

# **AIB Mortgage Bank**

Directors' Report & Financial Statements

Year ended 31 December 2007

# AIB Mortgage Bank

## Directors' report and financial statements

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# AIB Mortgage Bank

## Directors' and other information

### **Directors**

John O'Donnell (Chairman)  
Maeliosa Ó hOgartaigh (Deputy Chairman)  
David Kelly\* (Managing Director)  
Seymour Cresswell\*  
Kieran Crowley  
David Griffin\*  
Michael Keegan\*  
Gerry O'Connor\*  
Jennifer Winter

\* Executive Director

### **Registered office**

Bankcentre  
Ballsbridge  
Dublin 4  
Ireland

### **Secretary**

Tanya Barry

### **Registered Auditor**

KPMG  
Chartered Accountants  
1 Harbourmaster Place  
International Financial Services Centre  
Dublin 1  
Ireland

### **Solicitor**

Bryan Sheridan  
Group Law Agent  
Allied Irish Banks, p.l.c.  
Bankcentre  
Ballsbridge  
Dublin 4  
Ireland

### **Banker**

Allied Irish Banks, p.l.c.

### **Cover-Assets Monitor**

Mazars  
Harcourt Centre  
Block 3  
Harcourt Road  
Dublin 2  
Ireland

# AIB Mortgage Bank

## Directors' Report

The Directors present their report and financial statements for the year ended 31 December 2007. A statement of Directors' responsibilities in relation to the financial statements appears on page 7.

### Principal activities

AIB Mortgage Bank ('the Bank'), a public unlimited company, obtained an Irish banking licence under the Irish Central Bank Act, 1971 (as amended) and was registered as a designated mortgage credit institution under the Asset Covered Securities Act, 2001 on 8 February 2006. The Bank is a wholly owned subsidiary of Allied Irish Banks, p.l.c., ('AIB') and is regulated by the Central Bank and Financial Services Regulatory Authority of Ireland ('CBFSAI'). Its principal purpose is to issue Mortgage Covered Securities for the purpose of financing loans secured on residential property in accordance with the Asset Covered Securities Act, 2001 and the Asset Covered Securities (Amendment) Act 2007 ('the Asset Covered Securities Acts'). Such loans may be made directly by the Bank or may be purchased from Allied Irish Banks, p.l.c. and other subsidiary undertakings of AIB Group or third parties.

The Bank commenced trading on 13 February 2006, when Allied Irish Banks, p.l.c. transferred its Irish branch originated residential mortgage business, amounting to €13.6bn in mortgage loans, to AIB Mortgage Bank; certain other categories of Allied Irish Banks, p.l.c. residential mortgage loans were not included in this transfer. On 24 February 2006, a mortgage-backed promissory note facility between AIB Mortgage Bank and the Central Bank and Financial Services Regulatory Authority of Ireland was put in place.

In March 2006, the Bank launched a €15bn Mortgage Covered Securities Programme. The Bank has launched a number of covered bond issues since that date and continues to grow its business.

### Business review, future developments, risks and uncertainties

#### Organisation and Governance

The Bank's business activities are restricted, under the Asset Covered Securities Acts, to dealing in, and holding, mortgage credit assets and limited classes of other assets, engaging in activities connected with the financing and refinancing of such assets, entering into certain hedging contracts and engaging in other activities which are incidental to or ancillary to the above activities.

Most of the Bank's activities are outsourced to Allied Irish Banks, p.l.c. under an Outsourcing and Agency Agreement. Allied Irish Banks, p.l.c., as Service Agent for the Bank, originates residential mortgage loans through its retail branch network in the Republic of Ireland, services the mortgage loans, provides treasury services in connection with financing as well as a range of other support services.

The Bank's activities are financed through the issuance of mortgage covered securities and a mortgage-backed promissory note facility with the Central Bank and Financial Services Regulatory Authority of Ireland, with the balance of funding being provided by Allied Irish Banks, p.l.c.

Governance is exercised through a Board of Directors, chaired by the Group Finance Director of AIB, with three non executive Directors (two of whom are independent non executive Directors of Allied Irish Banks, p.l.c.) and five Executive Directors drawn from the AIB Bank Republic of Ireland Division and AIB Capital Markets Division.

In accordance with the Asset Covered Securities Acts, the Cover-Assets Monitor, Mazars, monitors compliance with the Acts and reports independently to the Central Bank and Financial Services Authority of Ireland.

#### Strategy

The residential mortgage market is a key component of AIB's overall approach to the personal banking market. AIB's strategy for the residential mortgage business is to achieve profitable growth in market share while preserving credit quality.

# AIB Mortgage Bank

## Directors' Report

### Global Market Dislocation

The following commentary outlines the impact on the Bank.

In common with debt markets generally, since August 2007, the market conditions for new covered bond issues has been difficult, market liquidity has been restricted, and where new bond issuance has taken place there has been an increase in the cost of funding. The Mortgage Bank completed a €1.5bn public issue in June 2007, and a €175m private placement in December 2007. In November 2007, a public covered bond issue was planned but due to volatility in the credit markets it was decided not to proceed with the planned issue. In March 2008, the Bank completed a 3 year €2.5bn private placement bond issue to its parent, Allied Irish Banks, p.l.c.

The cost of the funding provided by AIB has increased in line with market rates. This increased cost was not passed on to customers in the period up to 31 December 2007 and accordingly net interest income was lower in the second half of 2007 than in the first half.

### Developments

Apart from the above, there have been no significant developments in the Bank during the year.

### Outlook

The Board considers that, following a lengthy period of economic buoyancy in Ireland, the outlook for 2008 is for lower economic growth and a more difficult operating environment. Longer term growth and stability are supported by positive economic fundamentals.

The residential housing market correction is now well advanced. It is expected that new mortgage lending will be at lower levels in 2008 than in 2007.

The continuing global market dislocation may result in funding costs remaining at elevated levels which may continue to put pressure on interest margins. Covered bond issuance will remain a source of funding diversity. Further public issues may not however take place until there has been an improvement in market conditions.

### Risks and uncertainties

Information concerning the principal risks and uncertainties facing the Bank as required under the terms of the European Accounts Modernisation Directive (2003/51/EEC) is set out in Note 7 of the Financial Statements.

### **Results for the year**

The results for the year ended 31 December 2007 are wholly in respect of activity since 1 January 2007. The comparative period for 2006 is from 13 February 2006 to 31 December 2006. Profit before taxation was €108.4m (2006: €69.7m).

The residential mortgage loan business has performed well. The mortgage loan book increased from €16.3bn at 31 December 2006 to €18.4bn at 31 December 2007. Asset quality has remained strong.

Net interest income was €129.6m (2006: €126.5m). Interest income on mortgage loans was €31.3m (2006: €17.5m) and on deposits and interest rate swaps with Allied Irish Banks, p.l.c. was €11.2m (2006: €13.2m). Interest payable to the Central Bank and Financial Services Regulatory Authority of Ireland in respect of the mortgage-backed promissory note facility was €5.5m (2006: €5.8m), to holders of mortgage covered securities was €241.2m (2006: €96.6m) and to Allied Irish Banks, p.l.c. on funding and on interest rate swaps was €766.1m (2006: €401.8m).

# AIB Mortgage Bank

## Directors' Report

### Results for the year *(continued)*

Changes in fair value of interest rate swaps, and certain related account items being hedged, resulted in a trading gain of €22.7m (2006: €15.1m loss). A gain of €19.3m (2006: €12.9m loss) arose as a result of changes in fair value of swaps used to hedge the interest rate risk in the mortgage loan portfolio. Interest rate swaps are used solely to minimise interest rate risk, which the Directors consider is achieved, as far as practicable, from an economic standpoint and that interest rate risk management complies with the requirements of the Asset Covered Securities Acts.

Administrative expenses amounted to €42.5m (2006: €39.2m), and included €39.4m (2006: €38.1m) for services provided by Allied Irish Banks, p.l.c. under the Outsourcing and Agency Agreement.

Profit after taxation amounted to €94.9m (2006: €61.0m). The Board is recommending a dividend payment of €70m in respect of the year ended 31 December 2007 payable on 31 March 2008.

### Financing

During the year, the Bank undertook issues of mortgage covered securities (or covered bonds) under its €15bn Mortgage Covered Securities Programme as follows:

- On 29 June 2007, a €1.5bn public issue of 10 year mortgage covered securities due on 29 June 2017; and
- On 7 December 2007, a €75m private placement issue of 10 year mortgage covered securities due on 29 June 2017.

The total nominal amounts of principal outstanding in respect of mortgage covered securities issued was €7.175bn as at 31 December 2007.

### Share capital

The share capital of the Bank was increased from €405,000,000 at 31 December 2006 to €425,000,000 (ordinary shares of €1 each) at 31 December 2007 by the issue on 31 January 2007 of 20,000,000 shares for cash to Allied Irish Banks, p.l.c.

### Books of account

The measures taken by the Directors to secure compliance with the Bank's obligation to keep proper books of account are the use of appropriate systems and procedures and the employment of competent persons. The books of account of the Bank are kept at the Bank's registered office.

### Directors

The Directors and Secretary of the Bank are set out on page 1.

Mr. Maeliosa Ó'hOgartaigh was appointed as a Director and Deputy Chairman on 31 January 2007.

Mr. John Burns resigned and Ms. Tanya Barry was appointed Secretary on 18 May 2007.

### Directors' and Secretary's interests in shares

The beneficial interests of the Directors and the Secretary in office at 31 December 2007 and of their spouses and minor children in the shares of group companies are set out below. The shares referred to are €0.32 ordinary shares in Allied Irish Banks, p.l.c., the holding company.

# AIB Mortgage Bank

## Directors' Report

### Directors' and Secretary's interests in shares *(continued)*

| Ordinary shares       | 31 December<br>2007 | 1 January<br>2007* |
|-----------------------|---------------------|--------------------|
| <b>Directors:</b>     |                     |                    |
| Seymour Cresswell     | 1,923               | 1,970              |
| Kieran Crowley        | 12,520              | 12,520             |
| David Griffin         | 6,668               | 6,107              |
| Michael Keegan        | 4,707               | 3,146              |
| David Kelly           | 75,385              | 64,824             |
| Gerry O'Connor        | 37,798              | 27,224             |
| John O'Donnell        | 37,052              | 9,491              |
| Maeliosa Ó hOgartaigh | 10,394              | 8,833              |
| Jennifer Winter       | 480                 | 480                |
| <b>Secretary:</b>     |                     |                    |
| Tanya Barry           | 2,225               | 2,225              |

\* or later date of appointment

### Share options

Details of the Directors' and the Secretary's options to subscribe for ordinary shares in Allied Irish Banks, p.l.c., are given below. The vesting of these options to the individuals concerned is dependent on Earnings Per Share ("EPS") targets being met by AIB. Subject thereto, the options outstanding at 31 December 2007 are exercisable at various dates between 2008 and 2015. Details are shown in the Register of Directors' and Secretary's Interests, which may be inspected at the Bank's registered office.

|                       | 31 December<br>2007 | 1 January<br>2007* | Since 1 January,<br>2007* |           | Price of<br>options<br>exercised          | Market<br>price at<br>date of<br>Exercise | Weighted average<br>subscription price<br>of options<br>outstanding<br>at 31 December,<br>2007 |
|-----------------------|---------------------|--------------------|---------------------------|-----------|---|---|--|
|                       |                     |                    | Granted                   | Exercised |   |   |  |
| <b>Directors:</b>     |                     |                    |                           |           | €   | €   | €  |
| Seymour Cresswell     | -                   | -                  | -                         | -         | -   | -   | -  |
| David Griffin         | 22,500              | 22,500             | -                         | -         | -   | -   | 13.75  |
| Michael Keegan        | 22,500              | 22,500             | -                         | -         | -   | -   | 13.24  |
| David Kelly           | 25,000              | 35,000             | -                         | 10,000    | 11.98                                     | 16.84                                     | 14.08  |
| Gerry O'Connor        | -                   | 10,500             | -                         | 10,500    | 3,000@13.55<br>3,500@13.30<br>4,000@12.60 | 21.57<br>21.57<br>22.32                   | -<br>-<br>-  |
| John O'Donnell        | 96,000              | 96,000             | -                         | -         | -   | -   | 13.23  |
| Maeliosa Ó'hOgartaigh | 43,000              | 43,000             | -                         | -         | -   | -   | 13.68  |
| <b>Secretary:</b>     |                     |                    |                           |           |   |   |  |
| Tanya Barry           | 1,500               | 1,500              | -                         | -         | -   | -   | 13.30  |

\* or later date of appointment

Mr. O'Connor also has options to purchase 813 AIB shares under the AIB Group UK plc Sharesave Scheme.

# AIB Mortgage Bank

## Directors' Report

### Long term incentive plans

Details of the Directors' and the Secretary's conditional grants of awards of ordinary shares are given below. These conditional awards are subject to onerous performance targets being met by AIB, in terms of EPS growth and total shareholder return. In that regard, it was determined by the AIB Remuneration Committee during 2007 that the conditional awards made in 2002 had not met the related performance targets, and, accordingly, that they should lapse – see below. The conditional grants of awards outstanding at 31 December 2007 may wholly or partly vest between 2008 and 2010, depending on the date of the grant and the grant conditions being met.

|                       | <b>Total as at<br/>31 December 2007</b> | <b>Lapsed during<br/>2007</b> | <b>Granted during<br/>2007</b> | <b>Total as at<br/>1 January<br/>2007*</b> |
|-----------------------|---|-------------------------------|--------------------------------|--|
| <b>Directors:</b>     |   |                               |                                |  |
| Seymour Cresswell     | -                                       | -                             | -                              | -  |
| David Griffin         | 17,883                                  | -                             | 8,726                          | 9,157                                      |
| Michael Keegan        | 16,842                                  | 4,500                         | 8,726                          | 12,616                                     |
| David Kelly           | 20,805                                  | 4,500                         | 9,816                          | 15,489                                     |
| Gerry O'Connor        | 10,226                                  | -                             | 4,774                          | 5,452                                      |
| Maeliosa Ó hOgartaigh | 24,251                                  | -                             | 12,216                         | 12,035                                     |
| John O'Donnell        | 88,723                                  | 6,500                         | 27,486                         | 67,737                                     |
| <b>Secretary:</b>     |   |                               |                                |  |
| Tanya Barry           | -                                       | -                             | -                              | -  |

*\* or later date of appointment*

Apart from the interests set out above, the Directors and Secretary and their spouses and minor children have no other interests in the shares of Allied Irish Banks, p.l.c.

There were no changes in the Directors' and Secretary's interests between 31 December 2007 and 31 March 2008 save for the receipt by Mr. O'Connor of 35 shares under the Allied Irish Banks, p.l.c. UK Share Ownership Plan.

### Post balance sheet events

Other than the items previously mentioned, or as described in note 28 to the accounts, there are no other significant events that have occurred in the period subsequent to the year end date and the date of approving the financial statements.

### Independent auditor

The auditors, KPMG, Chartered Accountants, have signified willingness to continue in office under Section 160 (2) of the Companies Act, 1963.

### On behalf of the Board

*Chairman*            John O'Donnell

*Managing Director*       David J. Kelly

*31 March 2008*



# AIB Mortgage Bank

## Statement of Directors' responsibilities in relation to the Financial Statements

The Companies Acts require the Directors to prepare financial statements for each financial year. Under the Acts the Directors are required to prepare the financial statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU and applicable law.

The financial statements are required by law and IFRS to present fairly the financial position and performance of the Bank; the Companies Acts provide in relation to such financial statements that references to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing the Bank's financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Directors are responsible for keeping proper books of account that disclose with reasonable accuracy at any time the financial position of the Bank and enable them to ensure that its financial statements comply with the Companies Acts 1963 to 2006 and the Asset Covered Securities Acts. They are also responsible for taking such steps as are reasonably open to them to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the AIB Mortgage Bank corporate and financial information included on the Group's website. Legislation in Ireland governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors are also responsible for preparing a Directors' Report that complies with the requirements of the Companies Acts 1963 to 2006.

### On behalf of the Board

*Chairman*            John O'Donnell

*Managing Director*       David J. Kelly

31 March 2008

# AIB Mortgage Bank

## **Independent auditor's report to the members of AIB Mortgage Bank**

We have audited the financial statements of AIB Mortgage Bank ('the Bank') for the year ended 31 December 2007 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Statement of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 193 of the Companies Act 1990.

Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of Directors and auditor**

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 7.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with IFRS as adopted by the EU and have been properly prepared in accordance with the Companies Acts 1963 to 2006, and Article 4 of the IAS regulation.

We also report to you whether, in our opinion:

- proper books of account have been kept by the Bank;
- whether at the balance sheet date, there exists a financial situation requiring the convening of an extraordinary general meeting of the Bank; and
- whether the information given in the Directors' Report is consistent with the financial statements.

In addition, we state whether we have obtained all the information and explanations necessary for the purposes of our audit, and whether the Bank's balance sheet is in agreement with the books of account. We also report to you if, in our opinion, any information specified by law regarding Directors' remuneration and Directors' transactions is not disclosed and, where practicable, include such information in our report.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors' Report. We consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements.

# AIB Mortgage Bank

## **Basis of audit opinion** *(continued)*

It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free of material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

## **Opinion**

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Bank's affairs as at 31 December 2007 and of its profit for the year then ended; and
- the financial statements have been properly prepared in accordance with the Companies Acts 1963 to 2006, and Article 4 of the IAS regulation.

We have obtained all the information and explanations which we consider necessary for the purposes of our audit. In our opinion proper books of account have been kept by the Bank. The Bank's balance sheet is in agreement with the books of account.

In our opinion the information given in the Directors' Report is consistent with the financial statements.

The net assets of the Bank, as stated in the balance sheet are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 December 2007 a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the Bank.

**KPMG**

*Registered Auditor*

*Chartered Accountants*

*1 Harbourmaster Place*

*International Financial Services Centre*

*Dublin 1*

*31 March 2008*

(a) The maintenance and integrity of the website on which the AIB Mortgage Bank financial statements are included is the responsibility of the Directors; the work carried out by the auditor does not involve consideration of these matters and, accordingly, the auditor accept no responsibility for any changes that may have occurred to the financial statements or audit report since they were initially presented on the website.

(b) Legislation in the Republic of Ireland governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# AIB Mortgage Bank

## Accounting policies

**The accounting policies applied in the preparation of the financial statements for the year ended 31 December 2007 are set out below. There are no significant changes to the accounting policies described on pages 10 to 16 in the 2006 Annual Report.**

### Status of AIB Mortgage Bank

AIB Mortgage Bank ('the Bank') is a public unlimited company operating under the Irish Central Bank Act, 1971 (as amended) and as a designated mortgage credit institution under the Asset Covered Securities Acts. It is a wholly owned subsidiary of Allied Irish Banks, p.l.c. and is regulated by the Central Bank and Financial Services Regulatory Authority of Ireland. Its principal purpose is to issue Mortgage Covered Securities for the purpose of financing loans secured on residential property in accordance with the Asset Covered Securities Acts. Such loans may be made directly by the Bank to customers through the AIB Group branch network in the Republic of Ireland or may be purchased from Allied Irish Banks, p.l.c. and other members of the group or third parties.

### 1. Statement of compliance

The financial statements have been presented in accordance with International Accounting Standards and International Financial Reporting Standards (collectively 'IFRS') as adopted by the European Union ("EU") and applicable at 31 December 2007. The financial statements also comply with the requirements of Irish Statute comprising the Companies Acts 1963 to 2006, the Asset Covered Securities Acts and the European Communities (Credit Institutions Accounts) Regulations, 1992 as amended by the European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005.

### 2. Basis of preparation

The financial statements are presented in Euro, which is the functional currency of the company, rounded to the nearest thousand.

They have been prepared under the historical cost basis, with the exception of the following assets and liabilities which are stated at their fair value: derivative financial instruments, financial instruments at fair value through profit or loss and certain hedged financial assets and financial liabilities.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of certain assets, liabilities, revenues, expenses and disclosures of contingent assets and liabilities. The estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under these circumstances. Since management's judgement involves making estimates concerning the likelihood of future events, the actual results could differ from those estimates. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future period affected. The estimates that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are in the areas of impairment of financial assets and fair value of certain financial assets and liabilities. A description of these estimates and judgements is set out within item 14 of this section.

### 3. Interest income and expense recognition

Interest income and expense is recognised in the income statement for all interest-bearing financial instruments using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of assets and liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts the expected future cash payments or receipts through the expected life of the financial instrument, or when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The application of the method has the effect of recognising income (and expense) receivable (or payable) on the instrument evenly in proportion to the amount outstanding over the period to maturity or repayment.

# AIB Mortgage Bank

## Accounting policies

### 3. Interest income and expense recognition *(continued)*

In calculating the effective interest rate, the Bank estimates cash flows (using projections based on its experience of customers' behaviour) considering all contractual terms of the financial instrument but excluding future credit losses.

The calculation takes into account all fees, including those for early redemption, between parties to the contract that are an integral part of the effective interest rate and all other premiums and discounts.

All costs associated with mortgage incentive schemes including reduced introductory rates and 'cash back' incentives are included in the effective interest calculation.

### 4. Fee and commission income

Fees and commissions are generally recognised on an accruals basis when the service has been provided.

### 5. Net trading income

Net trading income comprises gains less losses relating to trading assets and liabilities, and includes all realised and unrealised fair value changes.

### 6. Financial assets

#### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market and which are not classified as available for sale. They arise when the Bank provides money or services directly to a customer with no intention of trading the loan. Loans are recognised when cash is advanced to the borrowers. Financial assets are initially recognised at fair value and are subsequently carried on an amortised cost basis.

Financial assets are derecognised when rights to receive cash flows from financial assets have expired or when the Bank has transferred substantially all the risks and rewards of ownership.

### 7. Financial liabilities

Issued financial instruments and their components are classified as liabilities where the substance of the contractual arrangement results in the Bank having a present obligation to either deliver cash or another financial asset to the holder or to exchange financial instruments on terms that are potentially unfavourable or to satisfy the obligation otherwise than by the exchange of a fixed amount of cash or another financial asset for a fixed number of equity shares.

Financial liabilities are initially recognised at fair value, being the issue proceeds (fair value of consideration received) net of transaction costs incurred. Financial liabilities are subsequently measured at amortised cost, any difference between the proceeds net of transaction costs and the redemption value is recognised in the income statement using the effective interest rate method.

Refer to derivatives and hedge accounting, set out within item 8 of this section, for the accounting policy for financial liabilities in a hedge accounting relationship.

### 8. Derivatives and hedge accounting

Derivatives, such as interest rate swaps, are used only for risk management purposes.

#### *Derivatives*

Derivatives are measured initially at fair value on the date on which the derivative contract is entered into and subsequently remeasured at fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, and discounted cash flow models and options pricing models as appropriate. Derivatives are included in assets when their fair value is positive, and in liabilities when their fair value is negative, unless there is the legal ability and intention to settle net. Profits or losses are only recognised on initial recognition of derivatives when there are observable current market transactions or valuation techniques that are based on observable market inputs.

# AIB Mortgage Bank

## Accounting policies

### 8. Derivatives and hedge accounting *(continued)*

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

#### *Hedging*

All derivatives are carried at fair value in the balance sheet and the accounting treatment of the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. Where derivatives are held for risk management purposes, and when transactions meet the criteria specified in IAS 39, the Bank designates certain derivatives as hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge).

When a financial instrument is designated as a hedge, the Bank formally documents the relationship between the hedging instrument and hedged item as well as its risk management objectives and its strategy for undertaking the various hedging transactions. The Bank also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value.

The Bank discontinues hedge accounting when:

- (a) it is determined that a derivative is not, or has ceased to be, highly effective as a hedge;
- (b) the derivative expires, or is sold, terminated, or exercised; and
- (c) the hedge item matures or is sold or repaid.

To the extent that the changes in the fair value of the hedging derivative differ from changes in fair value of the hedged risk in the hedged item; or the cumulative change in the fair value of the hedge derivative differs from the cumulative change in the fair value of expected future cash flows of the hedged item, ineffectiveness arises. The amount of ineffectiveness, (taking into account the timing of the expected cash flows, where relevant) provided it is not so great as to disqualify the entire hedge for hedge accounting, is recorded in the income statement.

In certain circumstances, the Bank may decide to cease hedge accounting even though the hedge relationship continues to be highly effective by no longer designating the financial instrument as a hedge.

#### *Fair value hedge accounting*

Changes in fair value of derivatives that qualify and are designated as fair value hedges are recorded in the income statement, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the fair value hedging adjustment cumulatively made to the carrying value of the hedged item is, for items carried at amortised cost, amortised over the period to maturity of the previously designated hedge relationship using the effective interest method.

Derivatives used to manage interest rate risk arising on mortgage covered securities have been designated as fair value hedges.

#### *Derivatives that do not qualify for hedge accounting*

Certain derivative contracts entered into as economic hedges do not qualify for hedge accounting. Changes to the fair value of derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

Derivatives used to manage interest rate risk arising on mortgage loans to customers do not qualify for hedge accounting. Changes in their fair value are recognised immediately in the income statement.

# AIB Mortgage Bank

## Accounting policies

### 9. Impairment of financial assets

It is company policy to make provisions for impairment of financial assets to reflect the losses inherent in those assets at the balance sheet date.

The Bank assesses whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired at each balance sheet date. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset on or before the balance sheet date, ('a loss event') and that loss event or events has had an impact such that the estimated present value of future cash flows is less than the current carrying value of the financial asset, or portfolio of financial assets.

Objective evidence that a financial asset, or a portfolio of financial assets, is impaired includes observable data that comes to the attention of the Bank about the following loss events:

- (a) significant financial difficulty of the obligor;
- (b) a breach of contract, such as a default or delinquency in interest or principal payments;
- (c) the granting to the borrower of a concession, for economic or legal reasons relating to the borrower's financial difficulty that the Bank would not otherwise consider;
- (d) it becomes probable that the borrower will enter bankruptcy or other financial reorganisation; and
- (e) observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
  - (i) adverse changes in the payment status of borrowers in the portfolio; and
  - (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (i.e. individually insignificant). If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and includes these performing assets under the collective incurred but not reported ('IBNR') assessment. An IBNR impairment provision represents an interim step pending the identification of impairment losses on an individual asset in a group of financial assets. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

For loans and receivables, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognised using an allowance account and the amount of the loss is charged to the income statement.

When a loan has been subject to a specific provision and there is no more than a remote likelihood of recovery of such amount, the amount is written off against the related provision for loan impairment. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

### 10. Employee benefits

#### *Retirement benefit obligations*

The Bank provides employees with post retirement benefits mainly in the form of pensions. It is AIB Group policy to provide for pension and other post-retirement benefits at rates recommended by independent actuaries. Staff members of the Bank are members of defined benefit or defined contribution schemes administered by Allied Irish Banks, p.l.c.

# AIB Mortgage Bank

## Accounting policies

### 10. Employee benefits (*continued*)

AIB's defined benefit scheme was closed to new members from December 1997. Employees who joined AIB since December 1997 joined on a defined contribution basis. In December 2007, the Group introduced a hybrid pension scheme for employees in the Republic of Ireland who are not members of the defined benefit scheme. This scheme includes elements of both a defined benefit and a defined contribution scheme. The standard employer contribution rate was 8% for 2007 and 2006. This increases to 22.3% for the defined benefit element and 10% in respect of the defined contribution elements of the hybrid scheme.

### 11. Non-credit risk provisions

Provisions are recognised for present, legal or constructive obligations arising as consequences of past events where it is probable that a transfer of economic benefit will be necessary to settle the obligation, and it can be reliably estimated.

### 12. Income tax

Income tax comprising current tax is recognised in the income statement. Current tax is the expected tax payable on the taxable income for the year using tax rates enacted or substantively enacted at the balance sheet date and any adjustment to tax payable in respect of previous years. Income tax payable on profits based on the applicable tax law is recognised as an expense in the period in which the profits arise.

### 13. Cash and cash equivalents

For the purposes of the cash flow statement, cash comprises cash on hand and demand deposits, and cash equivalents comprise highly liquid investments that are convertible into cash with an insignificant risk of changes in value and with original maturities of less than three months.

### 14. Accounting estimates and judgements

The estimates that have a significant impact on the financial statements and estimates with a significant risk of material adjustment in the next year are set out below:

#### (a) *Loan impairment*

The estimation of potential loan losses is inherently uncertain and depends upon many factors, including loan loss trends, portfolio grade profiles, local and international economic climates and other external factors such as legal and regulatory requirements. For example, should the expectation of loss within a portfolio increase, then this may result in an increase to the required incurred but not reported ('IBNR') loan loss provision level.

A specific provision is made against problem loans when, in the judgement of management, the estimated repayment realisable from the obligor, including the value of any security available, is likely to fall short of the amount of principal and interest outstanding on the obligor's loan account. The amount of the specific provision made in the Bank's financial statements is intended to cover the difference between the assets carrying value and the present value of estimated future cash flows discounted at the assets original effective interest rates. The management process for the identification of loans requiring provision is underpinned by independent tiers of review.

Credit quality and loan loss provisioning are independently monitored by management on a regular basis. A system for grading advances according to agreed credit criteria exists with an important objective being the timely identification of vulnerable loans so that remedial action can be taken at the earliest opportunity. Credit rating is fundamental to the determination of provisioning in the Bank; it triggers the process which results in the creation of a specific provision on individual loans where there is doubt on recoverability.

IBNR provisions are also maintained to cover loans, which are impaired at the balance sheet date and, while not specifically identified, are known from experience to be present in any portfolio of loans.



# AIB Mortgage Bank

## Accounting policies

### 14. Accounting estimates and judgements *(continued)*

IBNR provisions are maintained at levels that are deemed appropriate by management having considered: credit grading profiles and grading movements, historic loan loss rates, changes in credit management, procedures, processes and policies, levels of credit management skills, local and international economic climates, portfolio sector profiles and current estimates of expected loss in the portfolio.

Estimates of expected loss are driven by the following key factors;

- (a) Probability of default i.e. the likelihood of a customer defaulting on its obligations over the next 12 months,
- (b) Loss given default i.e. the fraction of the exposure amount that will be lost in the event of default, and
- (c) Exposure at default i.e. exposure is calculated by adding the expected drawn balance plus a percentage of the unused limits.

AIB's rating systems have been internally developed and are continually being enhanced, e.g. externally benchmarked, to help underpin the aforementioned factors which determine the estimates of expected loss. Estimated expected loss is only one element in assessing the adequacy of the Bank's allowances.

Provisions and provision adequacy are approved on a quarterly basis. These provisions are in turn reviewed and approved by the AIB Republic of Ireland Division on a quarterly basis with ultimate levels being approved by the AIB Mortgage Bank Audit Committee and the AIB Mortgage Bank Board of Directors.

### *(b) Fair value of financial instruments*

The Bank's financial instruments, which include derivatives are carried at fair value. Financial instruments are either priced with reference to a quoted market price for that instrument or by using a valuation model. Where the fair value is calculated using financial-markets pricing models, the methodology is to calculate the expected cash flows under the terms of each specific contract and then discount these values back to a present value. These models use as their basis independently sourced market parameters including, for example, interest rate yield curves. The valuation model used for a particular instrument, the quality and liquidity of market data used for pricing, other fair value adjustments not specifically captured by the model and market data are all subject to internal review and approval procedures and consistent application between accounting periods.

### 15. Share capital

Issued financial instruments, or their components, are classified as equity where they meet the definition of equity and confer on the holder a residual interest in the assets of the Bank.

Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instrument.

### 16. Contingent liabilities and assets

A contingent liability is a present obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity or a present obligation that arises from past events but is not recognised because it is not probable that an outflow of resources will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability.

The Bank discloses contingent liabilities and assets in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

# AIB Mortgage Bank

## Accounting policies

### 17. Prospective accounting changes

Any legislative changes and new accounting standards or amendments to standards, approved by the International Accounting Standards Board (IASB) in 2007 will impact financial reporting in future periods. If applicable they will be adopted in 2008.

The EU Transparency Directive (the “Directive”) was transposed into Irish Law on 13 June 2007 and will impact AIB Mortgage Bank’s external reporting from 1 January 2008. The Directive seeks to enhance transparency in EU capital markets in order to improve investor protection and market efficiency. The Directive sets out publication deadlines and content requirements in relation to annual financial reports. The Directive is not expected to have significant impact on reporting.

The IASB announced on 1 July 2006 that it will not require the application of new IFRSs under development or major amendments to existing IFRSs before 1 January 2009. Delaying implementation of new standards until 2009 will have provided four years of stability in the IFRS platform of standards for those companies that adopted IFRSs in 2005. Companies will however, be permitted to adopt a new standard on a voluntary basis before its effective date. Interpretations and minor amendments to correct problems identified in practice are not subject to this 2009 delay.

# AIB Mortgage Bank

## Income Statement

for the year ended 31 December 2007

|  |       | <b>31 Dec<br/>2007<br/>€ 000</b> | <b>Period 13 Feb<br/>to 31 Dec<br/>2006<br/>€000</b> |
|--|-------|----------------------------------|--|
|  | Notes |                                  |  |
| Interest and similar income                        | 1     | <b>1,142,487</b>                 | 630,665  |
| Interest expense and similar charges               | 2     | <b>(1,012,896)</b>               | (504,205)  |
| <b>Net interest income</b>                         |       | <b>129,591</b>                   | 126,460  |
| Trading gain/(loss)                                | 3     | <b>22,650</b>                    | (15,088)   |
| Other operating income                             |       | <b>7</b>                         | 4  |
| <b>Total operating income</b>                      |       | <b>152,248</b>                   | 111,376  |
| Administrative expenses                            | 4     | <b>(42,520)</b>                  | (39,169)   |
| <b>Operating profit before provisions</b>          |       | <b>109,728</b>                   | 72,207   |
| Provisions for impairment of loans and receivables | 5     | <b>(1,279)</b>                   | (2,469)  |
| <b>Operating profit before taxation</b>            |       | <b>108,449</b>                   | 69,738   |
| Taxation on ordinary activities                    | 6     | <b>(13,556)</b>                  | (8,717)  |
| <b>Profit for the year/period</b>                  |       | <b>94,893</b>                    | 61,021   |

The notes on pages 22 to 45 are an integral part of these financial statements.

*Chairman* John O'Donnell

*Managing Director*

David J. Kelly

*Finance Director* Michael L. Keegan

*Secretary* Tanya Barry

31 March 2008

# AIB Mortgage Bank

## Balance sheet

as at 31 December 2007

|   |       | 31 Dec<br>2007<br>€ 000 | 31 Dec<br>2006<br>€000 |
|---|-------|-------------------------|------------------------|
|   | Notes |                         |                        |
| <b>Assets</b>                                     |       |                         |                        |
| Balances at central bank                          |       | 25                      | 25                     |
| Loans and receivables to banks                    | 9     | 8,627,900               | 6,999,839              |
| Loans and receivables to customers                | 10    | 18,416,150              | 16,312,425             |
| Other assets                                      | 12    | 45,198                  | 33,553                 |
| Derivative financial instruments                  | 8     | 6,380                   | -                      |
| <b>Total assets</b>                               |       | <b>27,095,653</b>       | <b>23,345,842</b>      |
| <b>Liabilities</b>                                |       |                         |                        |
| Deposits by banks                                 | 13    | 18,831,652              | 16,965,052             |
| Customer accounts                                 |       | 183                     | 1,047                  |
| Derivative financial instruments                  | 8     | 90,503                  | 91,388                 |
| Debt securities in issue                          | 14    | 7,083,315               | 5,423,700              |
| Current taxation                                  |       | 3,556                   | 717                    |
| Other liabilities                                 |       | 353                     | 760                    |
| Accruals and deferred income                      | 15    | 205,177                 | 97,157                 |
| Subordinated liabilities                          | 16    | 300,000                 | 300,000                |
| <b>Total liabilities</b>                          |       | <b>26,514,739</b>       | <b>22,879,821</b>      |
| <b>Shareholders' equity</b>                       |       |                         |                        |
| Share capital                                     | 17    | 425,000                 | 405,000                |
| Profit and loss account                           |       | 155,914                 | 61,021                 |
| <b>Total shareholders' equity</b>                 |       | <b>580,914</b>          | <b>466,021</b>         |
| <b>Total liabilities and shareholders' equity</b> |       | <b>27,095,653</b>       | <b>23,345,842</b>      |

Chairman John O'Donnell

Managing Director David J. Kelly

Finance Director Michael L. Keegan

Secretary Tanya Barry

31 March 2008

# AIB Mortgage Bank

## Statement of cash flows

for the year ended 31 December 2007

|  | 31 Dec<br>2007<br>€ 000 | Period 13 Feb<br>to 31 Dec<br>2006<br>€000 |
|--|-------------------------|--|
| <b>Reconciliation of profit before taxation to net cash inflow from operating activities</b> |                         |  |
|  | Notes                   |  |
| Profit before taxation   | 108,449                 | 69,738                                     |
| Increase in prepayments and accrued income   | (11,346)                | (33,398)                                   |
| Increase in accruals and deferred income   | 108,020                 | 97,157                                     |
| (Decrease)/ Increase in customer accounts  | (864)                   | 1,047                                      |
| Increase in cash and balances at central bank  | -                       | (25)                                       |
| Increase in loans and receivables to customers   | (2,103,725)             | (16,312,425)                               |
| Increase in debt securities in issue   | 1,659,615               | 5,423,700                                  |
| (Decrease)/ Increase in derivative financial instruments                                     | (7,265)                 | 91,388                                     |
| Increase in loans and receivables to Allied Irish Banks, p.l.c.                              | (1,438,579)             | (6,942,982)                                |
| Increase in loans and receivables from Allied Irish Banks, p.l.c.                            | 1,866,560               | 16,965,092                                 |
| Increase in other assets   | (299)                   | (155)                                      |
| (Decrease)/ Increase in other liabilities  | (407)                   | 760  |
| <b>Net cash flow from operating assets and liabilities</b>                                   | <b>180,159</b>          | <b>(640,103)</b>                           |
| <b>Net cash inflow from operating activities before taxation</b>                             |                         |  |
| Taxation paid  | (13,569)                | (8,000)                                    |
| Taxation refund  | 2,852                   | -  |
| <b>Net cash flow from operating activities</b>   | <b>169,442</b>          | <b>(648,103)</b>                           |
| <b>Financing activities</b>  |                         |  |
| Issue of subordinated liabilities  | -                       | 300,000                                    |
| Issue of ordinary shares   | 20,000                  | 404,960                                    |
| <b>Increase/(decrease) in cash and cash equivalents</b>                                      | <b>189,442</b>          | <b>56,857</b>                              |
| Opening cash and cash equivalents  | 56,897                  | 40   |
| <b>Closing cash and cash equivalents</b>   | <b>246,339</b>          | <b>56,897</b>                              |
|  | 21                      |  |

# AIB Mortgage Bank

## Statement of recognised income and expense

*for the year ended 31 December 2007*

|   | <b>31 Dec<br/>2007<br/>€ 000</b> | Period 13 Feb<br>to 31 Dec<br>2006<br>€000 |
|---|----------------------------------|--|
| <hr/> <b>Income and expense recognised directly in equity</b> <hr/> |                                  |  |
| Profit for the year/ period   | <b>94,893</b>                    | 61,021                                     |
| <hr/>   |                                  |  |
| <b>Total recognised income and expense for the year/ period</b>     | <b>94,893</b>                    | 61,021                                     |
| <hr/>   |                                  |  |

# AIB Mortgage Bank

## Reconciliation of movements in shareholders' equity

*for the year ended 31 December 2007*

|                                       | Share capital  | Profit and<br>loss account | Total          |
|---------------------------------------|----------------|----------------------------|----------------|
|                                       | € 000          | € 000                      | € 000          |
| <b>Balance at 1 January 2006</b>      | 40             | -                          | 40             |
| Profit attributable to equity holders | -              | 61,021                     | -              |
| Ordinary shares issued                | 404,960        | -                          | -              |
| <b>Balance at 31 December 2006</b>    | 405,000        | 61,021                     | 466,021        |
| <b>Balance at 1 January 2007</b>      | <b>405,000</b> | <b>61,021</b>              | <b>466,021</b> |
| Profit attributable to equity holders | -              | <b>94,893</b>              | <b>94,893</b>  |
| Ordinary shares issued                | <b>20,000</b>  | -                          | <b>20,000</b>  |
| <b>Balance at 31 December 2007</b>    | <b>425,000</b> | <b>155,914</b>             | <b>580,914</b> |

# AIB Mortgage Bank

## Notes to the accounts

|   | 2007<br>€ 000    | Period 13 Feb<br>to 31 Dec<br>2006<br>€000 |
|---|------------------|--|
| <b>1. Interest and similar income</b>               |                  |  |
| Interest on loans and receivables to customers      | 831,306          | 517,466                                    |
| Interest receivable from Allied Irish Banks, p.l.c. | 311,181          | 113,199                                    |
|   | <b>1,142,487</b> | <b>630,665</b>                             |

All income earned derives from activities carried out in the Republic of Ireland.

|   | 2007<br>€ 000    | Period 13 Feb<br>to 31 Dec<br>2006<br>€000 |
|---|------------------|--|
| <b>2. Interest expense and similar charges</b>  |                  |  |
| Interest payable to Allied Irish Banks, p.l.c.  | 766,139          | 401,765                                    |
| Interest on debt securities in issue  | 241,268          | 96,610                                     |
| Interest on amounts due to the Central Bank and Financial Services Authority of Ireland | 5,489            | 5,830                                      |
|   | <b>1,012,896</b> | <b>504,205</b>                             |

|                                 | 2007<br>€ 000 | Period 13 Feb<br>to 31 Dec<br>2006<br>€000 |
|---------------------------------|---------------|--|
| <b>3. Trading gain / (loss)</b> |               |  |
| Trading gain / (loss)           | <b>22,650</b> | <b>(15,088)</b>                            |

Changes in fair value of interest rate swaps, and certain related account items being hedged, resulted in a trading gain of €22.7m (2006: €15.1m loss). A gain of €19.3m (2006: €12.9m loss) arose as a result of changes in fair value of swaps used to hedge the interest rate risk in the mortgage loan portfolio. While these swaps are highly effective in managing interest rate risk from an economic standpoint, it is not possible to establish accounting fair value hedging relationships between the swaps and the mortgage loan portfolio. As a result the mortgage loan portfolio is not reported at fair value but is reported on an amortised cost basis. This treatment may give rise to volatility in reported income. The balance of the trading gain, €3.4m (2006: €2.2m loss), is in respect of the ineffectiveness of the hedge for mortgage covered securities and represents the difference in the changes to fair value of interest rate swaps and of the related mortgage covered securities being hedged.



# AIB Mortgage Bank

## Notes to the accounts

|  | 2007<br>€ 000 | Period 13 Feb<br>to 31 Dec<br>2006<br>€000 |
|--|---------------|--|
| <b>4. Administrative expenses</b>  |               |  |
| Personnel expenses   |               |  |
| Wages and salaries   | 430           | 305  |
| Social security costs  | 44            | 32   |
| Retirement benefits  | 26            | 17   |
| Other personnel expenses   | 3             | 3  |
|  | <b>503</b>    | <b>357</b>                                 |
| Other administrative expenses  | 2,577         | 670  |
| Amounts payable to Allied Irish Banks, p.l.c. under the Outsourcing and Agency Agreement | 39,440        | 38,142                                     |
|  | <b>42,520</b> | <b>39,169</b>                              |

## 5. Provisions for impairment of loans and receivables

|   | 2007         |              |               | 2006         |              |               |
|---|--------------|--------------|---------------|--------------|--------------|---------------|
|   | Specific     | IBNR         | Total         | Specific     | IBNR         | Total         |
|   | € 000        | € 000        | € 000         | €000         | €000         | €000          |
| Balance at start of year/period                               | 6,088        | 5,994        | 12,082        | -            | -            | -             |
| Transfer from Allied Irish Banks, p.l.c. on 13 February 2006. | -            | -            | -             | 5,553        | 4,060        | 9,613         |
| Charge against income statement                               | 1,836        | (557)        | 1,279         | 535          | 1,934        | 2,469         |
| <b>At end of year/period</b>                                  | <b>7,924</b> | <b>5,437</b> | <b>13,361</b> | <b>6,088</b> | <b>5,994</b> | <b>12,082</b> |

# AIB Mortgage Bank

## Notes to the accounts

### 5. Provisions for impairment of loans and advances (*continued*)

| <u>By geographic location and industry sector</u> | <b>2007</b><br><b>€000</b> | Period 13 Feb<br>to 31 Dec<br>2006<br>€000 |
|---|----------------------------|--|
| Republic of Ireland                               |                            |  |
| Home mortgages                                    | <b>13,361</b>              | 12,082                                     |
|   | <b>13,361</b>              | 12,082                                     |

|                                   | <b>2007</b><br><b>€ 000</b> | Period 13 Feb<br>to 31 Dec<br>2006<br>€000 |
|-----------------------------------|-----------------------------|--|
| <b>6. Taxation</b>                |                             |  |
| Current tax                       |                             |  |
| Profit before tax €108.4m @ 12.5% | <b>13,556</b>               | 8,717                                      |
| Total income tax expense          | <b>13,556</b>               | 8,717                                      |

The tax charge for the year is at an effective rate of 12.5%, which is the same as the standard Irish corporation tax rate.

### 7. Risk management

Set out below are details on the risk management framework and interest rate sensitivities for AIB Mortgage Bank.

#### Risk Management – framework

Risk taking is inherent in the provision of financial services and AIB Mortgage Bank, as part of the AIB Group, assumes a variety of risk in undertaking its business activities. Risk is defined as any event that could: damage the core earnings capacity of the Bank, increase earnings or cash flow volatility; reduce capital; threaten business reputation or viability; and/or breach regulatory or legal obligations. AIB Group has adopted an Enterprise Risk Management approach to identifying, assessing and managing risks. The key elements of the framework are:

- Risk philosophy;
- Risk appetite;
- Risk governance and risk management organisation;
- Risk identification and assessment process;
- Risk strategy; and
- Stress and scenario testing.

Details of AIB Group's risk management framework are set out in the Annual Report of Allied Irish Banks, p.l.c.

# AIB Mortgage Bank

## Notes to the accounts

### 7. Risk management (continued)

#### Risk Management – Individual risk types

This section provides details of the exposure to, and risk management of, the following individual risk types which have been identified through the AIB Group risk assessment process and which are relevant to AIB Mortgage Bank:-

- 2.1 Credit risk
- 2.2 Liquidity risk
- 2.3 Operational risk
- 2.4 Regulatory compliance risk
- 2.5 Non-trading interest rate risk

The 5 applicable risk types are discussed below.

#### 2.1 Credit risk

Credit risk is defined as the risk that a customer or counterparty will be unable or unwilling to meet a commitment that it has entered into and that pledged collateral does not fully cover the Bank's claims. The table below sets out the maximum exposure to credit risk that arises within the Bank. The table distinguishes between those assets that are carried in the balance sheet at amortised cost and those carried at fair value. The most significant credit risks arise from lending activities to customers and banks, derivatives relating to interest rate risk management and 'off-balance sheet' commitments. The credit risks arising from balances at central banks are deemed to be negligible based on their maturity and counterparty status.

#### Maximum exposure to credit risk

|                                    | 2007                       |                        |                   | 2006                      |                       |               |
|------------------------------------|----------------------------|------------------------|-------------------|---------------------------|-----------------------|---------------|
|                                    | Amortised<br>cost<br>€ 000 | Fair<br>value<br>€ 000 | Total<br>€ 000    | Amortised<br>cost<br>€000 | Fair<br>value<br>€000 | Total<br>€000 |
| Balances at central banks          | 25                         | -                      | 25                | 25                        | -                     | 25            |
| Derivative financial instruments   | -                          | 6,380                  | 6,380             | -                         | -                     | -             |
| Loans and receivables to banks     | 8,627,900                  | -                      | 8,627,900         | 6,999,839                 | -                     | 6,999,839     |
| Loans and receivables to customers | 18,416,150                 | -                      | 18,416,150        | 16,312,425                | -                     | 16,312,425    |
| Included elsewhere:                |                            |                        |                   |                           |                       |               |
| Accrued interest                   | 44,744                     | -                      | 44,744            | 33,398                    | -                     | 33,398        |
|                                    | <b>27,088,819</b>          | <b>6,380</b>           | <b>27,095,199</b> | 23,345,687                | -                     | 23,345,687    |
| Loan commitments                   | <b>1,004,000</b>           | -                      | <b>1,004,000</b>  | 1,084,000                 | -                     | 1,084,000     |
| Maximum exposure to credit risk    | <b>28,092,819</b>          | <b>6,380</b>           | <b>28,099,199</b> | 24,429,687                | -                     | 24,429,687    |

# AIB Mortgage Bank

## Notes to the accounts

### 7. Risk management (*continued*)

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#### ***Risk identification and assessment***

All mortgage loans are subject to an individual underwriting process. In addition, credit risk is identified, assessed and measured through the use of credit rating and scoring tools for each borrower or transaction. The methodology used produces a quantitative estimate of the Probability of Default (PD) for the borrower. This assessment is carried out at the level of the individual borrower or transaction and at portfolio level when relevant. In the mortgage portfolio, which is characterised by a large number of customers with small individual exposures, risk assessment is largely informed through statistically-based scoring techniques. Both application scoring for new customers and behavioural scoring for existing customers are used to assess and measure risk as well as to facilitate the management of the portfolio.

The ratings influence the management of individual loans. Special attention is paid to lower quality rated loans and, when appropriate, loans are transferred to special units to help avoid default or, when in default, to minimise loss.

#### ***Role of stress and scenario analysis in the assessment of credit risk***

AIB Group conducts periodic stress tests on the mortgage loan portfolio.

#### ***Risk management and mitigation***

AIB Group has an established credit process with a framework of credit policy and delegated authorities, based on skill and experience, for the management and control of credit risk. Credit grading, scoring and monitoring systems accommodate the early identification and management of any deterioration in loan quality. The credit management system is underpinned by an independent system of credit review.

Divisional management approves the divisional credit policy within the parameters of relevant Group level policies. The divisional risk management function is an integral part of the approval process of divisional policies. Material divisional policies are referred to the Group Risk Management Committee (RMC) and/or to the Board, where relevant, for approval.

In addition, the Board of AIB Mortgage Bank reviews and approves the credit policy for residential property mortgage loans.

#### ***Credit risk mitigation***

The most significant and widely used credit risk mitigation tool available to the Group is its own robust internal credit risk control framework.

#### ***Provisioning for impairment***

The identification of loans for assessment as impaired is driven by the AIB Group's rating systems. The Group provides for impairment in a prompt and consistent way across the credit portfolios. The rating models provide a systematic discipline in the identification of loans as impaired and in triggering a need for provisioning on a timely basis. Loans are identified as impaired if they are past due for typically ninety days or more or exhibit, through lender assessment, an inability to meet their obligations to the Group.

# AIB Mortgage Bank

## Notes to the accounts

### 7. Risk management (continued)

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#### ***Provisioning for impairment (continued)***

Within its provisioning methodology, the Group uses two types of provisions: a) specific; and b) incurred but not reported (“IBNR”) – i.e. collective provisions for earning loans. Specific provisions arise when the recovery of a specific loan or group of loans is significantly in doubt. The amount of the specific provision will reflect the financial position of the borrower and the net realisable value of any security held for the loan or group of loans. In practice, the specific provision is the difference between the present value of expected future cash flows for the impaired loan(s) and the carrying value. IBNR provisions are maintained to cover loans which are impaired at the balance sheet date, and while not specifically identified, are known from experience to be present in any portfolio of loans. IBNR impairment provisions can only be raised for incurred losses and are not allowed for losses that are expected to happen as a result of likely future events. IBNR provisions are determined by reference to previous loss experience in loan portfolios and to the credit environment at the balance sheet date. Whilst provisioning is an ongoing process, all divisions formally review provision adequacy on a quarterly basis and determine the overall provision requirement. These provisions are, in turn, reviewed and approved on a quarterly basis at a Group level and by the Board of AIB Mortgage Bank.

#### ***Risk monitoring and reporting***

Relevant credit risk information is reported in a timely manner to the appropriate level to enable informed management decision making.

Credit managers receive sufficient account and customer information to pro-actively manage the Bank’s credit risk exposures at a transaction and relationship level.

#### **2.2 Liquidity risk**

Liquidity risk is the exposure to loss from not having sufficient funds available at an economic price to meet actual and contingent commitments. The objective of liquidity management is to ensure that, at all times, the Bank holds sufficient funds to meet its contracted and contingent commitments and regulatory requirements, at an economic price.

AIB Mortgage Bank’s liquidity risk is managed as part of the overall AIB Group liquidity management. This includes the risk identification and assessment, risk management and mitigation, and risk monitoring and reporting processes.

In addition, the Bank has fulfilled its regulatory requirement, which existed up to 1 July 2007, to hold on a continuous basis liquid assets equal to at least 25% of total borrowings.

#### **2.3 Operational risk**

Operational risk, which is inherent in all business activities, is the exposure to loss from inadequate or failed internal processes, people and systems, or from external events.

The management of operational risk is a line management responsibility. It is supported by specialist operational risk management (‘ORM’) functions within Allied Irish Banks, p.l.c. that assist and advise line management on specific operational risks. Examples include money laundering prevention, compliance, business continuity planning, information security and insurance.

An element of AIB Mortgage Bank’s ORM programme is an operational risk self-assessment process. This process requires the Bank to assess its operational risks and the effectiveness of the related controls to address these risks. It complements the risk-based audit approach applied by internal audit in its role as independent assessor of management’s control and risk management processes.

# AIB Mortgage Bank

## Notes to the accounts

### 7. Risk management (*continued*)

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#### 2.4 Regulatory compliance risk

Regulatory compliance risk is defined as the risk of regulatory sanctions, material financial loss or loss to reputation which the Bank may suffer as a result of failure to comply with all applicable laws, regulations, rules, related self regulatory standards and codes of conduct applicable to its activities.

AIB Mortgage Bank's regulatory compliance risk is managed as part of the overall AIB Group Regulatory compliance framework. This includes risk identification and assessment, risk management and mitigation, and risk monitoring and reporting processes.

#### 2.5 Non-trading interest rate risk

Interest rate risk is the exposure of the Bank's earnings to movements in market interest rates. The Bank is exposed to risk of interest rate fluctuations to the extent that assets and liabilities mature or reprice at different times or in differing amounts. Interest rate swaps are used to modify the repricing characteristics of assets and liabilities in order to minimise the exposure to interest rate risks. All interest rate swaps are contracted with the parent company, Allied Irish Banks, p.l.c. The Bank's interest rate risk arises mainly from variable interest rate mortgage loans the majority of which are based on the European Central Bank refinancing rate, whereas the related funding is based on the one month euribor rate. Interest rate swaps are used to hedge the Bank's mortgage loan portfolio and the mortgage covered securities in issue. Interest rate swaps are used solely for risk management and not trading purposes.

The Bank is not exposed to any other market risks, i.e. foreign exchange rates or equity prices.

Further details of AIB Group's Liquidity Risk, Operational Risk, Regulatory Compliance Risk and Non-Trading Interest Rate Risk frameworks are set out in the Annual Report of Allied Irish Banks, p.l.c.

#### Interest rate sensitivity

The net interest rate sensitivity of AIB Mortgage Bank at 31 December 2007 is illustrated in the following table. This information is presented for eight different time periods reflecting the balances of assets and liabilities with rates that are subject to change within each period, data regarding balances which are not sensitive to interest rate movements and any rate sensitive off-balance sheet contracts. The table shows the sensitivity of the balance sheet at one point in time and is not necessarily indicative of positions at other dates. In developing the classifications used in the table it has been necessary to make certain assumptions and approximations in assigning assets and liabilities to different repricing categories.

# AIB Mortgage Bank

## Interest Rate Sensitivity

Interest Rate Sensitivity analysis for the Bank at 31 December 2007 is as follows:

| <b>Assets</b>   | <b>0 ≤ 1 mth<br/>€ 000</b> | <b>1 ≤ 3 mths<br/>€ 000</b> | <b>3 ≤ 12 mths<br/>€ 000</b> | <b>1 ≤ 2yrs<br/>€ 000</b> | <b>2 ≤ 3yrs<br/>€ 000</b> | <b>3 ≤ 4yrs<br/>€ 000</b> | <b>4 ≤ 5yrs<br/>€ 000</b> | <b>5yrs+<br/>€ 000</b> | <b>Rate Insensitive<br/>€ 000</b> | <b>Total<br/>€ 000</b> |
|---|----------------------------|-----------------------------|------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|------------------------|-----------------------------------|------------------------|
| Cash and balances at central bank                                 | 25                         | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | 25                     |
| Loans and receivables to customers                                | 16,716,186                 | 53,266                      | 502,802                      | 436,407                   | 367,533                   | 151,788                   | 111,577                   | 76,591                 | -                                 | 18,416,150             |
| Loans and receivables to banks                                    | 8,627,900                  | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | 8,627,900              |
| Derivatives and other financial instruments                       | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | 6,380                             | 6,380                  |
| Other assets  | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | 45,198                            | 45,198                 |
| <b>Total assets</b>   | <b>25,344,111</b>          | <b>53,266</b>               | <b>502,802</b>               | <b>436,407</b>            | <b>367,533</b>            | <b>151,788</b>            | <b>111,577</b>            | <b>76,591</b>          | <b>51,578</b>                     | <b>27,095,653</b>      |
| <b>Liabilities</b>  |                            |                             |                              |                           |                           |                           |                           |                        |                                   |                        |
| Customer accounts   | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | 183                               | 183                    |
| Deposits by banks   | 18,831,652                 | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | 18,831,652             |
| Derivatives and other financial instruments                       | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | 90,503                            | 90,503                 |
| Debt issued   | -                          | -                           | -                            | 2,500,000                 | 2,000,000                 | -                         | -                         | 2,675,000              | (91,685)                          | 7,083,315              |
| Subordinated liabilities  | 300,000                    | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | 300,000                |
| Other liabilities   | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | 209,086                           | 209,086                |
| Shareholders' funds   | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | 580,914                           | 580,914                |
| <b>Total liabilities</b>  | <b>19,131,652</b>          | <b>-</b>                    | <b>-</b>                     | <b>2,500,000</b>          | <b>2,000,000</b>          | <b>-</b>                  | <b>-</b>                  | <b>2,675,000</b>       | <b>789,001</b>                    | <b>27,095,653</b>      |
| <b>Derivative financial instruments<br/>(Interest rate swaps)</b> |                            |                             |                              |                           |                           |                           |                           |                        |                                   |                        |
| Floating rate interest receivable                                 | 18,421,529                 | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | 18,421,529             |
| Floating rate interest payable                                    | (16,721,565)               | (53,266)                    | (502,802)                    | (436,407)                 | (367,533)                 | (151,788)                 | (111,577)                 | (76,591)               | -                                 | (18,421,529)           |
| Floating rate interest payable                                    | (7,175,000)                | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | (7,175,000)            |
| Fixed rate interest receivable                                    | -                          | -                           | -                            | 2,500,000                 | 2,000,000                 | -                         | -                         | 2,675,000              | -                                 | 7,175,000              |
| <b>Total derivatives</b>  | <b>(5,475,036)</b>         | <b>(53,266)</b>             | <b>(502,802)</b>             | <b>2,063,593</b>          | <b>1,632,467</b>          | <b>(151,788)</b>          | <b>(111,577)</b>          | <b>2,598,409</b>       |                                   |                        |
| Interest sensitivity gap  | 737,423                    | -                           | -                            | -                         | -                         | -                         | -                         | -                      | (737,423)                         |                        |
| Cumulative interest sensitivity gap                               | 737,423                    | 737,423                     | 737,423                      | 737,423                   | 737,423                   | 737,423                   | 737,423                   | 737,423                | -                                 |                        |

# AIB Mortgage Bank

## Interest Rate Sensitivity

Interest Rate Sensitivity analysis for the Bank at 31 December 2006 is as follows:

| <b>Assets</b>   | <b>0 ≤ 1 mth<br/>€ 000</b> | <b>1 ≤ 3 mths<br/>€ 000</b> | <b>3 ≤ 12 mths<br/>€ 000</b> | <b>1 ≤ 2yrs<br/>€ 000</b> | <b>2 ≤ 3yrs<br/>€ 000</b> | <b>3 ≤ 4yrs<br/>€ 000</b> | <b>4 ≤ 5yrs<br/>€ 000</b> | <b>5yrs+<br/>€ 000</b> | <b>Rate Insensitive<br/>€ 000</b> | <b>Total<br/>€ 000</b> |
|---|----------------------------|-----------------------------|------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|------------------------|-----------------------------------|------------------------|
| Cash and balances at central bank                                 | 25                         | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | 25                     |
| Loans and receivables to customers                                | 14,130,739                 | 110,324                     | 779,910                      | 387,589                   | 526,741                   | 107,751                   | 194,426                   | 74,945                 | -                                 | 16,312,425             |
| Loans and receivables to banks                                    | 6,999,839                  | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | 6,999,839              |
| Derivatives and other financial instruments                       | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | -                      |
| Other assets  | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | 33,553                            | 33,553                 |
| <b>Total assets</b>   | <b>21,130,603</b>          | <b>110,324</b>              | <b>779,910</b>               | <b>387,589</b>            | <b>526,741</b>            | <b>107,751</b>            | <b>194,426</b>            | <b>74,945</b>          | <b>33,553</b>                     | <b>23,345,842</b>      |
| <b>Liabilities</b>  |                            |                             |                              |                           |                           |                           |                           |                        |                                   |                        |
| Customer accounts   | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | 1,047                             | 1,047                  |
| Deposits by banks   | 16,965,052                 | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | 16,965,052             |
| Derivatives and other financial instruments                       | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | 91,388                            | 91,388                 |
| Debt issued   | -                          | -                           | -                            | -                         | 2,500,000                 | 2,000,000                 | -                         | 1,000,000              | (76,300)                          | 5,423,700              |
| Subordinated liabilities  | 300,000                    | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | 300,000                |
| Other liabilities   | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | 98,634                            | 98,634                 |
| Shareholders' funds   | -                          | -                           | -                            | -                         | -                         | -                         | -                         | -                      | 466,021                           | 466,021                |
| <b>Total liabilities</b>  | <b>17,265,052</b>          | <b>-</b>                    | <b>-</b>                     | <b>-</b>                  | <b>2,500,000</b>          | <b>2,000,000</b>          | <b>-</b>                  | <b>1,000,000</b>       | <b>580,790</b>                    | <b>23,345,842</b>      |
| <b>Derivative financial instruments<br/>(Interest rate swaps)</b> |                            |                             |                              |                           |                           |                           |                           |                        |                                   |                        |
| Floating rate interest receivable                                 | 16,321,214                 | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | 16,321,214             |
| Floating rate interest payable                                    | (14,139,528)               | (110,324)                   | (779,910)                    | (387,589)                 | (526,741)                 | (107,751)                 | (194,426)                 | (74,945)               | -                                 | (16,321,214)           |
| Floating rate interest payable                                    | (5,500,000)                | -                           | -                            | -                         | -                         | -                         | -                         | -                      | -                                 | (5,500,000)            |
| Fixed rate interest receivable                                    | -                          | -                           | -                            | -                         | 2,500,000                 | 2,000,000                 | -                         | 1,000,000              | -                                 | 5,500,000              |
| <b>Total derivatives</b>  | <b>(3,318,314)</b>         | <b>(110,324)</b>            | <b>(779,910)</b>             | <b>(387,589)</b>          | <b>1,973,259</b>          | <b>1,892,249</b>          | <b>(194,426)</b>          | <b>925,055</b>         | <b>-</b>                          | <b>-</b>               |
| Interest sensitivity gap  | 547,237                    | -                           | -                            | -                         | -                         | -                         | -                         | -                      | (547,237)                         |                        |
| Cumulative interest sensitivity gap                               | 547,237                    | 547,237                     | 547,237                      | 547,237                   | 547,237                   | 547,237                   | 547,237                   | 547,237                | -                                 |                        |



# AIB Mortgage Bank

## Notes to the accounts

### 8. Derivatives and other financial instruments

Set out below are details on fair values and derivative information for AIB Mortgage Bank.

The Bank uses two different types of interest rate swaps to hedge interest rate risk. The first type is used to hedge interest rate risk on mortgage loan accounts within the Cover Assets Pool and outside the Cover Assets Pool, effectively converting interest receivable from a fixed rate basis to a floating rate basis. Although these swaps are considered to be an effective hedge in economic terms, due to their nature, it has not been possible to establish a “fair value” hedging relationship under IAS 39 with the mortgage loan accounts and consequently, they are classified as “Trading”.

The second type of interest rate swaps are those interest rate swaps used to hedge the mortgage covered securities, converting interest payable from a fixed rate basis to a floating rate basis. Effective fair value hedging relationships (as stipulated by IAS 39) have been established between these swaps and the underlying covered bonds and consequently the change in fair value of the swaps is largely offset by fair value movements in the covered bonds themselves.

All derivatives are included in assets when fair value is positive and in liabilities when the fair value is negative. Allied Irish Banks, p.l.c. is the counterparty to all derivative contracts noted below.

|  | 31 Dec<br>2007<br>€000          | 31 Dec<br>2007<br>€000              | 31 Dec<br>2006<br>€000          | 31 Dec<br>2006<br>€000              |
|--|---------------------------------|-------------------------------------|---------------------------------|-------------------------------------|
|  | Contract/<br>Notional<br>Amount | Fair Value<br>Asset/<br>(Liability) | Contract/<br>Notional<br>Amount | Fair Value<br>Asset/<br>(Liability) |
| <b>Derivatives classified as trading</b>                       |                                 |                                     |                                 |                                     |
| Hedging mortgage loan accounts – outside the Cover Assets Pool | 6,918,838                       | 2,058                               | 8,538,235                       | (7,849)                             |
| Hedging mortgage loan accounts – within the Cover Assets Pool  | 11,502,691                      | 4,322                               | 7,782,979                       | (5,050)                             |
| Total derivatives classified as trading                        | 18,421,529                      | 6,380                               | 16,321,214                      | (12,899)                            |
| <b>Derivatives classified as hedging</b>                       |                                 |                                     |                                 |                                     |
| Hedging debt securities  | 7,175,000                       | (90,503)                            | 5,500,000                       | (78,489)                            |
| Total derivatives classified as hedging (Debt Securities)      | 7,175,000                       | (90,503)                            | 5,500,000                       | (78,489)                            |
| <b>Total derivatives</b>                                       | 25,596,529                      | (84,123)                            | 21,821,214                      | (91,388)                            |

The following table represents the underlying principal and gross replacement costs of the Bank’s derivatives as at 31 December 2007.

| 31 December 2007                   | Residual Maturity 2007      |                    |                       |                | Residual Maturity 2006     |                   |                      |               |
|------------------------------------|-----------------------------|--------------------|-----------------------|----------------|----------------------------|-------------------|----------------------|---------------|
|                                    | Within<br>one year<br>€ 000 | 1 to 5yrs<br>€ 000 | Over<br>5yrs<br>€ 000 | Total<br>€ 000 | Within<br>one year<br>€000 | 1 to 5yrs<br>€000 | Over<br>5yrs<br>€000 | Total<br>€000 |
| <b>Underlying principal amount</b> |                             |                    |                       |                |                            |                   |                      |               |
| Interest rate contracts            | 18,421,529                  | 4,500,000          | 2,675,000             | 25,596,529     | 16,321,214                 | 4,500,000         | 1,000,000            | 21,821,214    |
| <b>Gross replacement costs</b>     |                             |                    |                       |                |                            |                   |                      |               |
| Interest rate contracts            | -                           | 75,676             | 53,122                | 128,798        | -                          | 34,306            | -                    | 34,306        |

# AIB Mortgage Bank

## Notes to the accounts

### 8. Derivatives and other financial instruments *(continued)*

These tables present the notional and fair value amounts, weighted average maturity and weighted average receive and pay rates for instruments held for risk management purposes entered into by the Bank in 2007.

|  | Notional<br>principal<br>amount | Weighted average<br>maturity in<br>years | Weighted<br>average rate<br>Receive | Pay         | Estimated<br>Fair Value |
|--|---------------------------------|--|-------------------------------------|-------------|-------------------------|
|  | € 000                           |  | %                                   | %           | € 000                   |
| <b>Interest rate derivatives designated<br/>as fair value hedges</b> |                                 |  |                                     |             |                         |
| <b>Receive fixed</b>   |                                 |  |                                     |             |                         |
| 1 year or less   |                                 |  |                                     |             |                         |
| 1-5 years  |                                 |  |                                     |             | (62,041)                |
| Over 5 years   |                                 |  |                                     |             | (28,462)                |
|  | <b>7,175,000</b>                | <b>4.01</b>                              | <b>3.93</b>                         |             | <b>(90,503)</b>         |
| <b>Pay floating</b>  |                                 |  |                                     |             |                         |
| 1 year or less   |                                 |  |                                     |             |                         |
| 1-5 years  |                                 |  |                                     |             |                         |
| Over 5 years   |                                 |  |                                     |             |                         |
|  | <b>7,175,000</b>                | <b>0.08</b>                              |                                     | <b>4.52</b> | <b>-</b>                |
| <b>Other Interest rate derivatives*</b>                              |                                 |  |                                     |             |                         |
| <b>Interest rate swaps:</b>  |                                 |  |                                     |             |                         |
| <b>Pay floating</b>  |                                 |  |                                     |             |                         |
| 1 year or less   |                                 |  |                                     |             | (137,283)               |
| 1-5 years  |                                 |  |                                     |             | (86,130)                |
| Over 5 years   |                                 |  |                                     |             | (8,817)                 |
|  | <b>18,421,529</b>               | <b>0.08</b>                              |                                     | <b>4.94</b> | <b>(232,230)</b>        |
| <b>Receive floating</b>  |                                 |  |                                     |             |                         |
| 1 year or less   |                                 |  |                                     |             | 238,610                 |
| 1-5 years  |                                 |  |                                     |             | -                       |
| Over 5 years   |                                 |  |                                     |             | -                       |
|  | <b>18,421,529</b>               | <b>0.08</b>                              | <b>4.99</b>                         |             | <b>238,610</b>          |

\* These swaps are used to hedge the mortgage loan portfolio but do not qualify for fair value hedge accounting.

# AIB Mortgage Bank

## Notes to the accounts

### 8. Derivatives and other financial instruments *(continued)*

#### Fair value of financial instruments

The term “financial instruments” includes financial assets, financial liabilities and derivatives. The fair value of a financial instrument is the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arms length transaction.

Fair value is based upon quoted market prices where available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar instruments and adjusted for differences between the quoted instrument and the instrument being valued. In certain cases, including some lendings to customers, where there are no ready markets, various techniques have been used to estimate the fair value of the instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Readers of these financial statements are advised to use caution when using the data to evaluate the Bank’s financial position or to make comparisons with other institutions.

Fair value information is not provided for certain financial instruments or for items that do not meet the definition of a financial instrument. These items are material and accordingly, the fair value information presented does not purport to represent, nor should it be construed to represent, the underlying value of the Bank as a going concern at 31 December 2007.

The following table gives details of the carrying amounts and fair values of financial instruments at 31 December 2007.

|                                    | <b>2007</b>     | <b>2007</b>       | 2006       | 2006       |
|------------------------------------|-----------------|-------------------|------------|------------|
|                                    | <b>Carrying</b> | <b>Fair value</b> | Carrying   | Fair Value |
|                                    | <b>Amount</b>   | <b>Amount</b>     | Amount     | Amount     |
|                                    | <b>€ 000</b>    | <b>€ 000</b>      | €000       | €000       |
| <b>Non trading</b>                 |                 |                   |            |            |
| <b>Assets</b>                      |                 |                   |            |            |
| Cash and balances at central bank  | 25              | 25                | 25         | 25         |
| Derivative financial instruments   | 6,380           | 6,380             | -          | -          |
| Loans and receivables to banks     | 8,627,900       | 8,627,900         | 6,999,839  | 6,999,839  |
| Loans and receivables to customers | 18,416,150      | 18,402,650        | 16,312,425 | 16,304,789 |
| <b>Liabilities</b>                 |                 |                   |            |            |
| Deposits by banks                  | 18,831,652      | 18,831,652        | 16,965,052 | 16,965,052 |
| Customer accounts                  | 183             | 183               | 1,047      | 1,047      |
| Derivative financial instruments   | 90,503          | 90,503            | 91,388     | 91,388     |
| Debt securities in issue           | 7,083,315       | 7,083,315         | 5,423,700  | 5,423,700  |
| Subordinated liabilities           | 300,000         | 236,850           | 300,000    | 300,000    |

# AIB Mortgage Bank

## Notes to the accounts

### 8. Derivatives and other financial instruments *(continued)*

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The following methods and assumptions were used in estimating the fair value of financial instruments.

#### **Loans and receivables to banks and loans and receivables to customers**

The fair value of money market funds and loans and receivables to banks were estimated using discounted cash flows applying either market rates, where practicable, or rates currently offered by other financial institutions for placings with similar characteristics.

The Bank provides lending facilities of varying rates and maturities to corporate and personal customers. Valuation techniques including, using recent arm's length market transactions; reference to fair value of another similar instrument; discounted cash flow analysis; and option pricing models are employed, as considered appropriate, in estimating the fair value of loans. Where secondary market prices were available, they were used. The carrying amount of variable rate loans was considered to be at market value if there was no significant change in the credit risk of the borrower. The fair value of fixed rate loans was calculated by discounting expected cash flows using discount rates that reflected the credit and interest rate risk in the portfolio.

#### **Deposits by banks, customer accounts and debt securities in issue**

The fair value of deposits by banks and customer accounts is equal to their book value. The fair value of debt securities in issue is estimated using discounted cash flows applying either market rates, where applicable, or interest rates currently offered by AIB.

#### **Subordinated liabilities**

The fair value of the subordinated liabilities was estimated using discounted cash flows. In all cases, redemption prior to maturity is subject to the necessary prior approval of the Central Bank and Financial Services Regulatory Authority of Ireland.

#### **Derivative financial instruments**

The Bank uses various derivatives, designated as hedges, to manage its exposure to fluctuations in interest rates. The fair value of these instruments is estimated using market prices or pricing models consistent with the methods used in AIB Group for valuing similar instruments used for trading purposes.

# AIB Mortgage Bank

## Notes to the accounts

|  | <b>31 Dec<br/>2007<br/>€ 000</b> | 31 Dec<br>2006<br>€000 |
|--|----------------------------------|------------------------|
|--|----------------------------------|------------------------|

### 9. Loans and receivables to banks

Funds placed with Allied Irish Banks, p.l.c.

Analysed by remaining maturity:

|                                    |                  |           |
|------------------------------------|------------------|-----------|
| - 3 months or less                 | <b>1,452,900</b> | 1,499,839 |
| - 1 year or less but over 3 months | -                | -         |
| - 5 years or less but over 1 year  | <b>4,500,000</b> | 4,500,000 |
| - Greater than 5 years             | <b>2,675,000</b> | 1,000,000 |

|  |                  |           |
|--|------------------|-----------|
|  | <b>8,627,900</b> | 6,999,839 |
|--|------------------|-----------|

|  |                                  |                        |
|--|----------------------------------|------------------------|
|  | <b>31 Dec<br/>2007<br/>€ 000</b> | 31 Dec<br>2006<br>€000 |
|--|----------------------------------|------------------------|

### 10. Loans and receivables to customers

Analysed by remaining maturity:

|                                    |                   |            |
|------------------------------------|-------------------|------------|
| - 3 months or less                 | <b>195,283</b>    | 145,111    |
| - 1 year or less but over 3 months | <b>452,816</b>    | 412,431    |
| - 5 years or less but over 1 year  | <b>2,533,168</b>  | 2,231,001  |
| - Greater than 5 years             | <b>15,248,244</b> | 13,535,964 |

|  |                 |          |
|--|-----------------|----------|
| Provisions for impairment of loans and receivables<br>(note 5) | <b>(13,361)</b> | (12,082) |
|--|-----------------|----------|

|  |                   |            |
|--|-------------------|------------|
|  | <b>18,416,150</b> | 16,312,425 |
|--|-------------------|------------|

The unwind of the discount on the impairment provision amounted to €56k (2006: nil) and is included in the carrying value of loans and receivables to customers. This has been credited to interest income.

Loans and receivables to customers comprise only the AIB branch originated residential mortgage loan portfolio in the Republic of Ireland. This portfolio contains high quality loans which are well diversified by borrower, by market segment and by geographical location.

|  |                                  |                        |
|--|----------------------------------|------------------------|
|  | <b>31 Dec<br/>2007<br/>€ 000</b> | 31 Dec<br>2006<br>€000 |
|--|----------------------------------|------------------------|

By geographic location and sector

#### Republic of Ireland

|                |                   |            |
|----------------|-------------------|------------|
| Home mortgages | <b>18,416,150</b> | 16,312,425 |
|----------------|-------------------|------------|

|  |                   |            |
|--|-------------------|------------|
|  | <b>18,416,150</b> | 16,312,425 |
|--|-------------------|------------|

# AIB Mortgage Bank

## Notes to the accounts

### 11. Additional information on credit risk

#### Aged analysis of contractually past due but not impaired facilities – 31 December 2007

|                | <b>1-30days</b><br>€000 | <b>31-60days</b><br>€000 | <b>61-90days</b><br>€000 | <b>91+days</b><br>€000 | <b>Total</b><br>€000 |
|----------------|-------------------------|--------------------------|--------------------------|------------------------|----------------------|
| Home mortgages | 72,870                  | 25,570                   | 9,500                    | 2,030                  | 109,970              |
|                | <b>72,870</b>           | <b>25,570</b>            | <b>9,500</b>             | <b>2,030</b>           | <b>109,970</b>       |

#### Aged analysis of contractually past due but not impaired facilities – 31 December 2006

|                | <b>1-30days</b><br>€000 | <b>31-60days</b><br>€000 | <b>61-90days</b><br>€000 | <b>91+days</b><br>€000 | <b>Total</b><br>€000 |
|----------------|-------------------------|--------------------------|--------------------------|------------------------|----------------------|
| Home mortgages | 50,230                  | 4,570                    | 14,010                   | 17,300                 | 86,110               |
|                | <b>50,230</b>           | <b>4,570</b>             | <b>14,010</b>            | <b>17,300</b>          | <b>86,110</b>        |

#### Loans and receivables renegotiated

Loans and receivables renegotiated are those facilities at the current reporting date that, during the financial year, have had the terms renegotiated resulting in an upgrade from default status to performing status. This can be based on subsequent good performance or an improvement in the profile of the borrower.

Renegotiated loans and receivables were €1.14m as at 31 December 2007 (2006: €1.15m)

#### Individually impaired loans by geographic location and sector

|                            | <b>31 Dec</b><br><b>2007</b> | 31 Dec<br>2006 |
|----------------------------|------------------------------|----------------|
|                            | €000                         | €000           |
| <b>Republic of Ireland</b> |                              |                |
| Home mortgages             | <b>43,670</b>                | 36,000         |
|                            | <b>43,670</b>                | 36,000         |

# AIB Mortgage Bank

## Notes to the accounts

### 11. Additional information on credit risk (continued)

#### Collateral and other credit enhancements

The Bank takes collateral in support of its lending activities when deemed appropriate and has a series of policies and procedures in place for the assessment, valuation and taking of such collateral.

The main types of collateral for loans and receivables to customers are as follows:

Retail Mortgages; The Bank takes collateral in support of lending transactions for the purchase of residential property. There are clear policies in place which set out the type of property acceptable as collateral and the relationship of loan to property value. All properties are required to be fully insured and be subject to a legal charge in favour of the Bank.

|                         | <b>31 Dec<br/>2007<br/>€ 000</b> | <b>31 Dec<br/>2006<br/>€000</b> |
|-------------------------|----------------------------------|---------------------------------|
| <b>12. Other assets</b> |                                  |                                 |
| Accrued interest        | <b>44,744</b>                    | 33,398                          |
| Other assets            | <b>454</b>                       | 155                             |
|                         | <b>45,198</b>                    | 33,553                          |

|                                   | <b>31 Dec<br/>2007<br/>€ 000</b> | <b>31 Dec<br/>2006<br/>€000</b> |
|-----------------------------------|----------------------------------|---------------------------------|
| <b>13. Deposits by banks</b>      |                                  |                                 |
| Due to Allied Irish Banks, p.l.c. | <b>18,831,652</b>                | <b>16,965,052</b>               |
|                                   | <b>18,831,652</b>                | <b>16,965,052</b>               |

The Bank has a borrowing facility with its parent company, Allied Irish Banks, p.l.c., under which the parent company provides the balance of funding after the bank has availed of other sources of funds.

At 31 December 2007 there were no deposits (2006: €Nil) by the Bank that were secured on the Bank's obligations to the Central Bank and Financial Services Authority of Ireland under the terms of the Mortgage-Backed Promissory Note ('MBPN') programme. Such deposits by the Bank existed during the reporting period and these obligations were secured by way of a first floating charge to the CBFSAI over all its right, title, interest and benefit in loans and receivables to customers. Otherwise than with the prior written consent of the CBFSAI, the Bank had pledged under the terms of the floating charge to maintain the assets so charged free from any encumbrance and otherwise than in the ordinary course of business not to sell, transfer, lend or otherwise dispose of any part of the charged assets.

# AIB Mortgage Bank

## Notes to the accounts

|  | <b>31 Dec<br/>2007<br/>€ 000</b> | 31 Dec<br>2006<br>€000 |
|--|----------------------------------|------------------------|
|--|----------------------------------|------------------------|

### 14. Debt securities in issue

Mortgage covered securities in issue by remaining maturity :

|                                   |                  |           |
|-----------------------------------|------------------|-----------|
| - 5 years or less but over 1 year | <b>4,433,571</b> | 4,444,978 |
| - Greater than 5 years            | <b>2,649,744</b> | 978,722   |
|                                   | <b>7,083,315</b> | 5,423,700 |

In April 2006 the Bank issued €2,500m in mortgage covered securities at a coupon rate of 3.5% maturing in April 2009 and €1,000m in mortgage covered securities at a coupon rate of 3.75% maturing in April 2013. In December 2006, it issued €2,000m in mortgage covered securities at a coupon rate of 3.75% maturing in January 2010.

In June 2007, the Bank issued €1,500m in mortgage covered securities at a coupon rate of 4.875% maturing in June 2017. In December 2007 it also issued a mortgage covered security private placement of €175m at a coupon rate of 4.875% maturing in June 2017.

AIB Mortgage Bank is an issuer of mortgage covered securities under the Asset Covered Securities Act, 2001 as amended by the Asset Covered Securities Amendment Act, 2007 (the “Act”). The Act requires that mortgage covered securities are secured by assets that are included in a Cover Assets Pool maintained by the issuer and that a register of mortgage covered securities business is kept. At 31 December 2007, the Cover Assets Pool amounted to €12.4bn (€8.7bn in 2006), comprising of €1.5bn (€7.8bn in 2006) of mortgage credit assets (mortgage loan accounts) and €0.9bn (€0.9bn in 2006) of substitution assets (cash). Section 40 (2) of the Act requires that the following information be disclosed in respect of mortgage credit assets that are recorded in the register of mortgage covered securities business.

### 14 (a) Mortgaged properties and principal loan balances outstanding in the cover assets pool

| <b>Total Loan Balances<br/>From</b> | <b>To</b> | <b>Total Loan<br/>Balances<br/>(1 &amp; 2)<br/>2007<br/>€ m</b> | <b>Number of<br/>Mortgaged<br/>Properties<br/>2007</b> | <b>Total Loan<br/>Balances<br/>(1 &amp; 2)<br/>2006<br/>€m</b> | <b>Number of<br/>Mortgaged<br/>Properties<br/>2006</b> |
|-------------------------------------|-----------|---|--|--|--|
| 0                                   | €100,000  | 1,005   | 21,265   | 919  | 18,452   |
| €100,000                            | €200,000  | 3,010   | 20,004   | 2628   | 17,739   |
| €200,000                            | €500,000  | 5,647   | 19,569   | 3393   | 12,102   |
| Over €500,000                       |           | <u>1,846</u>  | <u>2,191</u>   | <u>843</u>   | <u>1,047</u>   |
|                                     |           | <u>11,508</u>   | <u>63,029</u>  | <u>7,783</u>   | <u>49,340</u>  |



# AIB Mortgage Bank

## Notes to the accounts

### 14. Debt securities in issue *(continued)*

- (1) The total loan balances are categorised by the total loan balance outstanding per mortgaged property, including principal and interest charged to the loan accounts, but excluding interest accrued but not charged to the loan accounts.
- (2) There could be one or more loan accounts per mortgaged property. The Cover Assets Pool contains 75,575 loan accounts (58,423 in 2006) secured on 63,029 properties (49,340 in 2006).

#### 14 (b) Geographical location of mortgaged properties in the cover assets pool

| Geographical Area | Number of Mortgaged Properties<br>2007 |             | Number of Mortgaged Properties<br>2006 |             |
|-------------------|--|-------------|--|-------------|
|                   |  |             |  |             |
| Co. Dublin        | 14,269                                 | 23%         | 10,804                                 | 22%         |
| Outside Dublin    | 48,760                                 | 77%         | 38,536                                 | 78%         |
|                   | <u>63,029</u>                          | <u>100%</u> | <u>49,340</u>                          | <u>100%</u> |

#### 14 (c) Mortgage loan accounts in default in the cover assets pool

As at 31 December 2007, there were no mortgage loan accounts (Nil in 2006) in default in the Cover Assets Pool (in default being defined as mortgage loan accounts in arrears by three months or more).

#### 14 (d) Mortgage loan accounts in default in the cover assets pool with arrears greater than €1,000

During the year ended 31 December 2007, 153 mortgage loan accounts (45 in 2006) in the Cover Assets Pool had been in default with arrears greater than €1,000. As at 31 December 2007, there were no accounts in default in the Cover Assets Pool (Nil in 2006).

#### 14 (e) Replacement of non-performing mortgage loan accounts from the cover assets pool

During the year ended 31 December 2007, 734 non-performing mortgage loan accounts (273 in 2006) were removed in total from the Cover Assets Pool. (For this purpose, non-performing is defined as in arrears by three months or more, i.e. has the same meaning as in default.) These loan accounts were not (immediately) replaced with other assets as the Cover Assets Pool continued to meet all regulatory requirements.

#### 14 (f) Amount of interest in arrears on mortgage loan accounts in the cover assets pool not written off

The total amount in arrears (including principal and interest) in respect of the 41 accounts (37 in 2006) as at 31 December 2007 was €362,031 (€243,187 in 2006). None of the accounts in question were written off as at 31 December 2007, as they were in arrears by less than three months.

# AIB Mortgage Bank

## Notes to the accounts

### 14. Debt securities in issue *(continued)*

#### 14 (g) Total principal and interest payments on mortgage loan accounts

The total amount of repayments (principal and interest) made by customers on mortgage loan accounts in the Cover Assets Pool during the year ended 31 December 2007 was €1,894m (€1,040m in 2006), of which €1,461m (€873m in 2006) represented repayment of principal and €433m (€167m in 2006) represented payment of interest. The repayments of principal include the repayment of mortgage loan accounts by customers closing their existing accounts when opening a new account.

#### 14 (h) Number and amount of mortgage loans in the cover assets pool secured on commercial property

As at 31 December 2007 there were no loan accounts (Nil in 2006) in the Cover Assets Pool that were secured on commercial properties.

|   | <b>31 Dec<br/>2007<br/>€ 000</b> | 31 Dec<br>2006<br>€000 |
|---|----------------------------------|------------------------|
| <b>15. Accruals and deferred income</b>         |                                  |                        |
| Interest payable on mortgage covered securities | <b>204,420</b>                   | 96,610                 |
| Expenses  | <b>757</b>                       | 547                    |
|   | <b>205,177</b>                   | 97,157                 |

|                                     | <b>31 Dec<br/>2007<br/>€ 000</b> | 31 Dec<br>2006<br>€000 |
|-------------------------------------|----------------------------------|------------------------|
| <b>16. Subordinated liabilities</b> |                                  |                        |
| Dated Capital Note (a)              | <b>100,000</b>                   | 100,000                |
| Perpetual Capital Note (b)          | <b>200,000</b>                   | 200,000                |
|                                     | <b>300,000</b>                   | 300,000                |

# AIB Mortgage Bank

## Notes to the accounts

### 16. Subordinated liabilities *(continued)*

(a) €100,000,000 Dated Subordinated Capital Note – the loan to which this note relates was received from the parent company, Allied Irish Banks, p.l.c. (“AIB”) on 13 February 2006. The Note with interest payable monthly in arrears has a fixed maturity date of 12 February 2031. Early repayment may occur at the option of AIB Mortgage Bank with the prior consent of the Central Bank and Financial Services Authority of Ireland (the “Central Bank”) on any interest payment date falling any time after five years and one day from the date of issuing the Note.

The loan capital is unsecured and all rights and claims of AIB shall be subordinated to the claims of all creditors who are depositors or other unsubordinated creditors of AIB Mortgage Bank.

(b) €200,000,000 Subordinated Perpetual Capital Note – the loan to which this note relates was received from AIB on 13 February 2006. The Note with interest payable monthly in arrears is undated and has no final maturity date but may be redeemed at the option of AIB Mortgage Bank with the prior consent of the Central Bank at any time after the fifth anniversary of its issue.

The loan capital is unsecured and all rights and claims of AIB shall be subordinated to the claims of all creditors who are depositors or other unsubordinated creditors of AIB Mortgage Bank and creditors of AIB Mortgage Bank whose claims are subordinated to the claims of depositors and other unsubordinated creditors of AIB Mortgage Bank but excluding Pari Passu Subordinated Creditors and those creditors of AIB Mortgage Bank whose claims rank or are expressed to rank junior to the claims of AIB.

|  | 31 Dec<br>2007<br>€ 000 | 31 Dec<br>2006<br>€000 |
|--|-------------------------|------------------------|
| <b>17. Share capital</b>   |                         |                        |
| Authorised:  |                         |                        |
| 1,000,000,000 ordinary shares of €1.00 each  | <b><u>1,000,000</u></b> | <u>1,000,000</u>       |
| Issued and fully paid:   |                         |                        |
| 425,000,000 ordinary shares of €1.00 each<br>(2006: 405,000,000 ordinary shares of €1.00 each) | <b>425,000</b>          | 405,000                |
| Movements in issued share capital:   |                         |                        |
| At 1 January   | <b>405,000</b>          | 40                     |
| New shares issued during the year  | <b>20,000</b>           | 404,960                |
| At 31 December   | <b>425,000</b>          | 405,000                |

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Bank. All shares rank equally with regard to the Bank’s residual assets.

# AIB Mortgage Bank

## Notes to the accounts

### 18. Capital Management

The AIB Group policy is to maintain adequate capital resources at all times, having regard to the nature and scale of its business and the risk inherent in its operations. Full details of AIB Group's Capital Management framework are set out in the Annual Report of Allied Irish Banks, p.l.c.

Since the balance sheet date, the Group has received permission from the Central Bank and Financial Services Authority of Ireland to use the Basel II Foundation Internal Ratings Based Approach in respect of its residential mortgage portfolios to determine regulatory capital requirements.

#### Capital resources and regulatory capital ratios

The table below shows AIB Mortgage Bank's capital resources as at 31 December 2007 and 31 December 2006.

|   | <b>31 Dec<br/>2007<br/>€'000</b> | <b>31 Dec<br/>2006<br/>€000</b> |
|---|----------------------------------|---------------------------------|
| Shareholders' equity  | <b>580,914</b>                   | 466,021                         |
| Dated capital notes   | <b>100,000</b>                   | 100,000                         |
| Undated capital notes   | <b>200,000</b>                   | 200,000                         |
| <b>Total capital resources</b>  | <b>880,914</b>                   | 766,021                         |
| Capital resources increased by €14.893m during the year ended 31 December 2007. The increase arose as a result of net retentions of €94.893m and a share capital issue of €20m. |                                  |                                 |
| The table below shows the components of the AIB Mortgage Bank's Tier 1 and total capital ratios as at 31 December 2007 and 31 December 2006.                                    |                                  |                                 |
|   | <b>31 Dec<br/>2007<br/>€'000</b> | <b>31 Dec<br/>2006<br/>€000</b> |
| <b>Tier 1</b>   |                                  |                                 |
| Paid up ordinary share capital  | <b>425,000</b>                   | 405,000                         |
| Eligible reserves   | <b>114,015</b>                   | -                               |
| <b>Total tier 1 capital</b>   | <b>539,015</b>                   | 405,000                         |
| <b>Tier 2</b>   |                                  |                                 |
| IBNR provisions   | <b>5,437</b>                     | 5,994                           |
| Subordinated perpetual loan capital   | <b>200,000</b>                   | 200,000                         |
| Subordinated term loan capital  | <b>100,000</b>                   | 100,000                         |
| <b>Total tier 2 capital</b>   | <b>305,437</b>                   | 305,994                         |
| <b>Gross capital</b>  |                                  |                                 |
| Supervisory deductions  | -                                | -                               |
| <b>Total capital</b>  | <b>844,452</b>                   | 710,994                         |

# AIB Mortgage Bank

## Notes to the accounts

### 18. Capital Management *(continued)*

|                                   | 31 Dec<br>2007<br>€ 000 | 31 Dec<br>2006<br>€000 |
|-----------------------------------|-------------------------|------------------------|
| Risk weighted assets              |                         |                        |
| Banking book                      | 9,533,674               | 8,363,617              |
| <b>Total risk weighted assets</b> | <b>9,533,674</b>        | <b>8,363,617</b>       |

### Capital ratios

|        |       |       |
|--------|-------|-------|
| Tier 1 | 5.65% | 4.84% |
| Total  | 8.86% | 8.50% |

The above information represents the data returned to the Regulator and does not include the profits for the second half of the year or the impact of the proposed dividend in 2007 (note 19)

### The Capital Requirements Directive (CRD) / AIB's implementation of the CRD

Full details of the Capital Requirements Directive and AIB's implementation of the CRD are set out in the Annual report of Allied Irish Banks, p.l.c.

|                     | 31 Dec<br>2007<br>€ 000 | 31 Dec<br>2006<br>€000 |
|---------------------|-------------------------|------------------------|
| <b>19. Dividend</b> |                         |                        |

Dividend Paid

- -

A dividend of €70m is recommended for approval, payable on 31 March 2008 to the Bank's parent company, Allied Irish Banks, p.l.c.

### 20. Employee Information

For the year ended 31 December 2007 the average number of employees was 6 (2006: 5). As at 31 December 2007, the Bank had 6 employees.

|                                   | 31 Dec<br>2007<br>€ 000 | 31 Dec<br>2006<br>€000 |
|-----------------------------------|-------------------------|------------------------|
| <b>21. Statement of cash flow</b> |                         |                        |

Loans and receivables to Allied Irish Banks, p.l.c.

246,339 56,897

**Cash and cash equivalents**

246,339 56,897

"Cash and Cash Equivalents" are part of loans and receivables to banks in the balance sheet on Page 18.

# AIB Mortgage Bank

## Notes to the accounts

|                                   | <b>31 Dec<br/>2007<br/>€ 000</b> | 31 Dec<br>2006<br>€000 |
|-----------------------------------|----------------------------------|------------------------|
| <b>22. Auditor's remuneration</b> |                                  |                        |
| Auditor's remuneration            |                                  |                        |
| Statutory audit                   | <b>71</b>                        | 50                     |
| Audit related services            | <b>19</b>                        | 5                      |
| Total auditor's remuneration      | <b>90</b>                        | 55                     |

Audit related services include fees for assignments which are of an audit nature.

|                                    | <b>31 Dec<br/>2007<br/>€ 000</b> | 31 Dec<br>2006<br>€000 |
|------------------------------------|----------------------------------|------------------------|
| <b>23. Directors' remuneration</b> |                                  |                        |
| Fees                               | <b>49</b>                        | 53                     |
|                                    | <b>49</b>                        | 53                     |

## 24. Reporting currency

The currency used in these accounts is euro which is denoted by 'EUR' or the symbol '€'.

## 25. Segmental Information

The Bank's income and assets are entirely attributable to mortgage lending activity in the Republic of Ireland.

## 26. Contingent liabilities and commitments

There were no contingent liabilities or assets at 31 December 2007 that would require disclosure under IAS 37 (2006: Nil).

At 31 December 2007 the Bank had €1,004m (2006: €1,084m) of approved mortgage loan applications that had not been drawn down as at the year end.

# AIB Mortgage Bank

## Notes to the accounts

### 27. Related party transactions

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#### *(a) Transactions with Allied Irish Banks, p.l.c.*

AIB Mortgage Bank is a subsidiary of Allied Irish Banks, p.l.c. ("AIB"). Banking transactions are entered into between AIB Mortgage Bank and AIB in the normal course of business. These include loans and deposits on an arms length basis. Interest paid to AIB and interest received from AIB are disclosed in Note 1 and Note 2 to the accounts.

Most of the Bank's activities are outsourced to Allied Irish Banks, p.l.c. under an Outsourcing and Agency Agreement. Allied Irish Banks, p.l.c., as Service Agent for the Bank, originates residential mortgage loans through its retail branch network in the Republic of Ireland, services the mortgage loans and provides treasury services in connection with financing as well as a range of support services.

The Bank's activities are financed through the issuance of mortgage covered securities and a mortgage backed promissory note facility with the Central Bank, with the balance of funding being provided by Allied Irish Banks, p.l.c..

#### *(b) Loans to Directors and Other Senior Executive Officers*

Loans to non-executive Directors are made in the ordinary course of business on normal commercial terms. Loans to executive Directors and staff are made (i) by the parent company on terms applicable to other employees of the parent company, in accordance with established policy, within limits set on a case by case basis, and/or (ii) otherwise, on normal commercial terms. The following amounts were outstanding at year-end in loans in respect of two Directors.

|                          | <b>31 Dec<br/>2007<br/>€ 000</b> | <b>31 Dec<br/>2006<br/>€000</b> |
|--------------------------|----------------------------------|---------------------------------|
| <b>Amount</b>            | <b>1,253</b>                     | <b>1,198</b>                    |
| <b>Number of persons</b> | <b>2</b>                         | <b>1</b>                        |

### 28. Post balance sheet events

---

There have been no material post-balance sheet events, other than those described below, which would require disclosure or adjustment to the 31 December 2007 financial statements.

The Board is recommending a dividend payment of €70m in respect of the year ended 31 December 2007 payable on 31 March 2008.

In March 2008, the Bank completed a 3 year €2.5bn private placement bond issue to its parent, Allied Irish Banks, p.l.c.

### 29. Approval of financial statements

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The financial statements were approved by the Directors on 31 March 2008.