.

Change in Interest Rate	Projected Percentage Change in Economic Net Interest Income(1)	Change in Portfolio Value, with Effect of Interest Rate Swaps	Estimated Change as a % on NAV(2)
-75 Basis Points	(21.4%)	0.4%	2.4%
-50 Basis Points	(16.0%)	0.4%	2.4%
-25 Basis Points	(7.7%)	0.2%	1.6%
Base Interest Rate	-	-	-
+25 Basis Points	4.9%	(0.3%)	(2.2%)
+50 Basis Points	10.2%	(0.7%)	(4.7%)
+75 Basis Points	14.7%	(1.1%)	(7.5%)

MBS Spread Shock	Estimated Change in Portfolio Market Value	Estimated Change as a % on NAV(2)
-25 Basis points	1.3%	9.0%
-15 Basis points	0.8%	5.4%
-5 Basis points	0.3%	1.8%
Base Interest Rate	-	-
+5 Basis points	(0.3%)	(1.8%)
+15 Basis points	(0.8%)	(5.3%)
+25 Basis points	(1.3%)	(8.8%)

(1) Scenarios include Investment Securities, repurchase agreements and interest rate swaps only. Economic net interest income includes interest expense on interest rate swaps.

(2) NAV includes common stock, additional paid-in capital, accumulated other comprehensive loss, and accumulated deficit.

## Credit and Counterparty Risk Management

counterparty fails to perform its contractual obligations. We have established policies and procedures for mitigating credit risk, including

Key risk parameters have been established to specify Annaly's credit risk appetite. We will maintain a high quality asset portfolio with at least 75% of the portfolio to be high quality mortgage-backed securities and short term investments (equivalency rating of AA+ or better), and an aggregate weighted average equivalency rating of single "A" or better.

While we do not expect to encounter credit risk in our Agency investments, we face credit risk on the non-Agency portions of our portfolio. We are exposed to credit risk on commercial real estate investments and corporate debt. We generally face more credit risk on investments where we hold subordinated debt or equity positions. We are exposed to risk of loss if an issuer, borrower or

reviewing and establishing limits for credit exposure, limiting transactions with specific counterparties, maintaining qualifying collateral and continually assessing the creditworthiness of counterparties, borrowers and issuers. We only originate or purchase commercial investments that meet our comprehensive underwriting process and credit standards and are approved by the appropriate committee. Once a commercial investment is made, our ongoing surveillance process includes regular reviews, analysis and oversight of investments by our investment personnel and appropriate committee. We review credit and other risks of loss associated with each investment and determine the appropriate allocation of capital to apply to each investment under our capital policy. Our management will monitor the overall portfolio risk and determine levels of provision for loss. Our portfolio composition as of March 31, 2014 and December 31, 2013 was as follows:

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis

## Asset Portfolio (using balance sheet values)

Category	March 31, 2014		December 31, 2013	
Agency mortgage-backed securities(1)	94.7	%	93.7	%
Agency debentures	3.0	%	4.0	%
Commercial real estate debt and preferred equity(2)	2.1	%	2.1	%
Corporate debt, held for investment	0.2	%	0.2	%

(1) Including TBAs held for delivery.

(2) Net of unamortized origination fees.

Our use of repurchase and derivative agreements create exposure to credit risk relating to potential losses that could be recognized if the counterparties to these agreements fail to perform their obligations under the contracts. In the event of default by a counterparty, we could have difficulty obtaining our assets pledged as collateral. A significant portion of our Agency securities are financed with repurchase agreements by pledging our agency securities as collateral to the lender. The collateral we pledge exceeds the amount of the borrowings under each agreement. If the counterparty to the repurchase agreement defaults on its obligations and we are not able to recover our pledged asset, we are at risk of losing the over-collateralization or haircut. The amount of this exposure is the difference between the amount loaned to us plus interest due to the counterparty and the fair value of the collateral pledged by us to the lender including accrued interest receivable on such collateral.

We also use interest rate swaps and other derivatives to manage interest rate risk. Under these agreements, we pledge securities and cash as collateral as part of a margin arrangement. If a counterparty were to default on its obligations, we would be exposed to a loss to a derivative counterparty to the extent that the amount of our securities or cash pledged exceeded the unrealized loss on the associated derivative and we were not able to recover the excess collateral.

We monitor our exposure to counterparties across several dimensions including by type of arrangement, collateral type, counterparty type, ratings and geography.

The following table summarizes our exposure to counterparties by geography as of March 31, 2014:

Country	Number of Counterparties	Repurchase Agreement Financing	Interest Rate Swaps at Fair Value	Exposure(1)
(dollars in thousands)				
North America	16	\$ 42,754,190	\$ (688,852 )	\$ 3,040,516
Europe	11	17,302,514	(242,874 )	1,019,009
Asia (non-Japan)	1	1,007,100	-	55,370
Japan	4	3,480,145	-	221,262
Total	32	\$ 64,543,949	\$ (931,726 )	\$ 4,336,157

(1) Represents the amount of cash and/or securities pledged as collateral to each counterparty less the aggregate of repurchase agreement financing and unrealized loss on swaps for each counterparty.

## Operational Risk Management

We are subject to operational risk in each of our business and support functions. Operational risk may arise from internal or external sources including human error, fraud, systems issues, process change, vendors, business interruptions and other external events. Model risk considers potential errors with a model's results due to uncertainty in model parameters and inappropriate methodologies used. The result of these

risks may include financial loss and reputational damage. We manage operational risk through a variety of tools including policies and procedures which cover topics such as business continuity, personal conduct and vendor management. Other tools include training, on topics such as cyber security awareness; testing, including disaster recovery testing; systems controls, including access controls; and monitoring, which includes the use of key risk indicators. Employee level lines of defense against operational risk include the

## ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis

empowerment of business units to identify and mitigate operational risk sources, an independent operational risk group which reports to the Chief Risk Officer of our Manager, testing by our internal audit staff, and our overall governance framework.

#### Compliance, Regulatory and Legal Risk Management

Our business is organized as a REIT and we plan to continue to meet the requirements for taxation as a REIT. The determination that we are a REIT requires an analysis of various factual matters and circumstances. Accordingly, we closely monitor our REIT status within our risk management program. The financial services industry is highly regulated and continues to receive increasing attention from regulators which may impact both our company as well as our business strategy. We proactively monitor the potential impact regulation may have both directly and indirectly on our firm. In conjunction with the legal department we maintain a process to actively monitor both actual and potential legal action that may affect us. Our risk management framework is designed to identify, monitor and manage these risks under the oversight of the Enterprise Risk Committee.

We currently rely on the exemption from registration provided by Section 3(c)(5)(C) of the Investment Company Act and we plan to continue to meet the requirements for this exemption from registration. The determination that we qualify for this exemption from registration depends on various factual matters and circumstances. Accordingly, in conjunction with the legal department, we closely monitor our compliance with Section 3(c)(5)(C) within our risk management program. The monitoring of this risk is also under the oversight of the Enterprise Risk Committee.

#### Critical Accounting Policies

Our critical accounting policies are as follows:

##### Valuation of Financial Instruments

Agency mortgage-backed securities and debentures

individual securities, which may include coupon, periodic and life caps, reset dates and the expected life of the security. All internal market values are compared to external sources or dealer quotes to determine reasonableness. Additionally, securities used as collateral for repurchase agreements are priced daily by counterparties to ensure sufficient collateralization, providing additional verification of our internal pricing.

##### Interest rate swaps

We use the overnight indexed swap (or OIS) curve as an input to value substantially all of our interest rate swaps. We believe using the OIS curve, which reflects the interest rate typically paid on cash collateral, enables us to most accurately determine the fair value of interest rate swaps. Consistent with market practice, we have negotiated agreements with certain counterparties to exchange collateral (or margining) based on the level of fair values of the interest rate swaps. Through this margining process, one party or each party to a derivative contract provides the other party with information about the fair value of the derivative contract to calculate the amount of collateral required, providing additional verification of our recorded fair value of the interest rate swaps.

##### Revenue Recognition

Interest income on Agency mortgage-backed securities and debentures is recognized over the projected life of the securities using the interest method. The projected life of the securities is determined based on expected prepayment speeds, past prepayment history of the security, government initiatives that would affect the Agency mortgage-backed securities market and market consensus. Adjustments are made for actual prepayment activity as it relates to calculating the effective yield. Gains or losses on investment securities are recorded on trade date based on the average cost of the security.

##### Use of Estimates

The use of GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of

There is an active market for Agency mortgage-backed securities and debentures. Since we primarily invest in securities that can be measured from actively quoted prices, there is a high degree of observable inputs and less subjectivity in measuring fair value. Internal market values are determined using quoted prices from the To-Be-Announced (or TBA) security market, the Treasury curve and the underlying characteristics of the

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

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

Glossary of Terms

A

---

**Adjustable-Rate Mortgage (ARM)**

A mortgage loan on which interest rates are adjusted at regular intervals according to predetermined criteria. An ARM's interest rate is tied to an objective, published interest rate index.

**Agency**

Refers to a federally chartered corporation, such as the Federal National Mortgage Association, or the Federal Home Loan Mortgage Corporation, or an agency of the U.S. Government, such as the Government National Mortgage Association.

**Agency Debentures**

Debt issued by a federal agency or a government-sponsored enterprise (GSE) for financing purposes. These types of debentures are not backed by collateral, but by the integrity and credit worthiness of the issuer. Agency debentures issued by a GSE are backed only by that GSE's ability to pay. The callable feature allows the agency to repay the bond prior to maturity.

**Agency Mortgage-Backed Securities**

Refers to residential mortgage-backed securities that are issued or guaranteed by an Agency.

**Amortization**

Liquidation of a debt through installment payments. Amortization also refers to the process of systematically reducing a recognized asset or liability (e.g., a purchase premium or discount for a debt security) with an offset to earnings.

**Average Life**

On a mortgage-backed security, the average time to receipt of each dollar of principal, weighted by the amount of each principal prepayment, based on prepayment assumptions.

B

benchmarks.

**Beneficial Owner**

One who benefits from owning a security, even if the security's title of ownership is in the name of a broker or bank ("street name").

**B-Note**

Subordinate mortgage notes and/or subordinate mortgage loan participations.

**B-Piece**

The most subordinate commercial mortgage-backed security bond class.

**Bond**

(1) The written evidence of debt, bearing a stated rate or stated rates of interest, or stating a formula for determining that rate, and maturing on a date certain, on which date and upon presentation a fixed sum of money plus interest (usually represented by interest coupons attached to the bond) is payable to the holder or owner. (2) For purposes of computations tied in to "per bond," a \$1,000 increment of an issue is used (no matter what the actual denominations are); (3) Bonds are long-term securities with an original maturity of greater than one year.

**Book Value Per Share**

Calculated by summing common stock, additional paid-in capital, accumulated other comprehensive income (loss) and accumulated deficit and dividing that number by the total common shares outstanding.

**Broker**

Generic name for a securities firm engaged in both buying and selling securities on behalf of customers on its own account.

C

---

**Capital Buffer**

Includes unencumbered financial assets which can be utilized as collateral to meet liquidity needs.



**Basis Point**

Smallest measure used in quoting yields on bonds and notes. One basis point is 0.01% of yield. For example, a bond's yield that changed from 6.52% to 7.19% would be said to have moved 67 basis points.

**Benchmark**

A bond whose terms are used for comparison with other bonds of similar maturity. The global financial market typically looks to U.S. Treasury securities as

**Capital Ratio**

Calculated as total stockholders' equity divided by total assets.

**Carry**

The cost of borrowing funds to finance an underwriting or trading position. A positive carry happens when the rate on the securities being financed is greater than the rate on the funds borrowed. A negative carry is when

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

the rate on the funds borrowed is greater than the rate on the securities that are being financed.

**Collateral**

Securities, cash or property pledged by a borrower to secure payment of a loan or derivative. If the borrower fails to repay the loan, the lender may take ownership of the collateral.

**Collateralized Mortgage Obligation (CMO)**

A multiclass bond backed by a pool of mortgage pass-through securities or mortgage loans.

**Commodity Futures Trading Commission (CFTC)**

An independent U.S. federal agency established by the Commodity Futures Trading Commission Act of 1974. The CFTC regulates the commodity futures and options markets. Its goals include the promotion of competitive and efficient futures markets and the protection of investors against manipulation, abusive trade practices and fraud.

**Constant Prepayment Rate (CPR)**

The percentage of outstanding mortgage loan principal that prepays in one year, based on the annualization of the Single Monthly Mortality, which reflects the outstanding mortgage loan principal that prepays in one month.

**Contingent Funding Plan (CFP)**

An action plan used for responding to a liquidity crisis. It is to be enacted when we experience heightened concerns regarding our liquidity position.

**Conventional Mortgage Loan**

A mortgage loan granted by a bank or thrift institution that is based solely on real estate as security and is not insured or guaranteed by a government agency.

**Convertible Securities**

Securities which may be converted into shares of another security under stated terms, often into the issuing company's common stock.

**Convexity**

swaps and Agency interest-only mortgage-backed securities, net loss on extinguishment of the 4% Convertible Senior Notes due 2015, net gains and losses on trading assets, impairment losses and loss on previously held equity interest in CreXus.

**Corporate Debt**

Non-government debt instruments. Long-term corporate debt can be issued as bonds or loans.

**Counterparty**

One of two entities in a transaction. For example, in the bond market a counterparty can be a state or local government, a broker-dealer or a corporation.

**Coupon**

The interest rate on a bond that is used to compute the amount of interest due on a periodic basis.

**Credit and Counterparty Risk**

Risk to earnings, capital or business, resulting from an obligor's or counterparty's failure to meet the terms of any contract or otherwise failure to perform as agreed. Credit and counterparty risk is present in lending, investing, funding and hedging activities.

**Current Face**

The current remaining monthly principal on a mortgage security. Current face is computed by multiplying the original face value of the security by the current principal balance factor.

**D**

---

**Dealer**

Person or organization that underwrites, trades and sells securities, e.g., a principal market-maker in securities.

**Default Risk**

Possibility that a bond issuer will fail to pay principal or interest when due.

**Derivative**

A financial product that derives its value from the price, price fluctuations and price expectations of an

A measure of the change in a security's duration with respect to changes in interest rates. The more convex a security is, the more its duration will change with interest rate changes.

**Core Earnings and Core Earnings Per Basic Share**  
Non-GAAP financial measures that represent GAAP net income and GAAP basic earnings per share adjusted for gains or losses on disposals of investments, trading assets and termination of interest rate swaps, unrealized gains or losses on interest rate

underlying instrument (e.g. futures contracts, options, interest rate swaps, interest rate swaptions and certain to-be-announced securities).

**Discount Price**

When the dollar price is below face value, it is said to be selling at a discount.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

Discount Rate

The rate the Federal Reserve charges on loans to member banks.

Duration

The weighted maturity of a fixed-income investment's cash flows, used in the estimation of the price sensitivity of fixed-income securities for a given change in interest rates.

E

---

Economic Capital

A measure of the risk a firm is subject to. It is the amount of capital a firm needs as a buffer to protect against risk. It is a probabilistic measure of potential future losses at a given confidence level over a given time horizon.

Economic Interest Expense

Non-GAAP financial measure that is composed of GAAP interest expense adjusted for gains or losses on interest rate swaps.

Economic Net Interest Income

Non-GAAP financial measure that is composed of GAAP net interest income adjusted for gains or losses on interest rate swaps.

Encumbered Assets

Assets on the company's balance sheet which have been pledged as collateral against an existing liability.

F

---

Face Amount

The par value (i.e., principal or maturity value) of a security appearing on the face of the instrument.

Factor

A decimal value reflecting the proportion of the outstanding principal balance of a mortgage security, which changes over time, in relation to its original principal value.

Federal Funds Rate

The interest rate charged by banks on overnight loans of their excess reserve funds to other banks.

Fixed-Rate Mortgage

A mortgage featuring level monthly payments, determined at the outset, which remain constant over the life of the mortgage.

Floating Rate Bond

A bond for which the interest rate is adjusted periodically according to a predetermined formula, usually linked to an index.

Floating Rate CMO

A CMO tranche which pays an adjustable rate of interest tied to a representative interest rate index such as the LIBOR, the Constant Maturity Treasury or the Cost of Funds Index.

Freddie Mac

Federal Home Loan Mortgage Corporation.

Futures Contract

A legally binding agreement to buy or sell a commodity or financial instrument in a designated future month at a price agreed upon at the initiation of the contract by the buyer and seller. Futures contracts are standardized according to the quality, quantity, and delivery time and location for each commodity. A futures contract differs from an option in that an option gives one of the counterparties a right and the other an obligation to buy or sell, while a futures contract represents an obligation of both counterparties, one to deliver and the other to accept delivery. A futures contract is part of a class of financial instruments called derivatives.

G

---

GAAP

Accounting principles generally accepted in the United States of America.

Ginnie Mae

Government National Mortgage Association.

Fannie Mae  
Federal National Mortgage Association.

H

---

Federal Deposit Insurance Corporation (FDIC)  
An independent agency created by the U.S. Congress to maintain stability and public confidence in the nation's financial system by insuring deposits, examining and supervising financial institutions for safety and soundness and consumer protection, and managing receiverships.

Hedge  
An investment made with the intention of minimizing the impact of adverse movements in interest rates or securities prices.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

I

---

**In-the-Money**

Description for an option that has intrinsic value and can be sold or exercised for a profit; a call option is in-the-money when the strike price is below the market price of the underlying security.

**Interest Bearing Liabilities**

Refers to repurchase agreements, convertible senior notes, securitized debt of consolidated VIE, participation sold, U.S. Treasury securities sold, not yet purchased and securities loaned.

**Interest Earning Assets**

Refers to Investment Securities, securities borrowed, U.S. Treasury securities, reverse repurchase agreements, cash and cash equivalents and commercial real estate debt and preferred equity interests.

**Interest Only (IO) Bond**

The interest portion of mortgage, Treasury or bond payments, which is separated and sold individually from the principal portion of those same payments.

**Interest Rate Risk**

The risk that an investment's value will change due to a change in the absolute level of interest rates, in the spread between two rates, in the shape of the yield curve or in any other interest rate relationship. As market interest rates rise, the value of current fixed income investment holdings declines. Diversifying, deleveraging and hedging techniques are utilized to mitigate this risk. Interest rate risk is a form of market risk.

**Interest Rate Swap**

A binding agreement between counterparties to exchange periodic interest payments on some predetermined dollar principal, which is called the notional principal amount. For example, one party will pay fixed and receive a variable rate.

**Interest Rate Swaption**

Options on interest rate swaps. The buyer of a swaption has the right to enter into an interest rate swap

firm is appropriately capitalized relative to the risks in our business.

**International Swaps and Derivatives Association (ISDA) Master Agreements**

Standardized contract developed by ISDA used as an umbrella under which bilateral derivatives contracts are entered into.

**Inverse IO Bond**

An interest-only bond whose coupon is determined by a formula expressing an inverse relationship to a benchmark rate, such as LIBOR. As the benchmark rate changes, the IO coupon adjusts in the opposite direction.

When the benchmark rate is relatively low, the IO pays a relatively high coupon payment, and vice versa.

**Investment/Market Risk**

Risk to earnings, capital or business resulting in the decline in value of our assets caused from changes in market variables, such as interest rates, which affect the values of invested securities and other investment instruments.

**Investment Securities**

Refers to Agency mortgage-backed securities and Agency debentures.

L

---

**Leverage**

The use of borrowed money to increase investing power.

**Leverage Ratio**

Calculated as total debt to total stockholders' equity. Includes non-recourse loan participations and mortgages payable.

**LIBOR (London Interbank Offered Rate)**

The rate banks charge each other for short-term Eurodollar loans. LIBOR is frequently used as the base for resetting rates on floating-rate securities.

**Liquidity Risk**

agreement at some specified date in the future. The swaption agreement will specify whether the buyer of the swaption will be a fixed-rate receiver or a fixed-rate payer. The writer of the swaption becomes the counterparty to the swap if the buyer exercises.

Internal Capital Adequacy Assessment Program (ICAAP)

The ongoing assessment and measurement of our risks, and the amount of capital which is necessary to hold against those risks. The objective is to ensure that the

Risk to earnings, capital or business arising from our inability to meet our obligations when they come due without incurring unacceptable losses because of inability to liquidate assets or obtain adequate funding.

Long-Term Debt

Debt which matures in more than one year.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

M

---

Master Netting Agreement

An agreement between two counterparties who have multiple derivative contracts or repurchase / reverse repurchase agreements with each other that provides for the net settlement of all contracts, as well as cash collateral, through a single payment, in a single currency, in the event of default on or termination of any one contract.

Monetary Policy

Action taken by the Board of Governors of the Federal Reserve System to influence the money supply or interest rates.

Mortgage-Backed Securities (MBS)

A security representing a direct interest in a pool of mortgage loans. The pass-through issuer or servicer collects the payments on the loans in the pool and "passes through" the principal and interest to the security holders on a pro rata basis.

N

---

NAV

Net asset value.

Net Capital Ratio

Calculated by taking total stockholders' equity divided by total assets less the net balances of U.S. Treasury securities and U.S. Treasury securities sold, not yet purchased, reverse repurchase agreements and repurchase agreements, and securities borrowed and securities loaned.

Net Equity Yield

Calculated using GAAP net income, excluding depreciation and amortization expense, divided by average net equity.

Net Interest Income

Represents interest income earned on our portfolio investments, less interest expense paid for borrowings.

Notional Amount

A stated principal amount in a derivative contract on which the contract is based.

O

---

Option Contract

A contract in which the buyer has the right, but not the obligation, to buy or sell an asset at a set price on or before a given date. Buyers of call options bet that a security will be worth more than the price set by the option (the strike price), plus the price they pay for the option itself. Buyers of put options bet that the security's price will drop below the price set by the option. An option is part of a class of financial instruments called derivatives, which means these financial instruments derive their value from the worth of an underlying investment.

Operational Risk

Risk to earnings, capital, reputation or business arising from inadequate or failed internal processes or systems, human factors or external events.

Original Face

The face value or original principal amount of a security on its issue date.

Other Income

Represents gains and losses on assets sold, gains and losses on trading assets and investment advisory and dividend income.

Out-of-the-Money

Description for an option that has no intrinsic value and would be worthless if it expired today; for a call option, this situation occurs when the strike price is higher than the market price of the underlying security; for a put option, this situation occurs when the strike price is less than the market price of the underlying security.

Over-The-Counter (OTC) Market

A securities market that is conducted by dealers throughout the country through negotiation of price rather than through the use of an auction system as



Net Interest Spread

Calculated by taking the annualized yield on average interest earning assets minus the annualized cost of funds on average interest bearing liabilities, including the net interest payments on interest rate swaps. Interest earning assets includes Investment Securities (includes Agency mortgage-backed securities and Agency debentures), U.S. Treasury securities, securities loaned, commercial real estate debt and preferred equity, reverse repurchase agreements and cash and cash equivalents.

represented by a stock exchange.

P

---

Pass Through Security

The securitization structure where a GSE or other entity “passes” the amount collected from the borrowers every month to the investor, after deducting fees and expenses.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

Principal and Interest

The term used to refer to regularly scheduled payments or prepayments of principal and of interest on a mortgage or other security.

Par

Price equal to the face amount of a security; 100%.

Par Amount

The principal amount of a bond or note due at maturity. Also known as par value.

Pool

A collection of mortgage loans assembled by an originator or master servicer as the basis for a security. In the case of Ginnie Mae, Fannie Mae, or Freddie Mac mortgage pass-through securities, pools are identified by a number assigned by the issuing agency.

Premium

The amount by which the price of a security exceeds its principal amount. When the dollar price of a bond is above its face value, it is said to be selling at a premium.

Prepayment

The unscheduled partial or complete payment of the principal amount outstanding on a mortgage loan or other debt before it is due.

Prepayment Risk

The risk that falling interest rates will lead to heavy prepayments of mortgage or other loans, forcing the investor to reinvest at lower prevailing rates.

Prime Rate

The indicative interest rate on loans that banks quote to their best commercial customers.

R

---

Rate Reset

The adjustment of the interest rate on a floating-rate security according to a prescribed formula.

Real Estate Investment Trust (REIT)

Repurchase Agreement

The sale of securities to investors with the agreement to buy them back at a higher price after a specified time period; a form of short-term borrowing. For the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement.

Residual

In a CMO, the residual is that tranche which collects any cash flow from the collateral that remains after obligations to the other tranches have been met.

Return on Average Equity

Calculated by taking earnings divided by average stockholders' equity excluding preferred shares.

Reverse Repurchase Agreement

Refer to Repurchase Agreement. From the customer's perspective, the customer provides a collateralized loan to the seller.

Risk Appetite Statement

Defines the types and levels of risk we are willing to take in order to achieve our business objectives, and reflects our risk management philosophy.

S

---

Secondary Market

Ongoing market for bonds previously offered or sold in the primary market.

Settlement Date

The date securities must be delivered and paid for to complete a transaction.

Short-Term Debt

Generally, debt which matures in one year or less. However, certain securities that mature in up to three years may be considered short-term debt.

Spread

When buying or selling a bond through a brokerage firm, an individual investor will be charged a

A special purpose investment vehicle that provides investors with the ability to participate directly in the ownership or financing of real-estate related assets by pooling their capital to purchase and manage mortgage loans and/or income property.

**Reinvestment Risk**

The risk that interest income or principal repayments will have to be reinvested at lower rates in a declining rate environment.

commission or spread, which is the difference between the market price and cost of purchase, and sometimes a service fee. Spreads differ based on several factors including liquidity.

**T**

---

**Target Assets**

Includes Agency mortgage-backed securities, to-be-announced forward contracts, agency debentures, commercial real estate investments, other mortgage-backed securities and corporate debt.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis

To-Be-Announced Securities (TBAs)

A contract for the purchase or sale of a mortgage-backed security to be delivered at a predetermined price, face amount, issuer, coupon and stated maturity on an agreed-upon future date but does not include a specified pool number and number of pools.

Total Return

Investment performance measure over a stated time period which includes coupon interest, interest on interest, and any realized and unrealized gains or losses.

Total Return Swap

A financial contract that transfers both the credit risk and market risk of an underlying asset.

U

---

Unencumbered Assets

Assets on our balance sheet which have not been pledged as collateral against an existing liability.

U.S. Government-Sponsored Enterprise (GSE)

Obligations

Obligations of agencies originally established or chartered by the U.S. government to serve public purposes as specified by the U.S. Congress; these obligations are not explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government.

U.S. Treasury

U.S. Department of the Treasury.

V

---

Value-at-Risk (VaR)

A statistical technique which measures the potential loss in value of an asset or portfolio over a defined period for a given confidence interval.

Volatility

A statistical measure of the variance of price or yield over time. Volatility is low if the price does not change very much over a short period of time, and high if there is a greater change.

W

---

Warehouse Lending

A line of credit extended to a loan originator to fund mortgages extended by the loan originators to property purchasers. The loan typically lasts from the time the mortgage is originated to when the mortgage is sold into the secondary market, whether directly or through a securitization. Warehouse lending can provide liquidity to the loan origination market.

Weighted Average Coupon

The weighted average interest rate of the underlying mortgage loans or pools that serve as collateral for a security, weighted by the size of the principal loan balances.

Weighted Average Life (WAL)

The assumed weighted average amount of time that will elapse from the date of a security's issuance until each dollar of principal is repaid to the investor. The WAL will change as the security ages and depending on the actual realized rate at which principal, scheduled and unscheduled, is paid to the loans underlying the MBS.

Y

---

Yield-to-Maturity

The expected rate of return of a bond if it is held to its maturity date; calculated by taking into account the current market price, stated redemption value, coupon payments and time to maturity and assuming all coupons are reinvested at the same rate; equivalent to the internal rate of return.



ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

---

Quantitative and qualitative disclosures about market risk are contained within the section titled "Risk Management" of Item 2. "Management's Discussion

and Analysis of Financial Condition and Results of Operations."

ITEM 4. CONTROLS AND PROCEDURES

---

Our management, including our Chief Executive Officer (the CEO) and Chief Financial Officer (the CFO), reviewed and evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act) as of the end of the period covered by this quarterly report. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed and implemented, (1) were effective in ensuring that information regarding the Company and its subsidiaries is accumulated and communicated to our management, including our CEO

and CFO, by our employees, as appropriate to allow timely decisions regarding required disclosure and (2) were effective in providing reasonable assurance that information the Company must disclose in its periodic reports under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods prescribed by the SEC's rules and forms.

There have been no changes in our internal controls over financial reporting that occurred during the quarter ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

PART II – OTHER INFORMATION

---

ITEM 1. LEGAL PROCEEDINGS

---

From time-to-time, we are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate

disposition of these matters will not have a material effect on our consolidated financial statements.

ITEM 1A. RISK FACTORS

---

There have been no material changes to the risk factors disclosed in Item 1A – Risk Factors of our most recent annual report on Form 10-K. The materialization of any risks and uncertainties identified in our Special Note Regarding Forward-Looking Statements contained in this report together with those previously disclosed in our most recent annual report on Form 10-K or those that are presently unforeseen could result in

significant adverse effects on our financial condition, results of operations and cash flows. See Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Special Note Regarding Forward-Looking Statements” in this quarterly report or our most recent annual report on Form 10-K.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 6. Exhibits

ITEM 6. EXHIBITS

---

Exhibits:

The exhibits required by this item are set forth on the Exhibit Index attached hereto.

Exhibit Number	Exhibit Description
3.1	Articles of Amendment and Restatement of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed on August 5, 1997).
3.2	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Registration Statement on Form S-3 (Registration Statement 333-74618) filed on September 12, 2002).
3.3	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed on August 3, 2006).
3.4	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.4 of the Registrant's Quarterly Report on Form 10-Q filed on May 7, 2008).
3.5	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed on September 23, 2011).
3.6	Form of Articles Supplementary designating the Registrant's 7.875% Series A Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.3 to the Registrant's Registration Statement on Form 8-A filed on April 1, 2004).
3.7	Articles Supplementary of the Registrant's designating an additional 2,750,000 shares of the Company's 7.875% Series A Cumulative Redeemable Preferred Stock, as filed with the State Department of Assessments and Taxation of Maryland on October 15, 2004 (incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed on October 4, 2004).
3.8	Articles Supplementary designating the Registrant's 6% Series B Cumulative Convertible Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on April 10, 2006).
3.9	Articles Supplementary designating the Registrant's 7.625% Series C Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on May 16, 2012).
3.10	Articles Supplementary designating the Registrant's 7.50% Series D Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on September 13, 2012).
3.11	Amended and Restated Bylaws of the Registrant, as amended (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on March 22, 2011).
3.12	



Amendment to the Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit 3.12 to the Registrant's Quarterly Report on Form 10-Q filed on August 8, 2013).

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Item 6. Exhibits

- 4.1 Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to Amendment No. 1 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed on September 17, 1997).
- 4.2 Specimen Preferred Stock Certificate (incorporated by reference to Exhibit 4.2 to the Registrant's Registration Statement on Form S-3 (Registration No. 333-74618) filed on December 5, 2001).
- 4.3 Specimen Series A Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form 8-A filed on April 1, 2004).
- 4.4 Specimen Series B Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on April 10, 2006).
- 4.5 Specimen Series C Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed on May 16, 2012).
- 4.6 Specimen Series D Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed on September 13, 2012).
- 4.7 Indenture, dated as of February 12, 2010, between the Registrant and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed on February 12, 2010).
- 4.8 Supplemental Indenture, dated as of February 12, 2010, between the Registrant and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.2 to the Registrant's Form 8-K filed on February 12, 2010).
- 4.9 Form of 4.00% Convertible Senior Note due 2015 (included in Exhibit 4.6).
- 4.10 Second Supplemental Indenture, dated as of May 14, 2012, between the Registrant and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.2 to the Registrant's Form 8-K filed on May 14, 2012).
- 4.11 Form of 5.00% Convertible Senior Note due 2015 (included in Exhibit 4.10).
- 31.1 Certification of Wellington J. Denahan, Chairman and Chief Executive Officer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Glenn A. Votek, Chief Financial Officer (Principal Financial Officer) of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Wellington J. Denahan, Chairman and Chief Executive Officer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Glenn A. Votek, Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 101.INS

XBRL Instance Document\*

Exhibit 101.SCH

XBRL Taxonomy Extension Schema Document\*

Exhibit 101.CAL

XBRL Taxonomy Extension Calculation Linkbase Document\*

Exhibit 101.DEF

XBRL Additional Taxonomy Extension Definition Linkbase Document Created\*

Taxonomy Extension Label Linkbase Document\*

Exhibit 101.LAB

XBRL

Exhibit 101.PRE

XBRL Taxonomy Extension Presentation Linkbase Document\*

\* Submitted electronically herewith. Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Financial Condition at March 31, 2014 (Unaudited) and December 31, 2013 (Derived from the audited Consolidated Statement of Financial Condition at December 31, 2013); (ii) Consolidated Statements of Comprehensive Income (Loss) (Unaudited) for the quarters ended March 31, 2014 and 2013; (iii) Consolidated Statement of Stockholders' Equity (Unaudited) for the quarters ended March 31, 2014 and 2013; (iv) Consolidated Statements of Cash Flows (Unaudited) for the quarters ended March 31, 2014 and 2013; and (v) Notes to Consolidated Financial Statements (Unaudited). Users of this data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, and otherwise is not subject to liability under these sections.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

Signatures

SIGNATURES

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

ANNALY CAPITAL MANAGEMENT, INC.

Dated: May 8, 2014

By: /s/ Wellington J. Denahan  
Wellington J. Denahan  
(Chief Executive Officer, and authorized officer of registrant)

Dated: May 8, 2014

By: /s/ Glenn A. Votek  
Glenn A. Votek  
(Chief Financial Officer and principal financial officer of the registrant)