

# **AIB MORTGAGE BANK**

**DIRECTORS' REPORT AND ANNUAL FINANCIAL STATEMENTS**  
**For the year ended 31 December 2014**

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## **DIRECTORS' AND OTHER INFORMATION**

### **DIRECTORS**

Dave Keenan	Group Non-Executive Director and Chairman
Jim O'Keeffe	Executive Director (Managing)
Gerry Gaffney	Executive Director
Eileen Kelliher	Independent Non-Executive Director
James Murphy	Group Non-Executive Director
Catherine Woods	Independent Non-Executive Director

### **SECRETARY**

Louise Cleary

### **REGISTERED OFFICE**

Bankcentre  
Ballsbridge  
Dublin 4  
Ireland

### **REGISTERED NUMBER**

404926

### **REGISTERED AUDITOR**

Deloitte & Touche  
Chartered Accountants & Statutory Audit Firm  
Hardwicke House  
Hatch Street  
Dublin 2  
Ireland

### **BANKER**

Allied Irish Banks, p.l.c.

### **SOLICITOR**

Helen Dooley  
Group General Counsel  
Allied Irish Banks, p.l.c.  
Bankcentre  
Ballsbridge  
Dublin 4  
Ireland

### **COVER-ASSETS MONITOR**

Mazars  
Harcourt Centre  
Block 3  
Harcourt Road  
Dublin 2  
Ireland

## DIRECTORS' REPORT

The Directors present their annual report and financial statements for the year ended 31 December 2014. The Statement of Directors' responsibilities in relation to the financial statements appears on page 8.

### Principal activities

AIB Mortgage Bank ('the Bank' or 'AIBMB'), 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' or the 'AIB Group'). AIB Group and its subsidiaries, including AIBMB, came under the direct supervision of, and are deemed to be authorised by the European Central Bank ('ECB') since the introduction on 4 November 2014 of the Single Supervisory Mechanism ('SSM'). The SSM places the ECB as the central prudential supervisor of financial institutions in the Eurozone, including AIB and its subsidiaries. The Bank continues to be supervised by the Central Bank of Ireland for non-prudential matters, including, consumer protection and the combat of money laundering.

The Bank's principal purpose is to issue mortgage covered securities for the purpose of financing mortgage 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 mortgage loans may be made directly by the Bank or may be purchased from AIB and other subsidiary undertakings of AIB Group or third parties.

The Bank commenced trading on 13 February 2006, when AIB Group transferred its Republic of Ireland branch originated residential mortgage business, amounting to €13.6bn in mortgage loans, to AIB Mortgage Bank. On 24 February 2006, a Mortgage-Backed Promissory Note (MBPN) facility between AIB Mortgage Bank and the Central Bank of Ireland was put in place. In March 2006, the Bank launched a €15bn Mortgage Covered Securities Programme (the 'Programme') and has launched a number of covered bond issuances since that date. The Programme was subsequently increased to €20bn in 2009.

On 25 February 2011, AIB transferred substantially all of its mortgage intermediary originated Irish residential loans, related security and related business (the 'Intermediary Business') to AIB Mortgage Bank, amounting to approximately €4.2 billion. The transfer was effected pursuant to the statutory transfer mechanism provided for in the Asset Covered Securities Acts. With effect from September 2014, AIB decided that all new lending through mortgage intermediaries would be completed by Haven Mortgages Limited, a business which is dedicated to serving the mortgage intermediary market.

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. 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 of Ireland.

The Bank's activities are financed through the issuance of mortgage covered securities with the balance of funding being provided by AIB Group. The Bank is also party to the MBPN agreements with the Central Bank of Ireland, however this type of funding has not been utilised since 2011.

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

### Corporate governance statement

The Bank is subject to the provisions of the Central Bank of Ireland's Corporate Governance Code for Credit Institutions and Insurance Undertakings ("the Central Bank Code") (which is available on [www.centralbank.ie](http://www.centralbank.ie)), which imposes minimum core standards upon all credit institutions and insurance undertakings licensed or authorised by the Central Bank of Ireland. The Bank is not required to comply with the additional requirements of the Central Bank Code for major institutions.

The Bank's corporate governance practices are designed to ensure compliance with applicable legal and regulatory requirements including, Irish company law and the Listing Rules of the Main Securities Market of the Irish Stock Exchange.

The Bank believes it has robust governance arrangements, which include a clear organisational structure with well defined, transparent, and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks to which it is or might be exposed, and adequate internal controls, including sound administrative and accounting procedures, IT systems and controls.

#### *The Board of Directors*

The Board is responsible for corporate governance encompassing leadership, direction and control of the Bank and is responsible for financial performance to its shareholder and parent AIB. Governance is exercised through a Board of Directors ("the Board") and a senior management team. The conditions of the Bank's Central Bank licence require that there should be a minimum of two Non-Executive Directors who are independent of the parent company. Throughout 2014, there were two independent Non-Executive Directors on the Board of the Bank. The Board also included two Executive Directors, both of whom were directly involved in the operation of AIB Mortgage Bank, and two other Directors who, while also employees of AIB, were deemed to be Non-Executive Directors by virtue of the roles they fulfilled in areas of AIB Group unrelated to the operations of AIB Mortgage Bank.

The Board is responsible for ensuring that appropriate systems of internal controls and risk management are maintained, specifically the Board sets the Risk Appetite Statement, approves the Risk Framework and approves the annual financial plans.

The Board receives regular updates on the Bank's risk profile through the quarterly report together with relevant updates from the Board Audit Committee. The Board held 4 scheduled meetings during 2014 and 2 additional out of course meetings or briefings.

#### *Board Committees*

The Board is assisted in the discharge of its duties by an Audit Committee which operates under Terms of Reference approved by the Board. The Audit Committee comprises Non-Executive Directors whom the Board has determined have the collective skills and relevant financial experience to enable the Committee to discharge its responsibilities. The Audit Committee has oversight responsibility for:

- the quality and integrity of the Bank's accounting policies, financial statements and disclosure practices;
- compliance with relevant laws, regulations, codes of conduct and "conduct of business" rules;
- the independence and performance of the External Auditor ("the Auditor") and Internal Audit; and
- the adequacy and performance of systems of internal control and the management of financial and non-financial risks.

## DIRECTORS' REPORT (CONTINUED)

### Corporate governance statement (continued)

These responsibilities are discharged through its meetings with and receipt of reports from the Auditor and management including Finance, Internal Audit, Risk and Compliance. During 2014 the Committee met on 4 occasions and amongst other activities the Committee reviewed the Bank's annual financial statements prior to approval by the Board, including the Bank's accounting policies and practices; reports on compliance; effectiveness of internal controls; and the findings, conclusions and recommendations of the Auditor and Internal Auditor. The Committee satisfied itself through regular reports from the Internal Auditor, Risk, Compliance and the Auditor that the system of internal controls were effective. The Committee ensure that appropriate measures are taken to consider and address any control issues identified by Internal Audit and the Auditor.

### Business review

The Irish economy improved generally during 2014 including a decreasing unemployment rate standing at 10.6% at the end of December 2014 against a peak of over 15% in 2013 (Source: Central Statistics Office) and decreasing mortgage arrears. Total market mortgage drawdowns in Ireland were €3.9bn in 2014 compared with €2.5bn in 2013.

The CSO Residential Property Price Index showed an increase in prices nationally of 16.3% in the 12 months to December 2014 (6.4% in 2013). This was particularly evident in Dublin where the 2014 annual increase was 22.3%. Property prices outside of Dublin increased in the 12 month period by 10.2% (reduction of 0.4% in 2013). The national fall from peak property prices (February 2007) was 37.6% at December 2014 (46.5% at December 2013).

The Bank continues to provide highly competitive home loans in the Irish market, offering a range of fixed and variable rates and channel options including Branch and Online. The Bank's main focus is to support viable owner-occupier and buy-to-let residential customers, including First Time Buyers, Home Movers, Home Improvements and those switching their mortgage to the Bank.

The Bank's loan portfolio before provisions decreased by 5% during 2014 to €21.9bn as at 31 December 2014 principally because repayments and write offs exceeded loans granted during the year (2013: decrease of 3%).

At 31 December 2014, AIB Mortgage Bank mortgage loans of €21.9bn (2013: €23.1bn) accounted for 56% (2013: 57%) of the AIB Group's residential mortgage portfolio of €38.8bn (2013: €40.8bn), including EBS Limited and UK.

AIB Mortgage Bank's residential mortgage portfolio comprises €16.2bn owner occupier (2013: €16.7bn) and €5.7bn buy-to-let mortgages (2013: €6.4bn). The owner occupier portfolio is comprised of 45% ECB tracker (2013: 48%), 45% variable interest rate (2013: 42%) and 10% fixed rate mortgage loans (2013: 10%). Interest only loans represent 2% of the owner occupier portfolio (2013: 2%). The buy-to-let portfolio is comprised of 62% ECB tracker (2013: 62%), 37% are on variable interest rates (2013: 35%) and 1% are fixed (2013: 2%). Interest only loans make up 9% of the buy-to-let portfolio (2013: 14%).

As a result of positive trends in the Irish economy, including an improving residential property market and decreasing unemployment, leading to an improvement in asset values and borrower repayment capacity, the Bank's impaired loans have decreased to €4.6bn, or 20.9% of total loans (2013: €5.1bn or 22.2%).

### Mortgage Arrears Resolution Strategy

AIB has developed a Mortgage Arrears Resolution Strategy ('MARS') which builds on and formalises AIB Group's Mortgage Arrears Resolution Process, to implement the Codes of Conduct as set out by the Central Bank of Ireland, for dealing in a professional and timely manner with mortgage customers in difficulty or likely to be in difficulty. The core objectives of MARS are to ensure that arrears solutions are sustainable in the long-term and that they comply with the spirit and the letter of all regulatory requirements. MARS includes long-term forbearance solutions which have been devised to assist existing primary residential mortgage customers in difficulty.

At 31 December 2014, there were forbearance solutions in place on circa 18k accounts with loan balances of €3.3bn (2013: circa 16k accounts with €3.4bn balance). The stock of loans subject to forbearance decreased by €0.1bn in 2014, driven by the Bank's strategy to ensure the forbearance solutions agreed with customers are sustainable in the long-term. During 2014 there was a migration from short term to longer term sustainable forbearance solutions in particular a reduction loan balances on interest only of €376m and reduced payment of €163m with increases in arrears capitalisations of €229m and split mortgages of €84m.

### Results for the year

AIB Mortgage Bank generated a profit before taxation for 2014 of €416m, compared to a loss of €96m in 2013. Return to profitability is due to a release of provisions for impaired loans charged against the income statement, and higher net interest income. Profit after tax of €364m was added to Shareholders Equity in 2014 compared to a loss after tax of €84m being a reduction in Shareholders Equity in 2013.

The Bank's particular focus is on New Lending and Net Interest Margin. During 2014, a significant number of players re-entered the mortgage market which resulted in an increased competitive environment. As a result, the Bank advanced new lending of €764m in 2014, compared to €816m in 2013.

The net interest margin for 2014 was 1.65% an increase of 0.32% compared to 1.33% for 2013. The improvement was driven by lower funding costs of €293m (2013: €397m), offset by lower interest income of €669m (2013: €710m) due to reductions in tracker rates following the ECB refinancing rate cuts of 10bps in June 2014 and 10bps in September 2014 and lower average loan balances.

Administrative expenses increased by €2m to €61m during the year due to higher professional and other fees in 2014.

Overall provision writeback for 2014 of €100m compares to provision charges of €351m in 2013, a reduction in provision charge of €451m. Specific impairment provision charges have reduced by €337m resulting in the €31m provision releases during the year, arising from a substantial reduction in the level of newly impaired loans, an improvement in asset values and the impact of arrears management activities. The Incurred but Not Reported ("IBNR") stock levels have been retained at similar levels as in 2013, resulting in a writeback of €19m (2013: €95m charge).

Specific provision stock amounts to €1,641m (2013: €1,972m) and IBNR provisions stand at €310m (2013: €329m) as at 31 December 2014.

**DIRECTORS' REPORT (CONTINUED)****Funding activities**

The covered bond market performed strongly over the course of 2014, supported by the low interest rate environment, ongoing liquidity provision by monetary authorities and favourable regulatory liquidity treatment. The ECB cut the main Refinancing Rate from 0.25% to 0.15% in June 2014 and to 0.05% in September 2014, while the deposit rate, which ECB reward banks for putting the money on deposit with ECB, moved into negative territory.

The ECB also introduced a number of measures with the goal of stimulating growth in the Eurozone economy. These measures included a new Targeted Long Term Refinancing Operation (TLTRO), aimed at providing banks with very competitively priced long term funding for a period up to four years based on achieving certain lending targets.

A Covered Bond Purchase Programme (CBPP3) and an Asset Backed Securities Purchase Programme (ABS) were also introduced. These programmes had combined purchases of circa €40bn in assets by 23 January 2015, largely through purchases in the covered bond primary and secondary markets. In January 2015, the ECB announced an expanded asset purchase programme targeting €60bn per month in Euro denominated investment grade securities including government bonds and state agency bonds, inclusive of CBPP3 and the ABS programme. The purchases will begin in March 2015 and run through to September 2016, and will in any case be conducted until there is a sustained adjustment in the path of inflation consistent with the ECB's aim of achieving inflation rates below, but close to, 2% over the medium term.

The combined effect of these measures was to further boost demand for covered bonds, which had already benefitted from a supply/demand imbalance and demand for high quality liquid assets. The impact can be seen in the spreads of the outstanding AIB Mortgage Bank Covered Bonds. AIBMB issued a new €500m 7 year covered bond in March 2014 at a spread of 95 basis points over the mid-swap curve. The transaction attracted strong demand with orders approaching €2.4bn from 140 investors. The demand was led by German investors (45%) and UK (22%), with Asset Managers (64%) dominating the order book. This bond tightened steadily to trade at +20bps at the end of the year. This performance was mirrored across the Bank's covered bond issuances, with all the outstanding maturities from 2015-2021 trading in the mid-swap +10bps-mid-swap +20bps range at year end.

In addition to issuance in the primary markets, AIBMB continued to avail of the various liquidity facilities provided by the ECB. Under normal ECB open market operations, Covered Bonds, including Irish Covered Bonds with appropriate ratings are accepted as collateral for sale and repurchase agreements, thus providing liquidity. AIB Mortgage Bank and AIB used internally issued Covered Bonds as a source of such liquidity throughout the year.

At 31 December 2014, the total amount of principal outstanding in respect of mortgage covered securities issued was €7.7bn (31 December 2013: €8.0bn), of which €3.8bn was held by external debt investors (31 December 2013: €3.3bn), €1.2bn by Allied Irish Banks, p.l.c. (31 December 2013: Nil) and €2.8bn was self-issued to AIB Mortgage Bank (31 December 2013: €4.8bn).

AIB Mortgage Bank was upgraded from Baa1 to A3 by Moody's in December 2014, following an earlier upgrade from Baa2 to Baa1 in March 2014. In March 2015, Standard & Poor's upgraded the AIB Mortgage Bank from A to A+.

The ratings as at 10 March 2015, for the Bank's Covered Bond Programme, AIB, and Ireland are shown below;

Rating Agency	AIB Mortgage Bank Covered Bond Programme	Allied Irish Banks, p.l.c Issuer default rating	Ireland (Sovereign)
Fitch	A	BBB	A-
Moody's	A3	Ba2	Baa1
Standard & Poor's	A+	BB	A

**Share capital**

The share capital of the Bank is €1,745m (2013: €1,745m), comprised of ordinary shares of €1 each.

**Capital resources and regulatory capital ratios**

The table below shows the components of the AIB Mortgage Bank's Common equity Tier 1 and Total capital ratios as at 31 December 2014 and 31 December 2013.

Basel II as reported		CRD IV Transitional basis	
31 December 2013		31 December 2014	Pro-forma 1 January 2014
€m		€m	€m
1,040	Core tier 1/common equity tier 1 capital	1,405	1,040
378	Total Tier 2 capital	368	375
1,418	Total capital	1,773	1,415
12,350	Risk Weighted Assets	11,251	12,142
8.4%	Core tier 1/common equity tier 1 ratio	12.5%	8.6%
11.5%	Total capital ratio	15.8%	11.7%

Under the fully loaded CRD IV capital basis the impact of the deduction of the deferred tax asset reduces the Total Capital ratio by 1.5%.

**DIRECTORS' REPORT (CONTINUED)****Outlook**

The capital position of the Bank is stable due to a return to profitability and the ongoing commitment of support from AIB. AIB is sufficiently capitalised to meet its regulatory requirements.

**Risk Management**

The risk management framework provides a firm-wide definition of risk and lays down principles of how risk is to be identified, assessed, measured, monitored and controlled / mitigated, and the associated allocation of capital against same. Further information in relation to the Risk Management are set out in the Risk Management Report on pages 9 to 36.

**Going concern**

The financial statements for the year ended 31 December 2014 have been prepared on a going concern basis as the Directors are satisfied, having considered the risks and uncertainties impacting the Bank, that it has the ability to continue in business for the period of assessment.

AIB Mortgage Bank is dependent on its Parent, Allied Irish Banks, p.l.c. for continued funding and is therefore dependent on the going concern status of the Parent.

The financial statements of Allied Irish Bank p.l.c for the year ended 31 December 2014 have been prepared on a going concern basis as the Directors of AIB Group are satisfied, having considered the risks and uncertainties impacting the AIB Group, that it has the ability to continue in business for the period of assessment. The period of assessment used by the AIB Group Directors is twelve months from the date of approval of these annual financial statements.

In making its assessment, the AIB Group Directors have considered a wide range of information relating to present and future conditions. These have included: financial plans approved in December 2014 covering the period 2015 to 2017; the Restructuring Plan approved by the European Commission in May 2014; liquidity and funding forecasts, and capital resources projections; and the results of the Comprehensive Assessment stress testing conducted by the ECB. There have all been prepared under base and stress scenarios having considered the outlook for the Irish, the eurozone and UK economies. In addition, the AIB Group Directors have considered the commitment of support provided to AIB by the Irish Government.

The AIB Group Directors have also considered the principal risks and uncertainties which could materially affect the AIB Group's future business performance and profitability.

The AIB Group Directors believe that the capital resources are sufficient to ensure that the AIB Group is adequately capitalised both in a base and stress scenario.

In relation to liquidity and funding, the AIB Group Directors are satisfied, based on AIB's position in the market place, that in all reasonable circumstances required liquidity and funding from the Central Bank of Ireland/ECB would be available to the AIB Group during the period of assessment.

On the basis of the continued availability of funding from Allied Irish Banks, p.l.c to AIB Mortgage Bank, the Directors of the Bank believe that it is appropriate to prepare the financial statements on a going concern basis having concluded that there are no material uncertainties related to events or conditions that may cast significant doubt on the its ability to continue as a going concern over the period of assessment.

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

The beneficial interests of the Directors and the Secretary in office at 31 December 2014 and of their spouses and minor children in the shares of group companies are set out below. The shares referred to are €0.0025 ordinary shares in Allied Irish Banks, p.l.c., the holding company.

	<b>31 December 2014</b>	<b>1 January* 2014</b>
<b>Ordinary shares</b>		
<b>Directors:</b>		
Dave Keenan	Nil	Nil
Eileen Kelliher	Nil	Nil
Gerry Gaffney	Nil	Nil
James Murphy	20,857	18,315
Jim O'Keefe	5,698	5,698
Catherine Woods	Nil	Nil
<b>Secretary</b>		
David Schorman	8,453	8,453

\*or date of appointment, if later

**DIRECTORS' REPORT (CONTINUED)****Directors' and Secretary's interests in shares (continued)****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 2014 are exercisable up to 26 April 2015, however as these options are deeply out of the money, there is no expectation that they will be exercised. Details are shown in the Register of Directors' and Secretary's Interests, which may be inspected at the Bank's registered office.

	31 December 2014	1 January 2014	Options lapsed during 2014	Weighted Average subscriptions price of options outstanding at 31 December 2014 €
<b>Directors:</b>				
Dave Keenan	Nil	Nil	Nil	Nil
Gerry Gaffney	Nil	Nil	Nil	Nil
James Murphy	5,000	5,000	Nil	16.20
Jim O'Keeffe	5,000	10,000	5,000	16.20
<b>Secretary:</b>				
David Schorman	Nil	Nil	Nil	Nil

Independent Non-Executive directors do not participate in share option plans. No options were granted or exercised during the year.

**Long term incentive plans**

There were no conditional grants of awards of ordinary shares outstanding to Executive Directors or the Company Secretary at 31 December 2014. Independent Non-Executive Directors do not participate in long term incentive plans. 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 2014 and 18 March 2015.

**Directors and Secretary**

The following Board changes occurred with effect from the dates shown:

Mr Ivor Larkin resigned as an Executive Director on 4 December 2014;  
 Mr Gerry Gaffney was appointed Executive Director on 4 December 2014;  
 Mr David Schorman resigned as Secretary on 18 March 2015;  
 Ms Louise Cleary was appointed Secretary on 18 March 2015.

**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, which is performed under an outsourcing and agency agreement by Allied Irish Banks, p.l.c. The books of account of the Bank are kept at the Bank's registered office.

**Events since the year end**

In the Directors' view, there have been no events since the year end that have had a material effect on the financial position of the Bank. See Note 25: Subsequent Events.

**Independent auditor**

The auditors, Deloitte & Touche, Chartered Accountants and Statutory Audit Firm, has expressed their willingness to continue in office under Section 160 (2) of the Companies Act, 1963.

On behalf of the Board

Chairman: Dave Keenan

Director: Catherine Woods

Managing Director: Jim O'Keeffe

Date: 18 March 2015



## STATEMENT OF DIRECTORS' RESPONSIBILITIES

The following statement, which should be read in conjunction with the statement of Auditors' responsibilities set out with their Audit Report, is made with a view to distinguish for shareholders the respective responsibilities of the Directors and of the Auditor in relation to the financial statements.

The Directors are responsible for preparing the Annual Report and financial statements, in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. The directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the EU and as applied in accordance with the provisions of the Companies Acts, 1963 to 2013.

The financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and performance of the Company; the Companies Acts, 1963 to 2013 provide in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the 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;
- state that the financial statements comply with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company 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 company and enable them to ensure that its financial statements comply with the Companies Acts, 1963 to 2013. They are also responsible for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Each of the Directors confirm, to the best of their knowledge and belief, that:

- they have complied with the above requirements in preparing the financial statements;
- the Company's financial statements prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the state of the Company's affairs as at 31 December 2014;
- the Directors' report, Business review and Risk management section, contained in the Directors' Report and Annual Financial Statements includes a fair review of the development and performance of the business and the financial position of the Company, together with a description of the principal risks faced by the Company;

On behalf of the Board

Chairman: Dave Keenan

Director: Catherine Woods

Managing Director: Jim O'Keeffe

Date: 18 March 2015

## **RISK MANAGEMENT REPORT**

### **1. Introduction**

All of the Bank's activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risks which are assessed on an AIB Group wide basis. Certain risks can be mitigated by the use of safeguards and appropriate systems and actions which form part of the AIB Group's risk management framework. The principal risks and uncertainties facing AIB Group are discussed on pages 51 to 56 of the Group's Annual Financial Report 2014.

### **2. Risk management framework**

AIB Mortgage Bank relies on the Group framework and its supporting policies, processes and governance. The AIB Group risk management framework is described on pages 57 to 59 of the Group's Annual Financial Report 2014. For more information on the operation of the Board of the Mortgage Bank and its Audit Committee see pages 3 to 4 of this report.

### **3. 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:

- 3.1 Credit risk
- 3.2 Liquidity risk
- 3.3 Operational risk
- 3.4 Regulatory compliance risk
- 3.5 Non-trading interest rate risk

The 5 applicable risk types are discussed overleaf.

## RISK MANAGEMENT REPORT

### 3.1 Credit risk

Credit risk is the risk that the Bank will incur losses as a result of a customer or counterparty being unable or unwilling to meet a commitment that it has entered into and that pledged collateral does not fully cover amounts due to the Bank. The most significant credit risks assumed by the Bank arise from mortgage lending activities to customers in Ireland. Credit risk also arises on funds placed with other banks and in respect of derivatives relating to interest rate risk management.

Credit risk management objectives are to:

- Establish and maintain a control framework to ensure credit risk taking is based on sound credit management principles;
- Control and plan credit risk taking in line with external stakeholder expectations;
- Identify, assess and measure credit risk clearly and accurately across the Bank, from the level of individual facilities up to the total portfolio; and
- Monitor credit risk and adherence to agreed controls.

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.

Maximum exposure to credit risk from on balance sheet and off balance sheet financial instruments is presented before taking account of any collateral held or other credit enhancements (unless such enhancements meet accounting offsetting requirements). For financial assets recognised on the statement of financial position, the maximum exposure to credit risk equals their carrying amount, and for loan commitments that are irrevocable over the life of the respective facilities, it is the full loan amount of the committed facilities.

The table below sets out the maximum exposure to credit risk that arises within the Bank and distinguishes between those assets that are carried in the Statement of Financial Position at amortised cost and those carried at fair value:

#### Maximum exposure to credit risk\*

	Amortised Cost €m	Fair Value €m	2014 Total €m	Amortised Cost €m	Fair Value €m	2013 Total €m
Derivative financial instruments	-	329	329	-	310	310
Loans and receivables to banks	469	-	469	463	-	463
Loans and receivables to customers	19,920	-	19,920	20,792	-	20,792
Included elsewhere:						
Accrued interest	44	-	44	32	-	32
Other assets	5	-	5	2	-	2
	20,438	329	20,767	21,289	310	21,599
Loan commitments	349	-	349	221	-	221
Maximum exposure to credit risk	20,787	329	21,116	21,510	310	21,820

#### Credit risk organisation and structure

The AIB Group's credit risk management systems operate through a hierarchy of lending authorities. The Bank relies on the AIB Group credit risk framework and its supporting policies, processes and governance. All customer mortgage applications are subject to an individual credit assessment process.

The role of the AIB Group ("Group") Credit Risk function is to provide direction, oversight and challenge of credit risk-taking. The Bank's Risk Appetite Statements sets out the credit risk appetite and framework. Credit Risk appetite is set at Board level and is described, reported and monitored through a suit of metrics, supported by credit risk policies, concentration limits to manage risk and exposure within the Bank's approved risk appetite. The Bank's risk appetite for credit risk is reviewed and approved annually.

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

### 3.1 Credit risk (continued)

#### Measurement of credit risk

One of the objectives of credit risk management is to accurately quantify the level of credit risk to which the Bank is exposed. The use of internal credit rating models is fundamental in assessing the credit quality of loan exposures, with variants of these used for the calculation of regulatory capital.

The primary model measures used are:

- Probability of default (“PD”) – the likelihood that a borrower is unable to repay his obligations;
- Exposure at default (“EAD”) – the exposure to a borrower who is unable to repay his obligations at the point of default;
- Loss given default (“LGD”) – the loss associated with a defaulted loan or borrower, and;
- Expected loss (“EL”) – the loss that can be incurred as a result of lending to a borrower that may default. It is the average expected loss in value over a specified period.

To calculate PD, AIB assesses the credit quality of borrowers and other counterparties and assigns a credit grade or score to these. This grading is fundamental to credit sanctioning and approval, to the on-going credit risk management of loan portfolios. It is a key factor in determining whether credit exposure limits are sanctioned for new borrowers, at which authority level they can be approved, and how any existing limits are managed for current borrowers.

Models generally use a combination of statistical analysis (using both financial and non-financial inputs) and expert judgement. For the purposes of calculating credit risk, each probability of default model segments counterparties into a number of rating grades, each representing a defined range of default probabilities. Exposures migrate between rating grades if the assessment of the counterparty probability of default changes. These individual rating models continue to be refined and recalibrated based on experience. In the retail portfolio, which is characterised by a large number of customers with small individual exposures, risk assessment is largely automated through the use of statistically-based scoring models.

Mortgage applications are generally assessed centrally with particular reference to affordability, assisted by scoring models. However, for larger cases with connected exposures, some mortgage applications are assessed by the Relevant Credit Authority. 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.

Credit grading and scoring systems facilitate the early identification and management of any deterioration in loan quality. Changes in the objective information are reflected in the credit grade of the borrower with the resultant grade influencing the management of individual loans. Special attention is paid to lower quality performing loans or ‘criticised’ loans. In AIB, criticised loans include ‘watch’, ‘vulnerable’ and ‘impaired’ loans which are defined as follows:

<b>Watch:</b>	The credit is exhibiting weakness but with the expectation that existing debt can be fully repaid from normal cash flows;
<b>Vulnerable:</b>	Credit where repayment is in jeopardy from normal cash flows and may be dependent on other sources; and
<b>Impaired:</b>	A loan is impaired if there is objective evidence of impairment as a result of one or more event(s) that occurred after the initial recognition of the asset (a ‘loss event’) and that loss event/event(s) has an impact such that the present value of future cash flows is less than the current carrying value of the financial asset or group of assets and requires an impairment provision to be recognised in the income statement.

The Bank’s criticised loans are subject to more intense assessments and reviews because of the increased risk associated with them.

Credit management and credit risk management continues to be the key areas of focus. Resourcing, structures, policy and processes are subjected to on-going review in order to ensure that the Bank is best placed to manage asset quality and assist borrowers in line with agreed treatment strategies.

#### Risk management and mitigation

AIB Mortgage Bank has an established credit process through AIB Group with a framework of a mortgage 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.

In addition, the Board of AIB Mortgage Bank and the Board of AIB Group review and approve the credit policy for residential property mortgage loans on an annual basis.

#### Collateral

Collateral is required as a secondary source of repayment in the event of the borrower’s default. Credit risk mitigation includes the requirement to obtain collateral as set out in the Bank’s policies and procedures. AIB Group maintains guidelines on the acceptability of specific classes of collateral.

For residential mortgages, the Bank takes collateral principally in the form of a legal charge in favour of AIB Mortgage Bank. All properties are required to be fully insured.

Collateral valuations are required at the time of origination of each residential mortgage. The Bank adjusts open market property values to take account of the costs of realisation and any discount associated with the realisation of collateral. The fair value at 31 December 2014 is based on property values at origination or date of latest valuation and applying the Central Statistics Office (“CSO”) Residential Property Price index (Republic of Ireland) to these values to take account of price movements in the interim.

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

### 3.1 Credit risk (continued)

#### Forbearance strategies\*

Forbearance occurs when a borrower is granted a temporary or permanent concession or agreed change to a loan ('forbearance measure') for reasons relating to the actual or apparent financial stress or distress of that borrower. A forbearance agreement is entered into where the customer is in financial difficulty to the extent that they are unable currently to repay both the principal and interest in accordance with the original contract terms. Modifications to the original contract can be of a temporary (e.g. interest only) or permanent (e.g. term extension) nature.

AIB Group uses a range of tools to support customers. The Group considers requests from customers who are experiencing cash flow difficulties on a case by case basis against their current and likely future financial circumstances and their willingness to resolve these difficulties, taking into account legal and regulatory obligations. Key principles include the objective of supporting customers to remain in a family home whenever possible. The Group has implemented the standards for the Codes of Conduct in relation to customers in difficulty as set out by the Central Bank of Ireland ensuring these customers are dealt with in a professional and timely manner.

The effectiveness of the forbearance measures over the lifetime of those arrangements will be measured and reviewed. A forbearance measure is deemed to be effective if the borrower meets the modified or original terms of the contract over a sustained period of time resulting in an improved outcome for the Group and the borrower.

The Group has developed a Mortgage Arrears Resolution Strategy ("MARS") for dealing with mortgage customers in difficulty or likely to be in difficulty. This builds on and formalises the Group's Mortgage Arrears Resolution Process ("MARP").

The strategy is built on three key factors:

- i) Segmentation – identifying customers in difficulty;
- ii) Sustainability – customer assessment; and
- iii) Suitable Treatment – identifying solutions.

The core objectives are to ensure that arrears solutions are sustainable in the long term and they comply with the spirit and the letter of all regulatory requirements. MARS includes the following new longer-term forbearance solutions which have been devised to assist existing Republic of Ireland primary residential mortgage customers in difficulty:

**Positive equity sustainable solution** – This solution involves a reduced payment to support customers who do not qualify for other forbearance solutions such as Split loans due to positive equity;

**Low fixed interest rate sustainable solution** – This solution is to support customers who have an income (and can afford a mortgage), but the income is not currently sufficient to cover full capital and interest on their mortgage based on their current interest rate(s) and/or personal circumstances. Their current income is, however, sufficient to cover full capital and interest at a lower rate. It involves the customer being provided with a low fixed interest rate for an agreed period after which the customer will convert to the prevailing variable rate for the remainder of the term of the mortgage on the basis that there is currently a reasonable expectation that the customer's income and/or circumstances will improve over the period of the reduced rate. The customer must pay full capital and interest throughout;

**Split mortgages** – A split mortgage will be considered where a customer can afford a mortgage but their income is not sufficient to fully support their current mortgage. The existing mortgage is split into two parts: Loan A being the sustainable element, which is repaid on the basis of principal and interest, and Loan B being the unsustainable element, which is deferred and becomes repayable at a later date. This may also include an element of debt write-off;

**Negative equity trade down** – This allows a customer to sell their house and subsequently purchase a new property and transfer the negative equity portion to a new loan secured on the new property. A negative equity trade down mortgage will be considered where a customer will reduce monthly loan repayments and overall indebtedness by trading down to a property more appropriate to his/her current financial and other circumstances; and

**Voluntary sale for loss** – A voluntary sale for loss solution will be considered where the loan is deemed to be unsustainable and the customer is agreeable to sell the property and put an appropriate agreement in place to repay any residual debt. This may also include an element of debt-write off.

Credit policies are in place which outlines the principles and processes underpinning the Group's approach to mortgage forbearance.

#### Loan loss provisioning\*

AIB's provisioning policy requires for impairments to be recognised promptly and consistently across the different loan portfolios. A financial asset is considered to be impaired, and therefore its carrying amount is adjusted to reflect the effect of impairment, when there is objective evidence that events have occurred which give rise to an adverse impact on the estimated future cash flows that can be reliably estimated.

Impairment provisions are calculated on individual loans and on groups of loans assessed collectively. All exposures, individually or collectively, are regularly reviewed for objective evidence of impairment. Impairment losses are recorded as charges to the income statement. The carrying amount of impaired loans on the balance sheet is reduced through the use of impairment provision accounts. Losses expected from future events are not recognised.

The identification of loans for assessment as impaired is facilitated by the Group's credit rating systems. Changes in the variables which drive the borrower's credit rating may result in the borrower being downgraded. This in turn influences the management of individual loans with special attention being paid to lower quality or criticised loans, i.e. in the Watch, Vulnerable or Impaired categories. The credit rating of an exposure is one of the key factors used to determine if a case should be assessed for impairment.

It is Group's policy to provide for impairment promptly and consistently across the loan book. All business areas formally review and confirm the appropriateness of their provisioning methodologies and the adequacy of their impairment provisions on a quarterly basis. Loans are tested for impairment on receipt of a forbearance request and when accounts reach 90 days past due.

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

### 3.1 Credit risk (continued)

#### Loan loss provisioning (continued)\*

The following are triggers to prompt/guide Case managers regarding the requirement to assess for impairment:

#### Mortgage portfolio triggers

- Deterioration in the debt service capacity.
- A material decrease in rents received on a buy-to-let property.
- Borrowers that are 90 days past due.
- On receipt of a forbearance request.

In addition, the following factors are taken into consideration, when assessing whether a loss event has occurred:

- Loss of significant tenant/material reduction in rental income;
- Significant financial difficulty;
- Decrease in cash flow; and
- Loss of employment.

For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

- the bank's aggregate exposure to the customer;
- the amount and timing of expected receipts and recoveries;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession; and
- the deduction of estimated costs involved in recovery of amounts outstanding.

#### Specific provisions

Specific impairment provisions arise when the recovery of a specific loan or group of loans is in doubt based on impairment triggers as outlined above and an assessment that all the expected future cash flows either from the loan itself or from the associated collateral will not be sufficient to repay the loan. The amount of the specific impairment provision is the difference between the present value of expected future cash flows for the impaired loan(s) discounted at the original effective interest rate and the carrying value of the loan(s).

When raising specific impairment provisions, AIB divides its impaired portfolio into two categories, namely Individually Significant and Individually Insignificant.

The Individually Significant threshold is €500,000 by customer connection. The calculation of an impairment charge for loans below the 'significant' threshold is undertaken on a collective basis.

#### *Individually Significant ('IS') Mortgages*

All loans that are considered individually significant are assessed on a case-by-case basis throughout the year if there is any objective evidence that a loan may be impaired. Assessment is based on ability to pay and collateral value. Individually significant provisions are calculated using discounted cash flows for each exposure. The cash flows are determined with reference to the individual characteristics of each credit including an assessment of the cash flows that may arise from foreclosure less costs to sell in respect of obtaining and selling any associated collateral. The time period likely to be required to realise the collateral and receive the cash flows is taken into account in estimating the future cash flows and discounting these back to present value.

#### *Individually Insignificant ('II') Mortgages*

Provisioning is assessed on a collective basis to estimate losses for homogeneous groups of loans that are considered individually insignificant. This applies for customer connections less than €500,000.

The Individually Insignificant mortgage provisioning methodology applies to both owner-occupier and buy-to-let exposures.

Individually insignificant mortgage specific provisions are calculated using a collective and IBNR mortgage provisioning model. This methodology is based on the calculation of three possible resolution outcomes: cure; advanced forbearance with loss; and repossession (forced and voluntary), with different loss rates associated with each. The methodology is regularly reviewed and updated to reflect current data on loss history and portfolio development as well as incorporating additional loss parameters assessed on restructuring outcomes.

The model parameters were refined during the year based on an additional one year dataset.

Key model parameters at 31 December 2014 for owner-occupier mortgages are as follows: cure (4%); and repossession/advanced forbearance (96%), in line with 2013.

The corresponding buy-to-let model parameters at 31 December 2014 are as follows: cure (0.5%) and repossession/advanced forbearance (99.5%), in line with 2013.

Cured loans are loans that were impaired and are no longer impaired and have performed satisfactorily for 12 months excluding any impact on forbearance.

The modelled loss is calculated on a case by case basis by subtracting the net present value of the modelled recovery amount from the current loan balance. The model parameters are determined from observed data where possible. Where not directly observable, related measures are used to infer the parameter where possible; otherwise it is based on expert judgement. The relevant model parameters include: percentage of forced disposals; costs and time to dispose (voluntary and forced); house price fall from peak; loss rate on advanced forbearance; and haircut on sale (voluntary and forced). The model parameters are reviewed at a Group Credit Committee on a quarterly basis.

\*Forms an integral part of the audited financial statements

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Loan loss provisioning (continued)\****Incurred But Not Reported Provisions (IBNR)*

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. This reflects impairment losses that the Bank has incurred as a result of events occurring before the balance sheet date, which the Bank is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis for impairment.

IBNR provisions can only be recognised for incurred losses i.e. losses that are present in the portfolio at the reporting date and are not permitted for losses that are expected to happen as a result of likely future events. IBNR provisions are determined by reference to loss experience in the portfolio and to the credit environment at the reporting date.

IBNR provisions are maintained at levels that are deemed appropriate by management having considered and having taken into account:

- historical loss experience (loss emergence rates based on historic grade migration experience or probability of default) in portfolios of similar credit risk characteristics (for example, by sector, loan grade or product);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate provision against the individual loan (emergence period);
- loss given default rates based on historical loan loss experience, adjusted for current observable data;
- management's experienced judgement as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience; and
- an assessment of higher risk portfolios, for example, non-impaired forbore mortgages and restructured loans.

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**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Loan loss provisioning (continued)\***

The residential mortgage portfolio IBNR is calculated using the Individually Insignificant and IBNR mortgage model described above. The table below sets out the parameters used in the calculation of IBNR for the residential mortgages portfolio as at 31 December 2014 and 31 December 2013:

Grade	2014					
	Owner-Occupier			Buy-to-let		
	Exposure €m	Average PD %	Average LGD %	Exposure €m	Average PD %	Average LGD %
Good upper	5,766	0.3	17.9	931	0.4	15.0
Good lower	6,316	2.4	19.4	1,279	3.6	18.8
Watch	1,645	15.1	21.7	392	25.1	20.1
Vulnerable	491	93.3	19.5	220	70.9	20.0

The parameters for Cured and Forborne – Not impaired, are set out below. As a result, these sub portfolios within the residential mortgages carry a higher level of IBNR:

Cured	261	56.4	18.0	184	54.7	21.2
Forborne – Not impaired	865	33.5	18.5	404	31.0	20.9

Grade	2013			
	Owner-Occupier		Buy-to-let	
	Average PD %	Average LGD %	Average PD %	Average LGD %
Good upper	0.2	17.4	0.2	17.4
Good lower	2.1	19.6	2.1	22.1
Watch	15.8	19.8	15.3	24.0
Vulnerable	83.8	19.7	73.1	25.6

The parameters for Cured and Forborne – Not impaired, are set out below. As a result, these sub portfolios within the residential mortgages carry a higher level of IBNR:

Cured	66.0	16.2	69.5	28.9
Forborne – Not impaired	31.8	18.0	26.4	25.2

Average PD and LGD are based on the PDs and LGDs, weighted by the EAD for all owner-occupier and buy-to-let loans included in the Individually Insignificant /IBNR mortgage model. The mortgage provision model calculates individually insignificant specific provisions and IBNR run rate provisions. Any additional IBNR, where appropriate, determined by management judgement is applied at a portfolio level and is not included in the analysis above.

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## RISK MANAGEMENT REPORT (CONTINUED)

### 3.1 Credit risk (continued)

#### Loan loss provisioning (continued)\*

##### Emergence period

The emergence period is key to determining the level of IBNR provisions. Emergence periods are determined by assessing the time it takes following a loss event for an unidentified impaired loan to be recognised as an impaired loan requiring a provision. Emergence periods for each portfolio are determined by taking into account current credit management practices, historic evidence of assets moving from 'good' to 'bad' and actual case studies.

Emergence periods are reflective of the characteristics of the particular portfolio. Emergence periods are estimated based on historic loan loss experience supported by back testing, and as appropriate individual case sampling.

Emergence periods are reviewed on at least an annual basis. At 31 December 2014, the emergence period for the mortgage portfolio has moved from 9 months to 12 months. Increasing the emergence period gave rise to higher IBNR provisions of €60 million for the mortgage portfolio. The increase has been observed as further information on the period from loss event to specific impairment has become available in 2014, particularly for the forbearance portfolio and also a continued emphasis on maintaining a conservative estimate of the unidentified incurred loss within the portfolio.

##### Approval Process

The AIB Group operates an approval framework for impairment provisions which are approved, depending on amount, by various delegated authorities and referred to Area Credit Committee level as required. These committees are chaired by the Chief Credit Officer ("CCO") or alternative specified Chair as outlined in the terms of reference for Credit Committees, where the valuation /impairment is reviewed and challenged for appropriateness and adequacy. Impairments in excess of the segment authorities are approved by the Group Credit Committee and Board (where applicable). Segment impairments and provisions are ultimately reviewed by the Group Credit Committee as part of the quarterly process.

The valuation assumptions and approaches used in determining the impairment provisions required are documented and the resulting impairment provisions are reviewed and challenged as part of the approval process by segment and Group senior management.

##### Write-offs

When the prospect of recovering a loan, either partially or fully, does not improve, a point will come when it will be concluded that as there is no realistic prospect of recovery and the loan (and any related specific provision) will be written off. Where the loan is secured, the write-off will take account of receipt of the net realisable value of security held. Partial write offs may also occur when it is considered that there is no prospect for the recovery of the provisioned amount, for example when a loan enters the legal process. The provision is written off but the remaining reduced loan balance remains on the balance sheet as impaired. In addition, some write-offs may reflect restructuring activity agreed with customers who are subject to the terms of the agreement and satisfactory performance.

##### Reversals of Impairment

If the amount of an impairment loss decreased in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment provision amounts accordingly. The write back is recognised in the income statement.

##### Impact of changes to key assumptions and estimates on the impairment provisions

Management is required to exercise judgement in making assumptions and estimations when calculating loan impairment provisions on both individually and collectively assessed loans and receivables. A significant judgemental area is the calculation of Individually Insignificant and IBNR impairment provisions which are subject to estimation uncertainty.

The methods involve the use of historical information which is supplemented with significant management judgement to assess whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience. In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio, though sometimes it provides less relevant information about the inherent loss in a given portfolio at the balance sheet date. For example; when there have been changes in economic, regulatory or behavioural conditions which result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models. In these circumstances, the risk factors are taken into account by adjusting the impairment provisions derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other influences on customer payment patterns. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example; loss rates and the expected timing of future recoveries are benchmarked against actual outcomes where available to ensure they remain appropriate.

However, the exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas.

The key variables include house price fall from peak c. 50% (49% Dublin and 51% non-Dublin) which determines the collateral value supporting loans in the mortgage portfolio and cure rates (rates by which defaulted or delinquent accounts are assumed to return to performing status).

Sensitivity to changes in estimates and assumptions are detailed below:

A 1% favourable change in the cure rate used for the collective mortgage provisions would result in a reduction in impairment provisions of 1.4% (blended rate of owner-occupier/buy-to-let) of c. €10 million.

\*Forms an integral part of the audited financial statements

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Loan loss provisioning (continued)****Impact of changes to key assumptions and estimates on the impairment provisions (continued)**

The value of collateral is estimated by applying changes in house price indices to the original assessed value of the property. A 1% change in the house price fall from peak assumption used for the collective mortgage provisions for December 2014 is estimated to result in movements in provisions of c. €17 million.

An increase in the assumed repossession rate of 1% for collective mortgage provisions would result in an increase in provisions of 0.14% (blended rate of owner-occupier/buy-to-let) of c. €1 million.

An IBNR provision is made for impairments that have been incurred but have not been separately identifiable at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period. In the Bank's mortgage portfolio, the emergence period is currently 12 months; a decrease of one month in the loss emergence period in respect of the loan portfolio assessed would result in a decrease in provisions of c. €19 million.

**Individually impaired loans by geographic location and sector\***

	<b>2014 €m</b>	<b>2013 €m</b>
Republic of Ireland		
Home Mortgages	<b>4,578</b>	5,123
	<b>4,578</b>	5,123

**Provision cover table**

	<b>Impaired Loan Balance</b>	<b>Specific Provision</b>	<b>Specific Provision Cover %</b>
Home mortgages – 31 December 2014	<b>4,578</b>	<b>1,641</b>	<b>36%</b>
Home mortgages – 31 December 2013	5,123	1,972	39%

The following pages provide details of:

- Analysis of the owner occupier and buy-to-let portfolios by arrears and provisions;
- Asset quality of residential mortgages
- Fair value of residential mortgage collateral;
- Arrears profile of mortgages which were past due but not impaired;
- Arrears profile of mortgages which were impaired;
- Forbearance:
  - Owner occupier
  - Buy-to-let
  - Total;
- Possessions;
- Loan to value profile; and
- Origination profile.

\*Forms an integral part of the audited financial statements

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)**

The following table analyses the owner-occupier and buy-to-let residential mortgage portfolios by arrears and provisions:

**Statement of financial position\***

	2014			2013		
	Owner-Occupier €m	Buy-to-Let €m	Total €m	Owner-Occupier €m	Buy-to-Let €m	Total €m
Total gross residential mortgages	16,173	5,698	21,871	16,706	6,387	23,093
In arrears (>30days past due) <sup>(1)</sup>	2,205	2,866	5,071	2,416	3,304	5,720
In arrears (>90 days past due) <sup>(1)</sup>	2,085	2,803	4,888	2,227	3,231	5,458
Of which impaired	1,887	2,691	4,578	2,019	3,104	5,123
Statement of financial position specific provisions	563	1,078	1,641	680	1,292	1,972
Statement of financial position IBNR provisions	222	88	310	222	107	329

<sup>(1)</sup> Includes all loans past due whether impaired or not.

Total impaired loans amounted to €4,578 million at 31 December 2014 (2013: €5,123 million), of which €2,865 million (2013: €3,213 million) was individually assessed for impairment and €1,713 million (2013: €1,910 million) was collectively assessed for impairment.

**Provision cover percentage\***

	2014			2013		
	Owner-Occupier %	Buy-to-Let %	Total %	Owner-Occupier %	Buy-to-Let %	Total %
Specific provisions as a % of impaired loans cover	29.8	40.1	35.8	33.7	41.6	38.5

**Income statement <sup>(2)</sup>**

	2014			2013		
	Owner-Occupier €m	Buy-to-Let €m	Total €m	Owner-Occupier €m	Buy-to-Let €m	Total €m
Income Statement: specific provisions	(39)	(42)	(81)	85	171	256
Income Statement: IBNR provisions	-	(19)	(19)	65	30	95
<b>Total impairment provisions</b>	<b>(39)</b>	<b>(61)</b>	<b>(100)</b>	<b>150</b>	<b>201</b>	<b>351</b>

<sup>(2)</sup> In the table above, writebacks of provisions are presented as a negative and charges presented as a positive.

**Asset quality of residential mortgages\***

The following table shows criticised loans for the total residential mortgages portfolio analysed between owner-occupier and buy-to-let. Criticised loans include watch, vulnerable and impaired loans.

	2014			2013		
	Owner-Occupier €m	Buy-to-Let €m	Total €m	Owner-Occupier €m	Buy-to-Let €m	Total €m
<b>Satisfactory</b>	<b>11,565</b>	<b>1,966</b>	<b>13,531</b>	<b>11,680</b>	<b>2,181</b>	<b>13,861</b>
Watch	1,211	247	1,458	1,689	419	2,108
Vulnerable	1,510	794	2,304	1,318	683	2,001
Impaired	1,887	2,691	4,578	2,019	3,104	5,123
<b>Criticised</b>	<b>4,608</b>	<b>3,732</b>	<b>8,340</b>	<b>5,026</b>	<b>4,206</b>	<b>9,232</b>
<b>Gross mortgages</b>	<b>16,173</b>	<b>5,698</b>	<b>21,871</b>	<b>16,706</b>	<b>6,387</b>	<b>23,093</b>
	%	%	%	%	%	%
Criticised loans as % of total mortgages	28	65	38	30	66	40
Impaired loans as % of total mortgages	12	47	21	12	49	22

\*Forms an integral part of the audited financial statements

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Collateral for the residential mortgage portfolio**

For residential mortgages, the Bank takes collateral in support of lending transactions for the purchase of residential property. Collateral valuations are required at the time of origination of each residential mortgage. The Bank adjusts open market property values to take account of the costs of realisation and any discount associated with the realisation of collateral. The fair value at 31 December 2014 is based on property values at origination or date of latest valuation and applying the CSO Residential Property Price index (Republic of Ireland) and indices to these values to take account of price movements in the interim.

**Loans and receivables to customers – residential mortgages\***

The following tables show the fair value of collateral held for residential mortgages at 31 December 2014 and 31 December 2013:

				2014
	Neither past due nor impaired €m	Past due but not impaired €m	Impaired €m	Total €m
<b>Fully collateralised</b>				
Loan-to-value ratio:				
Less than 50%	3,762	179	281	4,222
50%-70%	3,704	145	422	4,271
71%-80%	1,965	74	300	2,339
81%-90%	1,957	65	374	2,396
91%-100%	1,449	55	370	1,874
	12,837	518	1,747	15,102
<b>Partially collateralised</b>				
Collateral value relating to loans over 100% LTV	3,124	160	2,016	5,300
<b>Total collateral value</b>	<b>15,961</b>	<b>678</b>	<b>3,763</b>	<b>20,402</b>
<b>Gross residential mortgages</b>	<b>16,577</b>	<b>716</b>	<b>4,578</b>	<b>21,871</b>
Statement of Financial Position: specific provisions			(1,641)	(1,641)
Statement of Financial Position: IBNR provisions				(310)
<b>Net residential mortgages</b>			<b>2,937</b>	<b>19,920</b>

				2013
	Neither past due nor impaired €m	Past due but not impaired €m	Impaired €m	Total €m
<b>Fully collateralised</b>				
Loan-to-value ratio:				
Less than 50%	2,833	156	215	3,204
50%-70%	2,686	143	279	3,108
71%-80%	1,826	81	237	2,144
81%-90%	1,664	78	273	2,015
91%-100%	1,627	72	311	2,010
	10,636	530	1,315	12,481
<b>Partially collateralised</b>				
Collateral value relating to loans over 100% LTV	5,090	289	2,721	8,100
<b>Total collateral value</b>	<b>15,726</b>	<b>819</b>	<b>4,036</b>	<b>20,581</b>
<b>Gross residential mortgages</b>	<b>17,061</b>	<b>909</b>	<b>5,123</b>	<b>23,093</b>
Statement of Financial Position: specific provisions			(1,972)	(1,972)
Statement of Financial Position: IBNR provisions				(329)
<b>Net residential mortgages</b>			<b>3,151</b>	<b>20,792</b>

The fair value of collateral held for residential mortgages which are fully collateralised has been capped at the carrying value of the loans outstanding at each year end.

\*Forms an integral part of the audited financial statements

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Arrears profile of mortgages which were past due but not impaired\***

Residential mortgages are assessed for impairment if they are past due, typically, for more than 90 days or if the borrower exhibits an inability to meet its obligations to AIB based on objective evidence of loss events ("impairment triggers"), such as a request for a forbearance measure. Loans are deemed impaired where their carrying value is shown to be in excess of the present value of future cash flows, and an appropriate provision is raised. Where loans are not deemed to be impaired, they are collectively assessed as part of the IBNR provision calculation.

The following tables profile the residential mortgage portfolio that were past due but not impaired at 31 December 2014 and 31 December 2013:

			2014
	Owner – Occupier €m	Buy-to-Let €m	Total €m
1 - 30 days	154	69	223
31 - 60 days	78	44	122
61 - 90 days	43	19	62
91 - 180 days	68	30	98
181 - 365 days	74	35	109
Over 365 days	56	46	102
<b>Total past due but not impaired</b>	<b>473</b>	<b>243</b>	<b>716</b>

			2013
	Owner – Occupier €m	Buy-to-Let €m	Total €m
1 - 30 days	230	82	312
31 - 60 days	111	42	153
61 - 90 days	78	31	109
91 - 180 days	116	57	173
181 - 365 days	66	44	110
Over 365 days	26	26	52
<b>Total past due but not impaired</b>	<b>627</b>	<b>282</b>	<b>909</b>

**Arrears profile of mortgages which were impaired\***

The following tables profile the residential mortgage portfolio that were impaired at 31 December 2014 and 31 December 2013:

			2014
	Owner – Occupier €m	Buy-to-Let €m	Total €m
Not past due	458	561	1,019
1 - 30 days	81	81	162
31 - 60 days	46	59	105
61 - 90 days	37	55	92
91 - 180 days	110	147	257
181 - 365 days	212	308	520
Over 365 days	943	1,480	2,423
<b>Total impaired</b>	<b>1,887</b>	<b>2,691</b>	<b>4,578</b>

			2013
	Owner – Occupier €m	Buy-to-Let €m	Total €m
Not past due	359	718	1,077
1 - 30 days	79	135	214
31 - 60 days	78	113	191
61 - 90 days	73	105	178
91 - 180 days	242	269	511
181 - 365 days	363	439	802
Over 365 days	825	1,325	2,150
<b>Total impaired</b>	<b>2,019</b>	<b>3,104</b>	<b>5,123</b>

Impaired loans decreased by €545m during 2014 due to restructuring and write-offs of provisions. In addition the rate of new impairment slowed significantly in 2014 in comparison to 2013, driven by an improved economic environment. Of the residential mortgage portfolio that was impaired at 31 December 2014, €1,019m or 22% was not past due (31 December 2013: €1,077m or 21%), of which €589m (31 December 2013: €521m) was subject to forbearance measures at 31 December 2014 and were deemed to be impaired as part of their assessment for a forbearance solution.

\*Forms an integral part of the audited financial statements

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Forbearance**

AIB has developed a Mortgage Arrears Resolution Strategy ('MARS') for dealing with mortgage customers in difficulty or likely to be in difficulty which builds on and formalises AIB Group's Mortgage Arrears Resolution process. The core objectives of MARS are to ensure that arrears solutions are sustainable in the long-term and that they comply with the spirit and the letter of all regulatory requirements. MARS includes long-term forbearance solutions which have been devised to assist existing primary residential mortgage customers in difficulty.

The following table analyses the movement in stock of loans subject to forbearance by (i) owner-occupier, (ii) buy-to-let and (iii) total residential mortgages at 31 December 2014 and 31 December 2013:

**Residential owner-occupier mortgages – subject to forbearance\***

	<b>2014</b>		<b>2013</b>	
	<b>Number</b>	<b>Balance €m</b>	<b>Number</b>	<b>Balance €m</b>
At 1 January	8,793	1,632	10,025	1,927
Additions	3,931	595	2,466	443
Expired arrangements	(1,905)	(341)	(3,471)	(671)
Payments	-	(99)	-	(61)
Interest	-	27	-	13
Closed accounts <sup>(1)</sup>	(65)	(9)	(192)	(18)
Other movements	(38)	(65)	(35)	(1)
<b>At 31 December</b>	<b>10,716</b>	<b>1,740</b>	<b>8,793</b>	<b>1,632</b>

**Buy-to-let mortgages – subject to forbearance\***

	<b>2014</b>		<b>2013</b>	
	<b>Number</b>	<b>Balance €m</b>	<b>Number</b>	<b>Balance €m</b>
At 1 January	7,515	1,767	7,899	1,950
Additions	1,629	300	1,844	387
Expired arrangements	(1,701)	(377)	(2,143)	(496)
Payments	-	(113)	-	(68)
Interest	-	34	-	15
Closed accounts <sup>(1)</sup>	(125)	(22)	(120)	(22)
Other movements	(172)	(61)	35	1
<b>At 31 December</b>	<b>7,146</b>	<b>1,528</b>	<b>7,515</b>	<b>1,767</b>

**Total mortgage portfolio – subject to forbearance\***

	<b>2014</b>		<b>2013</b>	
	<b>Number</b>	<b>Balance €m</b>	<b>Number</b>	<b>Balance €m</b>
At 1 January	16,308	3,399	17,924	3,877
Additions	5,560	895	4,310	830
Expired arrangements	(3,606)	(718)	(5,614)	(1,167)
Payments	-	(212)	-	(129)
Interest	-	61	-	28
Closed accounts <sup>(1)</sup>	(190)	(31)	(312)	(40)
Other movements	(210)	(126)	-	-
<b>At 31 December</b>	<b>17,862</b>	<b>3,268</b>	<b>16,308</b>	<b>3,399</b>

<sup>(1)</sup> Accounts closed during the year due primarily to customer repayments and redemptions.

The stock of loans subject to forbearance measures decreased by €131m in 2014 (2013: decrease of €478m) due to the expiry of short-term forbearance arrangements (mainly periods of interest only) which were not matched by new arrangements in the period.

The following tables further analyse by type of forbearance, (i) owner-occupier, (ii) buy-to-let and (iii) total residential mortgages that were subject to forbearance measures at 31 December 2014 and 31 December 2013:

\*Forms an integral part of the audited financial statements

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Forbearance (continued)****Residential owner-occupier mortgages\***

	2014					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance €m	Number	Balance €m	Number	Balance €m
Interest only	1,180	224	549	112	631	112
Reduced payment (greater than interest only)	1,074	218	708	160	366	58
Payment moratorium	260	49	72	15	188	34
Low fixed interest rate	49	11	10	3	39	8
Arrears capitalisation	4,409	812	2,954	606	1,455	206
Term extension	2,479	319	210	38	2,269	281
Split mortgage	1,037	88	455	68	582	20
Sale for loss	129	8	69	6	60	2
Positive equity solution	98	11	21	3	77	8
Other	1	-	-	-	1	-
<b>Total</b>	<b>10,716</b>	<b>1,740</b>	<b>5,048</b>	<b>1,011</b>	<b>5,668</b>	<b>729</b>

	2013					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance €m	Number	Balance €m	Number	Balance €m
Interest only	1,359	285	642	151	717	134
Reduced payment (greater than interest only)	1,401	319	863	220	538	99
Payment moratorium	162	30	39	7	123	23
Low fixed interest rate	-	-	-	-	-	-
Arrears capitalisation	3,372	678	2,436	546	936	132
Term extension	2,421	310	226	35	2,195	275
Split mortgage	38	6	19	4	19	2
Sale for loss	39	3	24	2	15	1
Positive equity solution	-	-	-	-	-	-
Other	1	1	-	-	1	1
<b>Total</b>	<b>8,793</b>	<b>1,632</b>	<b>4,249</b>	<b>965</b>	<b>4,544</b>	<b>667</b>

\*Forms an integral part of the audited financial statements

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Forbearance (continued)****Buy-to-let mortgages\***

	2014					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance €m	Number	Balance €m	Number	Balance €m
Interest only	1,708	371	933	216	775	155
Reduced payment (greater than interest only)	748	179	430	107	318	72
Payment moratorium	291	40	154	22	137	18
Low fixed interest rate	2	-	1	-	1	-
Arrears capitalisation	3,461	818	2,917	718	544	100
Term extension	765	105	170	28	595	77
Split mortgage	16	2	14	2	2	-
Sale for loss	150	12	109	10	41	2
Positive equity solution	5	1	3	-	2	1
Other	-	-	-	-	-	-
<b>Total</b>	<b>7,146</b>	<b>1,528</b>	<b>4,731</b>	<b>1,103</b>	<b>2,415</b>	<b>425</b>

	2013					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance €m	Number	Balance €m	Number	Balance €m
Interest only	2,790	686	1,933	512	857	174
Reduced payment (greater than interest only)	1,071	241	686	158	385	83
Payment moratorium	79	17	67	15	12	2
Low fixed interest rate	-	-	-	-	-	-
Arrears capitalisation	2,848	723	2,539	670	309	53
Term extension	704	98	120	20	584	78
Split mortgage	-	-	-	-	-	-
Sale for loss	23	2	15	1	8	1
Positive equity solution	-	-	-	-	-	-
Other	-	-	-	-	-	-
<b>Total</b>	<b>7,515</b>	<b>1,767</b>	<b>5,360</b>	<b>1,376</b>	<b>2,155</b>	<b>391</b>

\*Forms an integral part of the audited financial statements.



**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Forbearance (continued)****Total mortgage portfolio\***

	2014					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance €m	Number	Balance €m	Number	Balance €m
Interest only	2,888	595	1,482	328	1,406	267
Reduced payment (greater than interest only)	1,822	397	1,138	267	684	130
Payment moratorium	551	89	226	37	325	52
Low fixed interest rate	51	11	11	3	40	8
Arrears capitalisation	7,870	1,630	5,871	1,324	1,999	306
Term extension	3,244	424	380	66	2,864	358
Split mortgage	1,053	90	469	70	584	20
Sale for loss	279	20	178	16	101	4
Positive equity solution	103	12	24	3	79	9
Other	1	-	-	-	1	-
<b>Total</b>	<b>17,862</b>	<b>3,268</b>	<b>9,779</b>	<b>2,114</b>	<b>8,083</b>	<b>1,154</b>

  

	2013					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance €m	Number	Balance €m	Number	Balance €m
Interest only	4,149	971	2,575	663	1,574	308
Reduced payment (greater than interest only)	2,472	560	1,549	378	923	182
Payment moratorium	241	47	106	22	135	25
Low fixed interest rate	-	-	-	-	-	-
Arrears capitalisation	6,220	1,401	4,975	1,216	1,245	185
Term extension	3,125	408	346	55	2,779	353
Split mortgage	38	6	19	4	19	2
Sale for loss	62	5	39	3	23	2
Positive equity solution	-	-	-	-	-	-
Other	1	1	-	-	1	1
<b>Total</b>	<b>16,308</b>	<b>3,399</b>	<b>9,609</b>	<b>2,341</b>	<b>6,699</b>	<b>1,058</b>

A key feature of the forbearance portfolio is the growth in the proportion of advanced forbearance solutions (split mortgages, low fixed interest rate, voluntary sale for loss, negative equity trade down) and positive equity solutions) driven by the AIB Group's strategy to deliver sustainable long-term solutions to customers. Advanced forbearance solutions at €133 million accounted for 4% of the total forbearance portfolio as at 31 December 2014, compared to less than 1% (€11 million) as at 31 December 2013. Following restructure, loans are reported as impaired for a probationary period of at least 12 months (unless a larger individually assessed case).

Interest income on impaired loans amounted to €73 million in 2014. At 31 December 2014, the net carrying value of impaired loans amounted to €2,937 million which included forbore impaired mortgages of €2,640 million.

\*Forms an integral part of the audited financial statements

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Forbearance (continued)****Credit profile of residential mortgages in forbearance****Forbearance stock - past due but not impaired\***

All loans that are assessed for a forbearance solution are tested for impairment either individually or collectively, irrespective of whether such loans are past due or not. Where the loans are deemed not to be impaired, they are collectively assessed as part of the IBNR provision calculation.

The following table profiles the residential mortgage portfolio that was subject to forbearance measures and which was past due but not impaired at 31 December 2014 and 31 December 2013:

	2014		
	Owner – Occupier €m	Buy-to-Let €m	Total €m
1 - 30 days	39	28	67
31 - 60 days	21	13	34
61 - 90 days	17	7	24
91 - 180 days	31	13	44
181 - 365 days	38	14	52
Over 365 days	32	17	49
<b>Total past due but not impaired</b>	<b>178</b>	<b>92</b>	<b>270</b>

  

	2013		
	Owner – Occupier €m	Buy-to-Let €m	Total €m
1 - 30 days	52	20	72
31 - 60 days	33	11	44
61 - 90 days	24	11	35
91 - 180 days	44	20	64
181 - 365 days	32	14	46
Over 365 days	14	11	25
<b>Total past due but not impaired</b>	<b>199</b>	<b>87</b>	<b>286</b>

8% of the residential mortgage portfolio that was subject to forbearance measures was past due but not impaired at 31 December 2014 (8%: 31 December 2013).

**Forbearance stock – impaired\***

The following table profiles the residential mortgage portfolio that was subject to forbearance measures and which was impaired at 31 December 2014 and 31 December 2013:

	2014		
	Owner – Occupier €m	Buy-to-Let €m	Total €m
Not past due	301	288	589
1 - 30 days	59	44	103
31 - 60 days	27	26	53
61 - 90 days	20	25	45
91 - 180 days	61	68	129
181 - 365 days	105	144	249
Over 365 days	336	465	801
<b>Total impaired</b>	<b>909</b>	<b>1,060</b>	<b>1,969</b>

\*Forms an integral part of the audited financial statements

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Forbearance (continued)****Credit profile of residential mortgages in forbearance (continued)****Forbearance stock – impaired (continued)\***

	Owner – Occupier € m	Buy-to-Let € m	2013 Total € m
Not past due	173	348	521
1 - 30 days	44	71	115
31 - 60 days	39	56	95
61 - 90 days	38	59	97
91 - 180 days	131	136	267
181 - 365 days	175	208	383
Over 365 days	275	453	728
Total impaired	875	1,331	2,206

**Analysis by Loan-to-value ('LTV') of residential mortgages in forbearance\***

The following table profiles the residential mortgage portfolio that was subject to forbearance measures by the indexed loan-to value ratios at 31 December 2014 and 31 December 2013:

	Owner – Occupier € m	Buy-to-Let € m	2014 Total € m
Less than 50%	325	111	436
50% - 70%	330	141	471
71% - 80%	181	101	282
81% - 90%	171	126	297
91% - 100%	146	129	275
101% -120%	269	300	569
121% - 150%	245	350	595
Greater than 150%	65	258	323
Unsecured (Zero Collateral)	8	12	20
<b>Total forbearance</b>	<b>1,740</b>	<b>1,528</b>	<b>3,268</b>

	Owner – Occupier € m	Buy-to-Let € m	2013 Total € m
Less than 50%	211	65	276
50% - 70%	219	93	312
71% - 80%	139	77	216
81% - 90%	127	95	222
91% - 100%	122	111	233
101% -120%	272	269	541
121% - 150%	318	467	785
Greater than 150%	224	590	814
Total forbearance	1,632	1,767	3,399

The degree of negative equity in the residential mortgage portfolio that was subject to forbearance measures at 31 December 2014 has reduced to 34% of the owner-occupier and 60% of the buy-to-let mortgages compared to 50% and 75% respectively at 31 December 2013, due primarily to the increase in property prices in 2014.

\* Forms an integral part of the audited financial statements.

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Properties in possession\***

AIB seeks to avoid repossession through working with customers, but where agreement cannot be reached, AIB proceeds to repossession of the property or the appointment of a fixed asset receiver, using external agents to realise the maximum value as soon as is practicable. Where AIB believes that the sale of a property will comprise only part of the recoverable amount of the loan against which it was being held as security, the customer remains liable for the outstanding balance and the remaining loan continues to be recognised on the statement of financial position.

For the purpose of the following table, a residential property is considered to be in AIB's possession when AIB has taken possession of and is in a position to dispose of the property. This includes situations of repossession, voluntary surrender and abandonment of the property. This is a change from repossessions reported prior to 2014. Accordingly, the stock of residential properties in possession at 31 December 2013 has been restated to include 22 properties which were in AIB's possession through abandonment, but where AIB had not secured legal title. AIB intends to dispose of all such properties in the foreseeable future.

The number (stock) of properties as at 31 December 2014 and 31 December 2013 is set out below:

	<b>2014</b>		<b>2013</b>	
	<b>Stock</b>	<b>Balance Outstanding €m</b>	<b>Stock</b>	<b>Balance Outstanding €m</b>
Owner-occupier	<b>81</b>	<b>22</b>	38	10
Buy-to-let	<b>58</b>	<b>13</b>	47	11
<b>Total</b>	<b>139</b>	<b>35</b>	85	21

The increase in the stock of repossessed properties in 2014 relates to 84 properties repossessed offset by 30 disposals.

The following tables analyse the disposals of repossessed properties during the years 31 December 2014 and 31 December 2013:

	<b>2014</b>					
	<b>Number of Disposals</b>	<b>Balance outstanding at repossession date €m</b>	<b>Gross sales proceeds €m</b>	<b>Costs to sell €m</b>	<b>Loss on sale<sup>(1)</sup> €m</b>	<b>Average LTV at sale Price %</b>
Owner-occupier	11	3	2	-	2	206%
Buy-to-let	19	6	2	-	4	247%
<b>Total residential</b>	<b>30</b>	<b>9</b>	<b>4</b>	<b>-</b>	<b>6</b>	<b>231%</b>

  

	<b>2013</b>					
	<b>Number of Disposals</b>	<b>Balance outstanding at repossession date €m</b>	<b>Gross sales proceeds €m</b>	<b>Costs to sell €m</b>	<b>Loss on sale<sup>(1)</sup> €m</b>	<b>Average LTV at sale Price %</b>
Owner-occupier	17	5	3	-	3	200%
Buy-to-let	20	6	2	-	4	295%
<b>Total residential</b>	<b>37</b>	<b>11</b>	<b>5</b>	<b>-</b>	<b>7</b>	<b>245%</b>

<sup>(1)</sup>Before specific impairment provisions.

The figures in the tables above do not cross total due to rounding.

Losses on the sale of properties in possession are recognised in the Income Statement as part of the specific provision charge.

\* Forms an integral part of the audited financial statements.

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Loan-to-value (LTV) (index linked) information**

The property values used in the completion of the following loan-to-value tables are determined with reference to the original or most recent valuation, indexed to the Central Statistics Office ("CSO") Residential Property Price Index for November 2014. The CSO Residential Property Price Index for November 2014 reported that national residential property prices were 38% lower than their highest level in early 2007 and reported an annual rise in residential property prices of 16% in the year to 30 November 2014.

**Actual and average LTV across mortgage portfolios\***

The following tables profile the residential mortgage portfolio by the indexed loan-to-value ('LTV') ratios and the weighted average indexed LTV ratios at 31 December 2014 and 31 December 2013:

			2014
	Owner – Occupier €m	Buy-to-Let €m	Total €m
Less than 50%	3,505	717	4,222
50% - 70%	3,492	779	4,271
71% - 80%	1,874	465	2,339
81% - 90%	1,897	499	2,396
91% - 100%	1,382	492	1,874
101% - 120%	2,120	967	3,087
121% - 150%	1,592	975	2,567
Greater than 150%	289	738	1,027
Unsecured (Zero Collateral)	22	66	88
<b>Total</b>	<b>16,173</b>	<b>5,698</b>	<b>21,871</b>
Weighted average indexed LTV <sup>(1)</sup>			
Stock of residential mortgages at year end	78%	102%	84%
New residential mortgages during year	69%	55%	69%
Impaired mortgages	101%	125%	115%

  

			2013
	Owner – Occupier €m	Buy-to-Let €m	Total €m
Less than 50%	2,675	529	3,204
50% - 70%	2,517	591	3,108
71% - 80%	1,749	395	2,144
81% - 90%	1,577	438	2,015
91% - 100%	1,542	468	2,010
101% - 120%	2,702	1,009	3,711
121% - 150%	2,590	1,402	3,992
Greater than 150%	1,354	1,555	2,909
<b>Total</b>	<b>16,706</b>	<b>6,387</b>	<b>23,093</b>
Weighted average indexed LTV <sup>(1)</sup>			
Stock of residential mortgages at year end	91%	119%	99%
New residential mortgages during year	72%	62%	71%
Impaired mortgages	118%	142%	132%

<sup>(1)</sup>Weighted average indexed LTV's are the individual indexed LTV calculations weighted by the mortgage balance against each property.

The weighted average indexed loan-to-value for the total residential mortgage book was 84% at 31 December 2014 compared to 99% at 31 December 2013, with the reduction driven primarily by the increase in property prices in 2014, coupled with amortisation of the loan book.

\*Forms an integral part of the audited financial statements.

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Actual and average LTV across mortgage portfolios (continued)****Neither past due nor impaired\***

The following tables profile the residential mortgage portfolio that was neither past due nor impaired by the indexed loan to value ratios at 31 December 2014 and 31 December 2013.

			2014
	Owner – Occupier	Buy-to-Let	Total
	€m	€m	€m
Less than 50%	3,191	570	3,761
50% - 70%	3,144	560	3,704
71% - 80%	1,666	300	1,966
81% - 90%	1,664	293	1,957
91% - 100%	1,193	259	1,452
101% - 120%	1,698	406	2,104
121% - 150%	1,134	249	1,383
Greater than 150%	120	122	242
Unsecured (Zero Collateral)	4	4	8
<b>Total</b>	<b>13,814</b>	<b>2,763</b>	<b>16,577</b>

			2013
	Owner – Occupier	Buy-to-Let	Total
	€m	€m	€m
Less than 50%	2,422	411	2,833
50% - 70%	2,250	436	2,686
71% - 80%	1,562	264	1,826
81% - 90%	1,380	284	1,664
91% - 100%	1,345	282	1,627
101% - 120%	2,265	503	2,768
121% - 150%	1,991	521	2,512
Greater than 150%	845	300	1,145
<b>Total</b>	<b>14,060</b>	<b>3,001</b>	<b>17,061</b>

**Past due but not impaired\***

The following tables profile the residential mortgage portfolio that was past due but not impaired at 31 December 2014 and 31 December 2013.

			2014
	Owner – Occupier	Buy-to-Let	Total
	€m	€m	€m
Less than 50%	138	41	179
50% - 70%	107	38	145
71% - 80%	51	23	74
81% - 90%	41	23	64
91% - 100%	32	23	55
101% - 120%	60	38	98
121% - 150%	37	35	72
Greater than 150%	7	22	29
Unsecured (Zero Collateral)	-	-	-
<b>Total</b>	<b>473</b>	<b>243</b>	<b>716</b>

			2013
	Owner – Occupier	Buy-to-Let	Total
	€m	€m	€m
Less than 50%	127	29	156
50% - 70%	112	31	143
71% - 80%	61	20	81
81% - 90%	59	19	78
91% - 100%	46	26	72
101% - 120%	87	46	133
121% - 150%	91	56	147
Greater than 150%	44	55	99
<b>Total</b>	<b>627</b>	<b>282</b>	<b>909</b>

\*Forms an integral part of the audited financial statements.

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Actual and average LTV across mortgage portfolios (continued)****Past due but not impaired (continued)**

Of the residential mortgages that were past due but not impaired at 31 December 2014, 22% of owner-occupier and 39% of buy-to-let mortgages were in negative equity (31 December 2013: 35% and 56% respectively). In terms of the total portfolio that was past due but not impaired, 28% was in negative equity at 31 December 2014 (31 December 2013: 42%).

**Greater than 90 days past due and/or impaired\***

The following tables profile the residential mortgage portfolio that was greater than 90 days past due and/or impaired by the indexed LTV ratios at 31 December 2014 and 31 December 2013.

			2014
	Owner – Occupier €m	Buy-to-Let €m	Total €m
Less than 50%	250	127	377
50% - 70%	294	197	491
71% - 80%	181	152	333
81% - 90%	204	193	397
91% - 100%	167	218	385
101% -120%	377	537	914
121% - 150%	430	710	1,140
Greater than 150%	165	607	772
Unsecured (Zero Collateral)	17	62	79
<b>Total</b>	<b>2,085</b>	<b>2,803</b>	<b>4,888</b>

  

			2013
	Owner – Occupier €m	Buy-to-Let €m	Total €m
Less than 50%	180	104	284
50% - 70%	205	138	343
71% - 80%	145	119	264
81% - 90%	160	144	304
91% - 100%	161	169	330
101% -120%	372	476	848
121% - 150%	528	849	1,377
Greater than 150%	477	1,231	1,708
<b>Total</b>	<b>2,228</b>	<b>3,230</b>	<b>5,458</b>

The proportion of residential mortgages that were greater than 90 days past due and/or impaired and in negative equity at 31 December 2014 (59%) decreased in comparison to 31 December 2013 (72%), reflecting the increases in residential property prices in the period.

**Residential Mortgages by year of origination\***

The following tables profile the residential mortgage portfolio and impaired residential mortgage portfolio at 31 December 2014 and 2013 by year of origination.

			2014	
	Number	Balance €m	Number	Balance €m
1996 and before	2,011	27	251	6
1997	1,003	19	118	3
1998	1,405	42	213	9
1999	1,933	79	258	17
2000	2,904	132	374	27
2001	3,249	181	365	28
2002	5,500	413	706	75
2003	8,587	817	1,261	169
2004	11,637	1,372	1,982	328
2005	15,748	2,179	3,112	609
2006	20,254	3,498	4,682	1,089
2007	18,973	3,479	4,105	1,048
2008	17,993	3,278	3,070	800
2009	12,344	2,045	1,270	284
2010	7,698	1,217	306	69
2011	3,569	549	74	13
2012	6,368	1,002	20	3
2013	4,959	792	4	1
2014	5,471	750	-	-
<b>Total</b>	<b>151,606</b>	<b>21,871</b>	<b>22,171</b>	<b>4,578</b>

\*Forms an integral part of the audited financial statements.

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Residential Mortgages by year of origination (continued)\***

	Mortgage portfolio		Impaired mortgage portfolio	
	Number	Balance € m	Number	Balance € m
1996 and before	2,604	38	296	7
1997	1,113	25	137	4
1998	1,595	57	232	11
1999	2,447	97	301	20
2000	3,145	156	401	32
2001	3,489	211	394	33
2002	5,891	478	752	87
2003	9,104	930	1,340	196
2004	12,498	1,529	2,048	363
2005	16,427	2,413	3,237	682
2006	20,838	3,824	4,786	1,234
2007	19,539	3,781	4,222	1,163
2008	18,476	3,581	3,109	908
2009	12,895	2,215	1,190	296
2010	7,919	1,295	288	72
2011	3,703	593	68	14
2012	6,536	1,064	10	1
2013	5,045	806	-	-
Total	153,264	23,093	22,811	5,123

The majority (€12.4bn or 57%) of the €21.9bn residential mortgage portfolio originated between 2005 and 2008, of which, 28.5% (€3.5bn) was impaired at 31 December 2014.

**Further information on credit risk**

Further information on credit risk can be found in the notes to the financial statements:

- Provisions for impairment of loans and receivables (*note 5*);
- Derivative financial instruments (*note 7*);
- Loans and receivables to banks (*note 8*); and
- Loans and receivables to customers (*note 9*).

\*Forms an integral part of the audited financial statements.



## RISK MANAGEMENT REPORT (CONTINUED)

### 3.2 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.

#### Funding and Liquidity

The funding and liquidity policy as approved by the Board of Directors of the Bank sets out the forms of funding which can be used by the Bank to meet its liquidity requirements. It also sets out the outsourcing arrangements which have been established with AIB to source and manage the funding and liquidity requirements. The policy also specifies reporting requirements with respect to funding and liquidity management.

#### Funding

The Bank is authorised to fund the assets it holds through the following forms of funding:

- (a) the issuance of Mortgage Covered Securities in accordance with the ACS Acts;
- (b) borrowing funds from Allied Irish Banks, p.l.c.;
- (c) borrowing from the Central Bank under a Mortgage-Backed Promissory Note (short term) facility ("MBPN Facility") and other funding from the Central Bank under facilities which may be available to the Bank from time to time;
- (d) wholesale and corporate market deposit taking; and
- (e) capital funding to ensure at a minimum compliance with the capital adequacy requirements of the Single Supervisory Mechanism ("SSM").

The MBPN Facility is secured by a floating charge over a pool of the Bank's home loans and related security which is separate to the Pool (that secures the Mortgage Covered Securities) maintained by the Issuer in accordance with the ACS Acts.

#### Liquidity

The primary liquidity requirements of the Bank are to have sufficient funds available at an economic price to meet its commitments to pay interest and principal to holders of the Bank's Mortgage Covered Securities, to repay any short term borrowings under the MBPN Facility and to lend to mortgage customers in accordance with outstanding offer letters. It is the Bank's policy to ensure that resources are available at all times to meet its obligations.

The SSM requires credit institutions to comply with a cash flow maturity mismatch approach for the management of their liquidity. This involves credit institutions analysing their cash flows on a consolidated basis under various headings and placing them in pre-determined time bands depending on when the cash is received or paid out. Limits are imposed on the first (0-8 days) and the second (8-31 days) time bands and monitoring ratios will be calculated for subsequent time bands.

On a day-to-day basis, the Bank meets its residual funding requirements through borrowing facilities in place with AIB and with the Central Bank of Ireland. The table on page 33 analyses the liabilities into relevant maturity groupings based on the remaining period at the reporting date to contractual maturity date.

In accordance with the Capital Requirements Regulation, the Bank has appointed AIB as its liquidity manager to fulfil daily cash flow management, oversee any changes required in liquidity management or reporting and manage the Bank's liquidity risk as part of the overall AIB liquidity risk management process. The means by which these liquidity management activities are performed, and the procedures by which AIB ensures the Bank complies with the AIB Group Liquidity Policy are managed through an Outsourcing and Agency Agreement.

\*Forms an integral part of the audited financial statements.

**RISK MANAGEMENT REPORT (CONTINUED)****3.2 Liquidity risk (continued)****Financial liabilities by contractual maturity\***

	<b>2014</b>					
	<b>Repayable on demand €m</b>	<b>3 months or less but not repayable on demand €m</b>	<b>1 year or less but over 3 months €m</b>	<b>5 years or less but over 1 year €m</b>	<b>Over 5 years €m</b>	<b>Total €m</b>
Deposits by Banks	12,966	1,000	-	-	-	13,966
Customer accounts	1	-	-	-	-	1
Derivative financial instruments	-	-	-	-	1	1
Debt securities in issue	-	-	500	3,473	1,209	5,182
Subordinated liabilities	-	-	-	-	300	300
Other liabilities	2	-	66	-	-	68
<b>Total</b>	<b>12,969</b>	<b>1,000</b>	<b>566</b>	<b>2,973</b>	<b>2,010</b>	<b>19,518</b>
Commitments	-	-	349	-	-	349

  

	<b>2013</b>					
	<b>Repayable on demand €m</b>	<b>3 months or less but not repayable on demand €m</b>	<b>1 year or less but over 3 months €m</b>	<b>5 years or less but over 1 year €m</b>	<b>Over 5 years €m</b>	<b>Total €m</b>
Deposits by Banks	15,783	1,100	-	-	-	16,883
Customer accounts	1	-	-	-	-	1
Derivative financial instruments	-	-	-	-	3	3
Debt securities in issue	-	-	-	3,419	103	3,522
Subordinated liabilities	-	-	-	-	300	300
Other liabilities	3	-	54	-	-	57
<b>Total</b>	<b>15,787</b>	<b>1,100</b>	<b>54</b>	<b>3,419</b>	<b>406</b>	<b>20,766</b>
Commitments	-	-	221	-	-	221

\*Forms an integral part of the audited financial statements.

## RISK MANAGEMENT REPORT (CONTINUED)

### 3.3 Operational risk\*

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes legal risk, information technology risk, business continuity risk, outsourcing risk, health and safety risk and legal risk. It does not include strategic and business risk. As such, operational risk covers a broad range of potential sources of financial loss which the Bank and the Group actively seek to mitigate against.

The key people, systems and processes supporting the Bank are provided by the Group and this relationship is governed by an outsourcing and agency agreement. The Group operational risk framework applies across all areas of the Group including AIB Mortgage Bank and the Group Operational Risk function is responsible for overseeing the management of operational risk across the Group. A key focus of operational risk management in AIB Mortgage Bank is the oversight of outsourced service activities, in particular activities related to the requirements of the ACS Act, as well as the end-to-end mortgage origination and servicing processes.

AIB Mortgage Bank undertakes an operational risk self-assessment which focuses on activities specific to the Bank, e.g. the Bank's funding activities and its compliance with the ACS Act. This process includes periodic assessments of relevant 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.

### 3.4 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.

### 3.5 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.

The Bank is exposed to interest rate risk arising from mortgage lending activities and the issuance of Mortgage Covered Securities. Interest rate swaps, as explained in the paragraphs below, are used to manage this exposure.

After taking account of the effect of interest rate swaps, the Bank's remaining interest rate exposure arises mainly from tracker interest rate mortgage loans, where the interest rate is based on the ECB Refinancing Rate, whereas the related funding cost is based on Euribor rates.

Interest rate risk arising from the issuance of fixed-rate Mortgage Covered Securities is managed through interest rate swaps with Allied Irish Banks, p.l.c. which have the effect of transforming fixed-rate liability risk into floating-rate risk.

The interest rate exposure of the Bank relating to its Irish residential lending is managed using two macro interest rate swaps with Allied Irish Banks, p.l.c. one of which, the Pool Hedge, relates only to the Pool and Mortgage Covered Securities issued by the Bank and the other of which (the Non-Pool Hedge) relates only to Irish residential loans which are not included in the Pool. This split is required by the Asset Covered Securities Acts.

The Pool Hedge and the Non-Pool Hedge contracts entail the monthly payment of the average customer rate on these mortgages and in return, the receipt of 1 month Euribor plus the current margin being achieved on the mortgage portfolio. The contract is reset each month to reflect the outstanding mortgage balances at that time and to reflect updated customer rates, Euribor and margin levels. Settlements are made between the Bank and Allied Irish Banks, p.l.c. to reflect the net amount payable/receivable in each month. AIB and the Bank amended the Pool and the Non-Pool Hedge structure in December 2013 to include a one-sided free option for the AIB Mortgage Bank to terminate the swaps without cost on any reset date.

Interest rate swaps are used solely for risk management and not trading purposes.

The total nominal values of the swaps are set out in note 7 to the financial statements.

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.

\*Forms an integral part of the audited financial statements.

**RISK MANAGEMENT REPORT (CONTINUED)****3.5 Non-trading interest rate risk\* (continued)****Interest Rate Sensitivity\***

The net interest rate sensitivity of AIB Mortgage Bank at 31 December 2014 is illustrated in the following table;

	0 1mth	1 3mths	3 12mths	1 2yrs	2 3yrs	3 4yrs	4 5yrs	5yrs+	Rate Insensitive	Total
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
<b>Assets</b>										
Loans and receivables to customers	20,246	158	722	382	141	39	67	116	(1,951)	19,920
Loans and receivables to bank	469	-	-	-	-	-	-	-	-	469
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	329	329
Other assets	-	-	-	-	-	-	-	-	204	204
<b>Total Assets</b>	<b>20,715</b>	<b>158</b>	<b>722</b>	<b>382</b>	<b>141</b>	<b>39</b>	<b>67</b>	<b>116</b>	<b>(1,418)</b>	<b>20,922</b>
<b>Liabilities</b>										
Deposits by banks	13,966	-	-	-	-	-	-	-	-	13,966
Customer accounts	1	-	-	-	-	-	-	-	-	1
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	1	1
Debt issued	1,150	-	500	500	1,675	500	65	525	267	5,182
Subordinated liabilities	300	-	-	-	-	-	-	-	-	300
Other liabilities	-	-	-	-	-	-	-	-	68	68
Shareholders' equity	-	-	-	-	-	-	-	-	1,404	1,404
<b>Total Liabilities</b>	<b>15,417</b>	<b>-</b>	<b>500</b>	<b>500</b>	<b>1,675</b>	<b>500</b>	<b>65</b>	<b>525</b>	<b>1,740</b>	<b>20,922</b>
<b>Derivatives financial instruments (interest rate swaps)</b>										
Floating rate interest receivable	(22,258)	-	-	-	-	-	-	-	-	(22,258)
Floating rate interest payable	20,633	158	722	382	141	39	67	116	-	22,258
Floating rate interest payable	3,765	-	-	-	-	-	-	-	-	3,765
Fixed rate interest receivable	-	-	(500)	(500)	(1,675)	(500)	(65)	(525)	-	(3,765)
<b>Total derivatives</b>	<b>2,140</b>	<b>158</b>	<b>222</b>	<b>(118)</b>	<b>(1,534)</b>	<b>(461)</b>	<b>2</b>	<b>(409)</b>	<b>-</b>	<b>-</b>
<b>Interest sensitivity gap</b>	<b>3,158</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(3,158)</b>	
<b>Cumulative interest sensitivity gap</b>	<b>3,158</b>	<b>3,158</b>	<b>3,158</b>	<b>3,158</b>	<b>3,158</b>	<b>3,158</b>	<b>3,158</b>	<b>3,158</b>	<b>-</b>	

The impact on net interest income over a twelve month period of a 100 basis point ("bp") downward/ upward movement in interest rates on 31 December 2014 would be circa €205k/ €36k respectively.

\*Forms an integral part of the audited financial statements.

**RISK MANAGEMENT REPORT (CONTINUED)****3.5 Non-trading interest rate risk\* (continued)****Interest Rate Sensitivity\* (continued)**

Interest Rate Sensitivity analysis for the Bank at 31 December 2013 is as follows:

	0 1mth	1 3mths	3 12mths	1 2yrs	2 3yrs	3 4yrs	4 5yrs	5yrs+	Rate Insensitive	Total
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
<b>Assets</b>										
Loans and receivables to customers	21,280	296	593	479	321	36	38	50	(2,301)	20,792
Loans and receivables to bank	463	-	-	-	-	-	-	-	-	463
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	310	310
Other assets	-	-	-	-	-	-	-	-	241	241
<b>Total Assets</b>	<b>21,743</b>	<b>296</b>	<b>593</b>	<b>479</b>	<b>321</b>	<b>36</b>	<b>38</b>	<b>50</b>	<b>(1,750)</b>	<b>21,806</b>
<b>Liabilities</b>										
Deposits by banks	16,883	-	-	-	-	-	-	-	-	16,883
Customer accounts	1	-	-	-	-	-	-	-	-	1
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	3	3
Debt issued	-	-	-	500	500	1,675	500	90	257	3,522
Subordinated liabilities	300	-	-	-	-	-	-	-	-	300
Other liabilities	-	-	-	-	-	-	-	-	57	57
Shareholders' equity	-	-	-	-	-	-	-	-	1,040	1,040
<b>Total Liabilities</b>	<b>17,184</b>	<b>-</b>	<b>-</b>	<b>500</b>	<b>500</b>	<b>1,675</b>	<b>500</b>	<b>90</b>	<b>1,357</b>	<b>21,806</b>
<b>Derivatives financial instruments</b> (interest rate swaps)										
Floating rate interest receivable	(23,337)	-	-	-	-	-	-	-	-	(23,337)
Floating rate interest payable	21,524	296	593	479	321	36	38	50	-	23,337
Floating rate interest payable	3,265	-	-	-	-	-	-	-	-	3,265
Fixed rate interest receivable	-	-	-	(500)	(500)	(1,675)	(500)	(90)	-	(3,265)
<b>Total derivatives</b>	<b>1,452</b>	<b>296</b>	<b>593</b>	<b>(21)</b>	<b>(179)</b>	<b>(1,639)</b>	<b>(462)</b>	<b>(40)</b>	<b>-</b>	<b>-</b>
Interest sensitivity gap	3,108	-	-	-	-	-	-	-	(3,108)	-
Cumulative interest sensitivity gap	3,108	3,108	3,108	3,108	3,108	3,108	3,108	3,108	-	-

The impact on net interest income over a twelve month period of a 100 basis point ("bp") downward/ upward movement in interest rates on 31 December 2013 would be circa €369k/ €395k respectively.

\*Forms an integral part of the audited financial statements.

## **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF AIB MORTGAGE BANK**

We have audited the financial statements of AIB Mortgage Bank (the "Company") for the year ended 31 December 2014 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows, the Statement of Changes in Shareholders' Equity and the related notes. The financial reporting framework that has been applied in their preparation is Irish law and International Financial Reporting Standards (IFRS) as adopted by the European Union.

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 auditors' 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 auditors**

As explained more fully in the Statement of Directors' responsibilities set out on page 8, the Directors are responsible for the preparation of the financial statements giving a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with Irish law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Director's Report and Financial Statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### **Opinion on financial statements**

In our opinion the financial statements:

- give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the affairs of the company as at 31 December 2014 and of the profit for the year then ended; and
- have been properly prepared in accordance with the Companies Acts 1963 to 2013.

### **Matters on which we are required to report by the Companies Acts 1963 to 2013**

- 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 Company.
- The financial statements are 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 company, as stated in the Statement of Financial Position 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 2014 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 company.

### **Matters on which we are required to report by exception**

We have nothing to report in respect of the provisions in the Companies Acts 1963 to 2013 which require us to report to you if, in our opinion the disclosures of directors' remuneration and transactions specified by law are not made.

**John McCarroll**  
**For and on behalf of Deloitte & Touche**  
**Chartered Accountants and Statutory Audit Firm**  
**Hardwicke House**  
**Hatch Street**  
**Dublin 2**

**18 March 2015**

**ACCOUNTING POLICIES\***

- |           |   |
|-----------|---|
| <b>1</b>  | Reporting entity                        |
| <b>2</b>  | Statement of compliance                 |
| <b>3</b>  | Basis of preparation                    |
| <b>4</b>  | Interest income and expense recognition |
| <b>5</b>  | Net trading income                      |
| <b>6</b>  | Financial assets                        |
| <b>7</b>  | Financial liabilities                   |
| <b>8</b>  | Derivatives and hedge accounting        |
| <b>9</b>  | Impairment of financial assets          |
| <b>10</b> | Non-credit risk provisions              |
| <b>11</b> | Income tax, including deferred tax      |
| <b>12</b> | Cash and cash equivalents               |
| <b>13</b> | Shareholders' equity                    |
| <b>14</b> | Contingent liabilities                  |
| <b>15</b> | Prospective accounting changes          |

\*Forms an integral part of the audited financial statements.

## ACCOUNTING POLICIES

The accounting policies applied in the preparation of the financial statements for the year ended 31 December 2014 are set out below.

### 1. Reporting entity

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 2001 and 2007. It is a wholly owned subsidiary of Allied Irish Banks, p.l.c. and is regulated by the SSM. 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 AIB Group or third parties.

### 2. Statement of compliance

The financial statements have been prepared in accordance with International Accounting Standards and International Financial Reporting Standards (collectively "IFRSs") as issued by the International Accounting Standards Board ("IASB") and International Financial Reporting Standards as adopted by the European Union ("EU") and applicable for the year ended 31 December 2014. The accounting policies have been consistently applied by the bank and are consistent with the previous year, unless otherwise described. The financial statements also comply with the Companies Acts 1963 to 2013 and the European Communities (Credit Institutions: Accounts) Regulations, 1992 (as amended) and the Asset Covered Securities Acts 2001 and 2007.

### 3. Basis of preparation

#### Functional and presentation currency

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

#### Basis of measurement

The financial statements 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, certain hedged financial assets and financial liabilities.

The financial statements comprise the income statement, the statement of comprehensive income, the statement of financial position, the statement of cash flows, and the statement of changes in shareholders' equity together with the related notes. These notes also include financial instrument related disclosures which are required by IFRS 7 and revised IAS 1, contained in the Risk Management section of the annual financial statements. The relevant information on those pages is identified as forming an integral part of the audited financial statements.

#### Use of estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of 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 the circumstances. Since management's judgement involves making estimates concerning the likelihood of future events, the actual results could differ from those estimates. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The estimates that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are in the areas of loan impairment and impairment of other financial instruments; the recoverability of deferred tax and determination of the fair value of certain financial assets and liabilities. In addition, the designation of financial assets and financial liabilities has a significant impact on their income statement treatment and could have a significant impact on reported income. A description of these estimates and judgements is set out in section 16 of the accounting policies.

#### Going concern

The financial statements for the year ended 31 December 2014 have been prepared on a going concern basis as the Directors are satisfied, having considered the risks and uncertainties impacting the Bank, that it has the ability to continue in business for the period of assessment.

AIB Mortgage Bank is dependent on its Parent, Allied Irish Banks, p.l.c for continued funding and is therefore dependent on the going concern status of the Parent.

The financial statements of Allied Irish Bank p.l.c for the year ended 31 December 2014 have been prepared on a going concern basis as the Directors of AIB Group are satisfied, having considered the risks and uncertainties impacting the AIB Group, that it has the ability to continue in business for the period of assessment. The period of assessment used by the AIB Group Directors is twelve months from the date of approval of its annual financial statements.



## ACCOUNTING POLICIES (continued)

### 3. Basis of preparation (continued)

#### Going concern (continued)

In making its assessment, the AIB Group Directors have considered a wide range of information relating to present and future conditions. These have included: financial plans approved in December 2014 covering the period 2015 to 2017; the Restructuring Plan approved by the European Commission in May 2014; liquidity and funding forecasts, and capital resources projections; and the results of the Comprehensive Assessment stress testing conducted by the ECB. There have all been prepared under base and stress scenarios having considered the outlook for the Irish, the eurozone and UK economies. In addition, the AIB Group Directors have considered the commitment of support provided to AIB by the Irish Government.

The AIB Group Directors have also considered the principal risks and uncertainties which could materially affect the AIB Group's future business performance and profitability.

The AIB Group Directors believe that the capital resources are sufficient to ensure that the AIB Group is adequately capitalised both in a base and stress scenario.

In relation to liquidity and funding, the AIB Group Directors are satisfied, based on AIB's position in the market place, that in all reasonable circumstances required liquidity and funding from the Central Bank of Ireland/ECB would be available to the AIB Group during the period of assessment.

#### Conclusion

On the basis of the continued availability of funding from Allied Irish Banks, p.l.c to AIB Mortgage Bank, the Directors of the Bank believe that it is appropriate to prepare the financial statements on a going concern basis having concluded that there are no material uncertainties related to events or conditions that may cast significant doubt on its ability to continue as a going concern over the period of assessment.

#### Adoption of new accounting standards

The following standards/amendments to standards have been adopted by AIB Group and the Bank during the year ended 31 December 2014. The impact of these amendments on the financial statements is set out in the notes to the accounts.

##### *Amendments to IAS 32 Financial Instruments: Presentation on Offsetting Financial Assets and Financial Liabilities*

These amendments are effective from 1 January 2014. The amendments clarify that the right of set-off must be currently available and legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy.

##### *Amendments to IAS 39 Financial Instruments: Recognition and Measurement on Novation of Derivatives and Continuation of Hedge Accounting*

These amendments, which are effective from 1 January 2014, provide an exception to the requirement to discontinue hedge accounting where a hedging derivative is novated, provided certain criteria are met.

#### Changes to accounting policies

Arising from the adoption of the IFRSs set out above, the following accounting policy was revised effective from 1 January 2014:

– Derivatives and hedge accounting (Accounting Policy number 8).

This change to accounting policy has had no material effect on the financial statements.

## ACCOUNTING POLICIES (continued)

### 4. 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 financial assets or financial 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 estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability. The application of the method has the effect of recognising income receivable and expense payable on the instrument evenly in proportion to the amount outstanding over the period to maturity or repayment.

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 any expected early redemption, and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts.

All costs associated with mortgage incentive schemes are included in the effective interest rate calculation.

Interest income and expense presented in the income statement includes:

- Interest on financial assets and financial liabilities at amortised cost on an effective interest method; and
- Net interest income and expense on qualifying hedge derivatives designated as cash flow hedges or fair value hedges which are recognised in interest income or interest expense.

### 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 in 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 and receivables are initially recognised at fair value adjusted for direct and incremental transaction costs and are subsequently carried on an amortised cost basis.

### 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 with 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.

The Bank derecognises a financial liability when its contractual obligation is discharged, cancelled or expired. Any gain or loss on the extinguishment or re-measurement of a financial liability is recognised in profit or loss.

## ACCOUNTING POLICIES (continued)

### 8. Derivatives and hedge accounting

Derivatives, such as interest rate swaps are used 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 from valuation techniques using discounted cash flow models and option 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 an asset and liability on a net basis.

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.

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.

#### Hedging

All derivatives are carried at fair value 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 where transactions meet the criteria specified in IAS 39 'Financial Instruments: Recognition and Measurement', 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 values or cash flows of the hedged items.

The Bank discontinues hedge accounting when:

- it is determined that a derivative is not, or has ceased to be, highly effective as a hedge;
- the derivative expires, or is sold, terminated, or exercised;
- the hedged 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 hedging 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 in the fair value of these derivative instruments 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.

## ACCOUNTING POLICIES (continued)

### 9. Impairment of financial assets

It is the Bank's policy to make provisions for impairment of financial assets to reflect the losses inherent in those assets at the reporting date.

#### Impairment

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired. 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 reporting 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 issuer or 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;
- e) the disappearance of an active market for that financial asset because of financial difficulties; or
- f) 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.

#### Incurred but not reported

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.

#### Collective evaluation of impairment

For the purpose of collective evaluation of impairment (individually insignificant impaired assets and IBNR), financial assets are grouped on the basis of similar risk characteristics. These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and the historical loss experience for assets with credit risk characteristics similar to those in group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

The methodology and assumption used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

#### Impairment loss

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 is included in the income statement.

Following impairment, interest income is recognised using the original effective rate of interest which was used to discount the future cash flows for the purpose of measuring the impairment loss. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

When a loan has been subjected to a specific provision and the prospects of recovery do not improve, a time will come when it may be concluded that there is no real prospect of recovery. When this point is reached, the amount of the loan which is considered to be beyond the prospect of recovery 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.

## ACCOUNTING POLICIES (continued)

### 9. Impairment of financial assets (continued)

#### Collateralised financial assets – Repossessions

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure, costs for obtaining and settling the collateral, and whether or not foreclosure is probable. For loans which are impaired, the Bank may repossess collateral previously pledged as security in order to achieve an orderly realisation of the loan. The Bank will then offer this repossessed collateral for sale. However, if the Bank believes the proceeds of the sale will comprise only part of the recoverable amount of the loan with the customer remaining liable for any outstanding balance, the loan continues to be recognised and the repossessed asset is not recognised. However, if the Bank believes that the sale proceeds of the asset will comprise all, or substantially all, of the recoverable amount of the loan, the loan is derecognised and the acquired asset is accounted for in accordance with the applicable accounting standard. Any further impairment of the repossessed asset is treated as an impairment of the relevant asset and not as an impairment of the original loan.

#### Past due loans

When a borrower fails to make a contractually due payment, a loan is deemed to be past due. 'Past due days', is the term used to describe the cumulative numbers of days that a missed payment is overdue. Past due days commence from the close of business on the day on which a payment is due but not received.

When a borrower is past due, the entire exposure is reported as past due, rather than the amount of any excess or arrears.

#### Loans renegotiated and forbearance

From time to time, the Bank will modify the original terms of a customer's loan either as part of the on-going relationship with the customer or arising from changes in the customer's circumstances such when that customer is unable to make the agreed original contractual repayments.

#### Forbearance

A forbearance agreement is entered into where the customer is in financial difficulty to the extent that they are unable to repay both the principal and interest on their loan in accordance with their original contract. Following an assessment of the customer's repayment capacity, a potential solution will be determined from the options available. There are a number of different types of forbearance options including interest and/or arrears capitalisation, interest rate adjustments, payment holidays, term extensions and split loans. These are detailed in the Credit Risk section 3.1. A request for a forbearance solution acts as a trigger for an impairment test. All loans that are assessed for a forbearance solution are tested for impairment under IAS 39 and where a loan is deemed impaired, an appropriate provision is raised to cover the difference between the loan's carrying value and the present value of estimated future cash flows discounted at the loan's original effective interest rate. Where, having assessed the loan for impairment and the loan is not deemed to be impaired, it is included within the collective assessment as part of the IBNR provision calculation.

Forbearance mortgage loans, classified as impaired, may be upgraded from impaired status, subject to a satisfactory assessment by the appropriate credit authority as to the borrower's continuing ability and willingness to repay and confirmation that the relevant security held by the Bank continues to be enforceable. In this regard, the borrower is required to display a satisfactory performance following the restructuring of the loan in accordance with new agreed terms, comprising typically, a period of twelve months of consecutive payments of full principal and interest and, the upgrade would initially be to Watch/Vulnerable grades. Where upgraded out of impaired, loans are included in the Bank's collective assessment for IBNR provisions.

Where the terms on a renegotiated loan which has been subject to an impairment provision differ substantially from the original loan terms either in a quantitative or qualitative analysis, the original loan is derecognised and a new loan is recognised at fair value. Any difference between the carrying amount of the loan and the fair value of the new renegotiated loan terms is recognised in the Income Statement. Interest accrues on the new loan based on the current market rates in place at the time of renegotiation.

#### Non-forbearance renegotiation

Occasionally, the Bank may temporarily amend the contractual repayments terms on a loan (e.g. payment moratorium) for a short period of time due to a temporary change in the life circumstances of the borrower. Because such events are not directly linked to repayment capacity, these amendments are not considered forbearance. The changes in expected cash flows are accounted for under IAS 39 paragraph AG8 i.e. the carrying amount of the loan is adjusted to reflect the revised estimated cash flows which are discounted at the original effective interest rate. Any adjustment to the carrying amount of the loan is reflected in the income statement.

However, where the terms on a renegotiated loan differ substantially from the original loan terms either in a quantitative or qualitative analysis, the original loan is derecognised and a new loan is recognised at fair value. Any difference arising between the derecognised loan and the new loan is recognised in the income statement.

Where a customer's request for a modification to the original loan agreement is deemed not to be a forbearance request (i.e. the customer is not in financial difficulty to the extent that they are unable to repay both the principal and interest), these loans are not disaggregated for monitoring/reporting or IBNR assessment purposes.

## ACCOUNTING POLICIES (continued)

### 10. 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.

When the effect is material, provisions are determined by discounting expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Payments are deducted from the present value of the provision, and interest at the relevant discount rate, is charged annually to interest expense using the effective interest method. Changes in the present value of the liability as a result of movements in interest rates are included in other income. The present value of provisions is included in other liabilities.

### 11. Income tax, including deferred tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income, in which case it is recognised in other comprehensive income. Income tax relating to items in equity is recognised directly in equity.

Current tax is the expected tax payable on the taxable income for the year using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous years.

Deferred income tax is provided, using the financial statement liability method, on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax is determined using tax rates based on legislation enacted or substantively enacted at the reporting date and expected to apply when the deferred tax asset is realised or the deferred tax liability is settled. Deferred income tax assets are recognised when it is probable that future taxable profits will be available against which the temporary differences will be utilised. The deferred tax asset is reviewed at the end of each reporting period and the carrying amount will reflect the extent that sufficient taxable profits will be available to allow the asset to be recovered.

The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle the current tax assets and liabilities on a net basis or to realise the asset and settle the liability simultaneously.

The principal temporary differences arise from the revaluation of certain financial assets and financial liabilities including derivative contracts.

### 12. Cash and cash equivalents

For the purposes of the cash flow statements, cash comprises cash on hand and cash equivalents comprise highly liquid investments that are convertible into cash with an insignificant risk of changes in value and with a maturity of less than three months from the date of acquisition.

### 13. Shareholder's Equity

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.

#### *Share capital*

Share capital represents funds raised by issuing shares in return for cash or other consideration. Share capital comprises ordinary shares.

#### *Dividends and distributions*

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's shareholders or in the case of the interim dividend when it has been approved for payment by the Board of Directors.

#### *Capital reserves*

Capital reserves represent transfers from retained earnings in accordance with relevant legislation.

#### *Revenue reserves*

Revenue reserves represent retained earnings of the Bank.

### 14. Contingent liabilities

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.

**ACCOUNTING POLICIES (continued)****15. Prospective accounting changes**

The following new accounting standards and amendments to existing standards approved by the IASB, but not early adopted by the Bank, will impact the Bank's financial reporting in future periods. The Bank is currently considering the impacts of these amendments. The new accounting standards and amendments which are more relevant to the Bank are detailed below.

**(a) Amendments to IAS 1 Presentation of Financial Statements: Disclosure Initiative***Nature of Change*

The amendments to IAS 1 are designed to further encourage companies to apply professional judgement in determining what information to disclose in the financial statements. Furthermore, the amendments clarify that companies should use professional judgement in determining where and in what order information is presented in the financial disclosures.

These amendments are not expected to have a significant impact on AIB Group. The amendments are subject to EU endorsement.

*IASB Effective Date*

Annual periods beginning on or after 1 January 2016.

**(b) Annual improvements to IFRSs 2012–2014 cycle***Nature of Change*

The IASB's annual improvements project provides a process for making amendments to IFRSs that are considered non-urgent but necessary. The amendments clarify guidance and wording, or correct for relatively minor unintended consequences, conflicts or oversights in existing IFRSs. Annual Improvements to IFRSs 2012-2014 Cycle amend IFRSs in relation to four issues addressed during this cycle.

None of the amendments are expected to have a significant impact on reported results or disclosures. The amendments are subject to EU endorsement.

*IASB Effective Date*

Annual periods beginning on or after 1 January 2016.

**(c) IFRS 15 Revenue from Contracts with Customers***Nature of Change*

IFRS 15, which was issued in May 2014, replaces IAS 11 *Construction Contracts* and IAS 18 *Revenue* in addition to IFRIC 13, IFRIC 15, IFRIC 18 and SIC-31. IFRS 15 specifies how and when an entity recognises revenue from a contract with a customer through the application of a single, principles based five-step model. The standard specifies new qualitative and quantitative disclosure requirements to enable users of financial statements understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

The impacts of this standard are being considered by AIB Group and the Bank. The standard is subject to EU endorsement.

*IASB Effective Date*

Annual periods beginning on or after 1 January 2017.

**(d) IFRS 9 Financial Instruments***Nature of Change*

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments*. This completes the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. The main changes are as follows:

*Classification and measurement*

IFRS 9 introduces a single, principles-based classification approach that has two measurement categories: amortised cost and fair value. The basis of classification depends on how an entity manages its financial instruments (its business model) and the contractual cash flow characteristics of the financial assets.

*Impairment*

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model with this model being applied to all financial instruments. IFRS 9 requires an entity to account for expected credit losses from when financial instruments are first recognised and to recognise full lifetime credit losses on a timely basis.

*Hedge accounting*

IFRS 9 replaces the rules-based general hedge accounting requirements in IAS 39 *Financial Instruments: Recognition and Measurement* with a principles-based approach that more closely aligns the accounting treatment with risk management activities. However, an entity may continue to apply the hedge accounting requirements of IAS 39. The accounting for macro hedges is not included within IFRS 9 and continues to be accounted for in accordance with the requirements of IAS 39.

## **ACCOUNTING POLICIES (continued)**

### **15. Prospective accounting changes (continued)**

#### **(d) IFRS 9 Financial Instruments (continued)**

##### *Own credit*

IFRS 9 requires that changes in the fair value of an entity's own debt caused by changes in its own credit quality be recognised in other comprehensive income rather than in profit and loss.

AIB Group and the Bank are currently assessing the impact that IFRS 9 will have on its financial statements. While the impact is expected to be significant, it is not practicable to provide a reasonable estimate of the effects at this time but expect to do so prior to the effective date. The standard is subject to EU endorsement.

##### IASB Effective Date

Annual periods beginning on or after 1 January 2018.



## CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

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

### *(a) Going concern*

The financial statements for the year ended 31 December 2014 have been prepared on a going concern basis as the Directors are satisfied, having considered the risks and uncertainties impacting the Bank, that it has the ability to continue in business for the period of assessment.

AIB Mortgage Bank is dependent on its Parent, Allied Irish Banks, p.l.c. for continued funding and is therefore dependent on the going concern status of the Parent.

The financial statements of Allied Irish Bank p.l.c for the year ended 31 December 2014 have been prepared on a going concern basis as the Directors of AIB Group are satisfied, having considered the risks and uncertainties impacting the AIB Group, that it has the ability to continue in business for the period of assessment. The period of assessment used by the AIB Group Directors is twelve months from the date of approval of these annual financial statements.

In making its assessment, the AIB Group Directors have considered a wide range of information relating to present and future conditions. These have included: financial plans approved in December 2014 covering the period 2015 to 2017; the Restructuring Plan approved by the European Commission in May 2014; liquidity and funding forecasts, and capital resources projections; and the results of the Comprehensive Assessment stress testing conducted by the ECB. There have all been prepared under base and stress scenarios having considered the outlook for the Irish, the eurozone and UK economies. In addition, the AIB Group Directors have considered the commitment of support provided to AIB by the Irish Government.

The AIB Group Directors have also considered the principal risks and uncertainties which could materially affect the AIB Group's future business performance and profitability.

The AIB Group Directors believe that the capital resources are sufficient to ensure that the AIB Group is adequately capitalised both in a base and stress scenario.

In relation to liquidity and funding, the AIB Group Directors are satisfied, based on AIB's position in the market place, that in all reasonable circumstances required liquidity and funding from the Central Bank of Ireland/ECB would be available to the AIB Group during the period of assessment.

On the basis of the continued availability of funding from Allied Irish Banks, p.l.c to AIB Mortgage Bank, the Directors of the Bank believe that it is appropriate to prepare the financial statements on a going concern basis having concluded that there are no material uncertainties related to events or conditions that may cast significant doubt on its ability to continue as a going concern over the period of assessment.

### *(b) Loan impairment*

The Bank's accounting policy for impairment of financial assets is set out in accounting policy number 9. The provisions for impairment on loans and receivables at 31 December 2014 represent management's best estimate of the losses incurred in the loan portfolios at the reporting date. The estimation of loan losses is inherently uncertain and depends upon many factors, including loan loss trends, portfolio grade profiles, local economic climate, conditions in various industries to which borrowers are exposed, and other external factors such as legal and regulatory requirements.

The management process for the identification of loans requiring provision is underpinned by a series of independent stages, including regular monitoring of credit quality and loan loss provisions by AIB Group credit and risk management. The Bank assesses and approves its provisions on a quarterly basis. A quarterly assessment of provision adequacy is also considered by AIB Group Credit Committee, prior to AIB Group Audit Committee and Board approval being sought.

After a period of time when it is concluded that there is no real prospect of recovery of loans/part of loans which have been subjected to a specific provision, the Bank writes off that amount of the loan deemed irrecoverable against the specific provision held against the loan.

## CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

### *Specific provisions*

A specific provision is made against an impaired loan when, in the judgement of management, the estimated realisable value, including available security, is expected to fall short of the principal and interest amount outstanding on the loan. A specific provision is set aside based on the estimate of the difference between the present value of future cash flows, and the assets' carrying value.

As the amount of specific provision required is primarily model driven, and based on estimates of the timing and amount of future cash flows, the amount of the Bank's provision is somewhat uncertain, and may not fully reflect the impact of the prevailing market conditions. Underlying assumptions are reviewed and updated on a regular basis. For further details please refer to: 'Impact of changes to key assumptions and estimates on the impairment provisions' on pages 16 and 17 of the Risk management section of this report.

### *Incurred but not reported provisions*

Incurred but not reported ("IBNR") provisions are maintained to cover impaired loans which are known to be present within the portfolio, but have not been specifically identified as impaired at the reporting date. IBNR provisions are maintained at levels that are deemed appropriate following management assessment of a wide range of credit, portfolio, sectorial, and other economic factors.

The total amount of impairment loss in the Bank's non-impaired portfolio, and therefore the adequacy of the IBNR provision is inherently uncertain. Key assumptions underpinning the Bank's estimates of collective and IBNR provisions are regularly reviewed in line with experience. For further details of the potential impact of an increase in the emergence period, please refer to: 'Impact of changes to key assumptions and estimates on the impairment provisions' on pages 16 and 17 of the Risk management section of this report.

### *Forbearance*

The Bank has developed a number of forbearance strategies to assist customers experiencing financial difficulties, which involve modifications to contractual repayment terms, in order to improve the recoverability of outstanding debt. Advanced forbearance strategies currently being implemented are subject to high levels of judgement and estimation, which may impact on loan impairment provisions.

### *(c) Deferred tax*

Deferred tax assets are recognised for unused tax losses to the extent that it is probable (defined for this purpose as more likely than not) that there will be sufficient future taxable profits against which the losses can be used. For a company with a history of recent losses, there must be convincing other evidence to underpin this assessment. The recognition of the deferred tax asset relies on the assessment of future profitability, and the sufficiency of profits to absorb losses carried forward. It requires significant judgements to be made about long-term profitability projections over several future accounting periods over which recovery extends.

In assessing the future profitability of the Bank, the Board has considered a range of positive and negative evidence for this purpose. Among this evidence, the principal positive factors include the:

- absence of any expiry dates for Irish tax losses;
- non-enduring nature of the loan impairments at levels which resulted in recent years' losses; and
- the Bank's return to profitability in 2014.

The Bank returned to profitability in 2014 and believes that it will generate profits for the foreseeable future. In the absence of any expiry date for tax losses in Ireland, the Bank therefore believes that it is more likely than not that there will be future profits against which to use the tax losses. The Bank has carried out an exercise to determine the likely number of years required to utilise the deferred tax, which indicates the deferred tax asset will be fully utilised within next 5 years.

IAS 12 does not permit a company to apply present value discounting to its deferred tax assets or liabilities, regardless of the estimated timescales over which those assets or liabilities are projected to be realised. The Bank's deferred tax assets are projected to be realised over a long timescale, benefiting from the absence of any expiry date for Irish tax losses. As a result, the carrying value of the deferred tax assets on the Statement of financial position does not reflect the economic value of those assets.

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

The best evidence of fair value is quoted prices in an active market. The absence of quoted prices increases reliance on valuation techniques and requires the use of judgement in the estimation of fair value. This judgement includes but is not limited to: evaluating available market information; determining the cash flows for the instruments; identifying a risk free discount rate and applying an appropriate credit spread.

Valuation techniques that rely to a greater extent on non-observable data require a higher level of management judgement to calculate a fair value than those based wholly on observable data.

The choice of contributors, the quality of market data used for pricing, and the valuation techniques used are all subject to internal review and approval procedures. Given the uncertainty and subjective nature of valuing financial instruments at fair value, any change in these variables could give rise to the financial instruments being carried at a different valuation, with a consequent impact on shareholders' equity and, in the case of derivatives and contingent capital instruments, the income statement.

**INCOME STATEMENT**

For the year ended 31 December 2014

	<b>Note</b>	<b>2014</b> <b>€m</b>	<b>2013</b> <b>€m</b>
Interest income and similar income	<b>1</b>	<b>669</b>	710
Interest expense and similar charges	<b>2</b>	<b>(293)</b>	(397)
<b>Net Interest Income</b>		<b>376</b>	313
Net trading gain	<b>3</b>	<b>1</b>	1
<b>Total Operating Income</b>		<b>377</b>	314
Administrative expenses	<b>4</b>	<b>(61)</b>	(59)
<b>Operating profit before impairment losses and taxation</b>		<b>316</b>	255
Writeback/(provisions) for impairment of loans and receivables to customers	<b>5</b>	<b>100</b>	(351)
<b>Operating profit/(loss) before taxation</b>		<b>416</b>	(96)
Income tax (charge)/credit	<b>6</b>	<b>(52)</b>	12
<b>Profit/(loss) for the year</b>		<b>364</b>	(84)

The operating profit/ (loss) arises from continuing operations.

The notes on pages 55 to 71 are an integral part of these financial statements.

Chairman: Dave Keenan

Director: Catherine Woods

Managing Director: Jim O'Keeffe

Secretary: Louise Cleary

Date: 18 March 2015

**STATEMENT OF COMPREHENSIVE INCOME**

For the year ended 31 December 2014

	Note	2014	2013
		€m	€m
Profit/(loss) for the year		364	(84)
<b>Total comprehensive income for the year</b>		<b>364</b>	<b>(84)</b>

**STATEMENT OF FINANCIAL POSITION**

As at 31 December 2014

	Note	2014 €m	2013 €m
<b>Assets</b>			
Derivative financial instruments	7	329	310
Loans and receivables to banks	8	469	463
Loans and receivables to customers	9	19,920	20,792
Other assets	10	49	34
Deferred taxation	11	155	207
<b>Total assets</b>		<b>20,922</b>	<b>21,806</b>
<b>Liabilities</b>			
Deposits by banks	12	13,966	16,883
Customer accounts	13	1	1
Derivative financial instruments	7	1	3
Debt securities in issue	14	5,182	3,522
Accruals and deferred income	15	66	57
Subordinated liabilities	16	300	300
Other liabilities		2	-
<b>Total liabilities</b>		<b>19,518</b>	<b>20,766</b>
<b>Shareholders' equity</b>			
Ordinary share capital	17	1,745	1,745
Capital reserves	18	580	580
Revenue reserves		(921)	(1,285)
Shareholders' equity		1,404	1,040
<b>Total liabilities and shareholders' equity</b>		<b>20,922</b>	<b>21,806</b>

The notes on pages 55 to 71 are an integral part of these financial statements

Chairman: Dave KeenanDirector: Catherine WoodsManaging Director: Jim O'KeeffeSecretary: Louise Cleary

Date: 18 March 2015

**STATEMENT OF CASH FLOWS**

For the Year Ended 31 December 2014

		<b>2014</b>	<b>2013</b>
	<b>Note</b>	<b>€m</b>	<b>€m</b>
<b>Cash flows from operating activities</b>			
Operating profit/(loss) for the year before taxation		<b>416</b>	(96)
Change in accruals and deferred income	<b>15</b>	<b>9</b>	(18)
(Writeback)/provisions for impairment on loans and receivables	<b>5</b>	<b>(100)</b>	351
		<b>325</b>	237
<b>Changes in operating assets and liabilities</b>			
Change in debt securities in issue		<b>1,660</b>	(1,096)
Change in derivative financial instruments		<b>(21)</b>	42
Change in deposits by banks		<b>(2,917)</b>	(39)
Change in other assets		<b>(15)</b>	16
Change in other liabilities		<b>2</b>	-
Change in loans and receivables to customers		<b>972</b>	605
<b>Net cash flows from operations before taxation</b>		<b>6</b>	(235)
Taxation paid		<b>-</b>	-
<b>Net cash flows from operations</b>		<b>6</b>	(235)
<b>Net cash flow from investing activities</b>		<b>-</b>	-
<b>Cash flows from financing activities</b>			
Proceeds from issue of ordinary share capital		<b>-</b>	200
<b>Net cash flows from financing activities</b>		<b>-</b>	200
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>6</b>	(35)
Cash and cash equivalents at 1 January		<b>463</b>	498
<b>Cash and cash equivalents at 31 December *</b>	<b>20</b>	<b>469</b>	463

\*Cash and cash equivalent balances include funds held as collateral for derivatives with AIB Group of €434m in 2014 (2013: €428m) and Cash Substitution Pool Assets with Barclays Bank p.l.c. of €35m in 2014 (2013: €35m).

**STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**

For the Year Ended 31 December 2014

	Ordinary Share Capital €m	Capital Reserve €m	Revenue Reserves €m	Total Shareholders' Equity €m
<b>At 1 January 2014</b>	<b>1,745</b>	<b>580</b>	<b>(1,285)</b>	<b>1,040</b>
<b>Total comprehensive income for the period</b>	<b>-</b>	<b>-</b>	<b>364</b>	<b>364</b>
<b>At 31 December 2014</b>	<b>1,745</b>	<b>580</b>	<b>(921)</b>	<b>1,404</b>
<b>At 1 January 2013</b>	<b>1,545</b>	<b>580</b>	<b>(1,201)</b>	<b>924</b>
Total comprehensive income for the period	-	-	(84)	(84)
Issue of ordinary shares	200	-	-	200
<b>At 31 December 2013</b>	<b>1,745</b>	<b>580</b>	<b>(1,285)</b>	<b>1,040</b>

## NOTES TO THE FINANCIAL STATEMENTS

## 1. INTEREST INCOME AND SIMILAR INCOME

	2014 €m	2013 €m
Interest on loans and receivables to customers	579	610
Interest receivable from Allied Irish Banks, p.l.c	90	100
	669	710

Included in the interest receivable from Allied Irish Banks, p.l.c. is €90m (2013: €96m) relating to mortgage covered securities hedges (bond swaps). In 2013, the interest receivable on intercompany positions of €4m is also included in the interest receivable from Allied Irish Banks, p.l.c, where as in 2014 the corresponding €2m is netted off against the interest expenses and similar charges (Note 2).

## 2. INTEREST EXPENSE AND SIMILAR CHARGES

	2014 €m	2013 €m
Interest payable to Allied Irish Banks, p.l.c.	154	261
Interest on debt securities in issue	139	136
	293	397

Included in the Interest payable to Allied Irish Banks, p.l.c. is interest payable on one month Euribor funding and other additional funding costs of €133m (2013: €223m), and also interest payable on loan portfolio swaps of €21m (2013: €38m).

## 3. NET TRADING GAIN

	2014 €m	2013 €m
Debt Securities	1	1
	1	1

## 4. ADMINISTRATIVE EXPENSES

	2014 €m	2013 €m
Other administrative expenses	3	1
Amounts payable to Allied Irish Banks, p.l.c under the outsourcing and Agency Agreement	58	58
	61	59

Other administrative expenses consists of professional fees €2m (2013: €1m) and statutory payments €1m (2013: NIL).

*Employee Information*

	2014	2013
Average no. of employees during year	3	4
No. of employees at end of year	3	3

For the year ended 31 December 2014 the average number of employees was 3 (2013: 4). As at 31 December 2014, the Bank had 3 employees.

*Auditors remuneration (excluding VAT)*

	2014 €'000	2013 €'000
Statutory audit	70	54
Other assurance services	37	16
Tax advisory services	-	-
Other non-audit services	-	-
<b>Total auditors remuneration</b>	<b>107</b>	<b>70</b>



**NOTES TO THE FINANCIAL STATEMENTS (continued)****4. ADMINISTRATIVE EXPENSES (continued)**

The disclosure of Auditors' remuneration are in accordance with Statutory Instrument 220<sup>(1)</sup> which mandates fees in particular categories and that fees paid to the AIB Mortgage Bank's Auditor (Deloitte & Touche) for services to the Bank only be disclosed in this format. Other assurance services include fees for additional assurance issued by the firm outside of the audit of the statutory financial statements. These fees include assignments where the auditor provides assurance to third parties.

<sup>(1)</sup> SI220 is titled the European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010.

*Directors remuneration*

	<b>2014</b> <b>€'000</b>	2013 €'000
Fees	<b>35</b>	31

No additional remuneration has been made to any individuals employed directly by Allied Irish Banks, p.l.c. for roles discharged as directors of AIB Mortgage Bank.

**5. PROVISIONS FOR IMPAIRMENT OF LOANS AND RECEIVABLES**

	<b>2014</b>			<b>2013</b>		
	<b>Specific €m</b>	<b>IBNR €m</b>	<b>Total €m</b>	<b>Specific €m</b>	<b>IBNR €m</b>	<b>Total €m</b>
Balance at start of year	<b>1,972</b>	<b>329</b>	<b>2,301</b>	1,774	234	2,008
(Release)/charge against income statement	<b>(81)</b>	<b>(19)</b>	<b>(100)</b>	256	95	351
Amounts written off	<b>(250)</b>	<b>-</b>	<b>(250)</b>	(58)	-	(58)
<b>Balance at end of year</b>	<b>1,641</b>	<b>310</b>	<b>1,951</b>	1,972	329	2,301

<b>By geographical location and industry sector</b>	<b>2014</b> <b>€m</b>	2013 €m
Republic of Ireland Home Mortgages	<b>1,951</b>	2,301

**6. TAXATION**

	<b>2014</b> <b>€m</b>	2013 €m
Origination of temporary differences (note 11)	<b>(52)</b>	12
<b>Total tax (charge)/credit for the period</b>	<b>(52)</b>	12

The tax charge (2013: credit) for the year is at an effective rate of 12.5%, which is the same as the standard Irish corporation tax rate.

**NOTES TO THE FINANCIAL STATEMENTS (continued)****7. DERIVATIVES 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 both 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 "Held for Trading". AIB and the Bank amended the Pool and the Non-Pool Hedge structure in December 2013 to include a one-sided free option for the Bank to terminate the swaps without cost on any reset date.

The Bank also uses interest rate swaps to hedge the mortgage covered securities, converting interest payable from a fixed rate basis to a floating rate basis. Effective fair value hedging relationships 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 carried as assets when fair value is positive and as liabilities when fair value is negative. Allied Irish Banks, p.l.c. is the counterparty to all derivative contracts noted below.

	<b>Contract/ Notional Amount €m</b>	<b>2014 Fair Value Asset/ Liability €m</b>	<b>Contract/ Notional Amount €m</b>	<b>2013 Fair Value Asset/ Liability €m</b>
<b>Derivatives classified as trading</b>				
Interest rate swaps	22,258	(1)	23,337	(3)
<b>Derivatives classified as hedging (Debt Securities)</b>				
Interest rate swaps	3,765	329	3,265	310
<b>Total derivatives</b>	<b>26,023</b>	<b>328</b>	<b>26,602</b>	<b>307</b>

The fair value of derivatives classified as trading is a liability of €1m (2013: liability €3m)

The following table represents the underlying principal and gross replacement costs of the Bank's derivatives as at 31 December 2014 and 31 December 2013.

	<b>Residual Maturity 2014</b>				<b>Residual Maturity 2013</b>			
	<b>Within 1 yr €m</b>	<b>1 to 5 yrs €m</b>	<b>Over 5 yrs €m</b>	<b>Total €m</b>	<b>Within 1 yr €m</b>	<b>1 to 5 yrs €m</b>	<b>Over 5 yrs €m</b>	<b>Total €m</b>
<b>Underlying principal amount</b>								
Interest rate contracts	22,758	2,740	525	26,023	23,337	3,175	90	26,602
<b>Positive fair value</b>								
Interest rate contracts	2	284	43	329	-	295	15	310

**NOTES TO THE FINANCIAL STATEMENTS (continued)****8. LOANS AND RECEIVABLES TO BANKS**

	2014 €m	2013 €m
<b>Funds placed with Allied Irish Banks, p.l.c</b>		
Analysed by remaining maturity:		
3 months or less	434	428
<b>Funds placed with Barclays Bank, p.l.c</b>		
Analysed by remaining maturity:		
3 months or less	35	35
	<b>469</b>	<b>463</b>

The balances with Allied Irish Banks, p.l.c. include a balance of €434m (2013: €428m) placed with AIB as collateral for the derivatives. The remaining balances are held by Barclays Bank, p.l.c. and represent the Cash Substitution Pool Assets.

**9. LOANS AND RECEIVABLES TO CUSTOMERS**

	2014 €m	2013 €m
Analysed by remaining maturity:		
Repayable on demand	4,635	5,173
3 months or less	5	4
1 year or less but over 3 months	31	19
5 years or less but over 1 year	455	403
Greater than 5 years	16,745	17,494
	<b>21,871</b>	<b>23,093</b>
Provisions for impairment of loans and receivables (Note 5)	(1,951)	(2,301)
	<b>19,920</b>	<b>20,792</b>

Amounts repayable on demand includes instances where customers have failed to meet specified repayment terms, and are therefore classified as repayable on demand, in accordance with lending conditions.

Loans and receivables to customers comprise AIB branch and intermediary originated residential mortgages in the Republic of Ireland. This portfolio is well diversified by borrower and by geographical location within the Republic of Ireland.

Interest recognised on impaired loans amounted to €73m (2013: €81m) and is included in the carrying value of loans and receivables to customers. This has been credited to interest income.

*By geographic location and sector*

	2014 €m	2013 €m
<i>Republic of Ireland</i>		
Home mortgages (net of provision)	<b>19,920</b>	<b>20,792</b>

**10. OTHER ASSETS**

	2014 €m	2013 €m
Accrued interest	44	32
Other assets	5	2
	<b>49</b>	<b>34</b>

**NOTES TO THE FINANCIAL STATEMENTS (continued)****11. DEFERRED TAXATION**

	<b>2014</b>	2013
	<b>€m</b>	€m
At 1 January	<b>207</b>	195
Income statement (note 6)	<b>(52)</b>	12
At 31 December	<b>155</b>	207

At 31 December 2014 deferred tax assets on tax losses and other temporary differences, net of deferred tax liabilities, totalled €155m (2013: €207m). The tax losses arise in the Irish tax jurisdiction and their utilisation is dependent on the generation of future taxable profits. Temporary differences recognised in 2014 in the income statement consist largely of a writeback of a provision for impairment of loans and receivables. In 2013, the temporary differences consisted largely of a provision for impairment.

The Bank returned to profitability in 2014 and believes that it will generate profits in the foreseeable future. In the absence of any expiry date for tax losses in Ireland, the Bank therefore believes that it is more likely than not that there will be future profits against which to use the tax losses. The Bank has carried out an exercise to determine the likely number of years required to utilise the deferred tax, which indicates the deferred tax asset will be fully utilised within the next 5 years.

**12. DEPOSITS BY BANKS**

	<b>2014</b>	2013
	<b>€m</b>	€m
Allied Irish Banks, p.l.c	<b>13,966</b>	16,883

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. Included in the funding balance is €1,000m (2013: €1,100m) of repo funding with Allied Irish Banks, p.l.c. AIB Mortgage Bank self-issued covered bonds are first repoed for value with Allied Irish Banks, p.l.c. and then are subject to a sale and repurchase agreement with the ECB.

**13. CUSTOMER ACCOUNTS**

	<b>2014</b>	2013
	<b>€m</b>	€m
Current accounts	<b>1</b>	1

The customer account balance reflects €0.93m (2013: €0.58m) credits on customer mortgage accounts due to short-term receipts such as payments received in the course of property disposals or mortgage redemptions.

**14. DEBT SECURITIES IN ISSUE**

	<b>2014</b>	2013
	<b>€m</b>	€m
<i>Mortgage covered securities in issue to external investors of €3.77bn (2013: €3.27bn) and in issue to Allied Irish Banks, p.l.c. of €1.15bn (2013: Nil) by remaining maturity:</i>		
1 year or less	<b>500</b>	-
5 years or less but over 1 year	<b>3,240</b>	3,175
Greater than 5 years	<b>1,175</b>	90
Nominal Value of Debt Securities	<b>4,915</b>	3,265
Gain or loss on the hedged item attributable to the hedged risk	<b>267</b>	257
Carrying Value of Debt Securities	<b>5,182</b>	3,522
<i>Mortgage covered securities in issue to external investors and internal issuances at nominal value:</i>		
External investors	<b>3,765</b>	3,265
Allied Irish Banks, p.l.c.	<b>1,150</b>	-
AIB Mortgage Bank *	<b>2,750</b>	4,770
	<b>7,665</b>	8,035

**NOTES TO THE FINANCIAL STATEMENTS (continued)****14. DEBT SECURITIES IN ISSUE (continued)**

\*Of the total mortgage covered securities in issue to AIB Mortgage Bank of €2.75bn (2013: €4.77bn) the following values have been used in Sale and Repurchase agreement:

	2014 €m	2013 €m
Bond Nominal used for Sale and Repurchase with AIB, p.l.c	1,070	1,240
Liquidity provided under the Sale and Repurchase with AIB, p.l.c	1,000	1,100

Mortgage covered securities issued by AIB Mortgage Bank are first repoed for value with Allied Irish Banks, p.l.c. and then are subject to a sale and repurchase agreement with the ECB, providing liquidity for the Bank and the Group.

Mortgage covered securities issued as self-issuances to AIB Mortgage Bank are not recognised in the Statement of Financial Position. As the bearer securities and the mortgage covered securities do not meet the criteria of an asset and a liability under the International Accounting Standards Board ("IASB") Framework, no asset or liability has been recognised. The self-issuance of securities is however disclosed above. Self-issuances of mortgage covered securities that are the subject of a sale and repurchase agreement with Allied Irish Banks, p.l.c. by AIB Mortgage Bank give rise to the recognition of an asset and a liability (See note 12 – deposits by banks).

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 2014, the Cover Assets Pool amounted to €15bn (2013: €15.7bn), comprising of €15bn (2013: €15.7bn) of mortgage credit assets (mortgage loan accounts) and €0.04bn (2013: €0.04bn) of substitution assets (cash on deposit with Barclays Bank, p.l.c). 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.

**(a) Mortgaged properties and principal loan balances outstanding in the cover assets pool***Total Loan Balances*

From	To	Total Loan Balances 2014 (1 & 2) €m	Number of Mortgaged Properties 2014 €m	Total Loan Balances 2013 (1 & 2) €m	Number of Mortgaged Properties 2013 €m
-	€100,000	1,995	39,177	1,949	38,287
€100,000	€200,000	5,293	36,191	5,305	36,115
€200,000	€500,000	6,647	24,090	7,160	25,691
Over €500,000		1,089	1,434	1,293	1,699
		15,024	100,892	15,707	101,792

(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 113,666 loan accounts (2013: 115,364) secured on 100,892 properties (2013: 101,792).

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

Geographical Area	Number of Mortgaged Properties 2014		Number of Mortgaged Properties 2013	
Co. Dublin	26,970	27%	26,986	27%
Outside Dublin	73,922	73%	74,806	73%
	100,892	100%	101,792	100%

**NOTES TO THE FINANCIAL STATEMENTS (continued)****14. DEBT SECURITIES IN ISSUE (continued)****(c) Mortgage loan accounts in default in the cover assets pool**

As at 31 December 2014, there were no mortgage loan accounts (2013: Nil) in default in the Cover Assets Pool (in default being defined as impaired mortgage loan accounts).

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

During the year ended 31 December 2014, 15 mortgage loan accounts (2013: 100) in the Cover Assets Pool had been in default with arrears greater than €1,000. As at 31 December 2014, there were no accounts in default in the Cover Assets Pool (2013: Nil).

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

During the year ended 31 December 2014, 414 non-performing mortgage loan accounts (2013: 1,438) were removed in total from the Cover Assets Pool (For this purpose, non-performing is defined as in default). These loan accounts were not replaced with other assets as the Cover Assets Pool continued to meet all regulatory requirements.

**(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 273 accounts (2013: 584) as at 31 December 2014 was €222,471 (2013: €488,540). €97,421 of this represented non-payment of interest.

**(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 2014 was €1,702m (2013: €1,679m), of which €1,275m (2013: €1,209m) represented repayment of principal and €427m (2013: €471m) 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.

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

As at 31 December 2014 there were no loan accounts (2013: Nil) in the Cover Assets Pool that were secured on commercial properties.

**15. ACCRUALS AND DEFERRED INCOME**

	2014 €m	2013 €m
Interest payable on mortgage covered securities	64	55
Expenses	2	2
	<b>66</b>	<b>57</b>

**16. SUBORDINATED LIABILITIES**

	2014 €m	2013 €m
Dated Capital Note (a)	100	100
Perpetual Capital Note (b)	200	200
	<b>300</b>	<b>300</b>

(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. Interest on the amount of principle is calculated on a year of 360 days at a rate of 53 basis points over Euribor payable monthly in arrears. The Note 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 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.

(b) €200,000,000 Subordinated Perpetual Capital Note – the loan to which this note relates was received from AIB on 13 February 2006. Interest on the amount of principle is calculated on a year of 360 days at a rate of 100 basis points over Euribor payable monthly in arrears. The Note 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.

**NOTES TO THE FINANCIAL STATEMENTS (continued)****17. SHARE CAPITAL**

	<b>2014</b> <b>€m</b>	2013 €m
Authorised: 3,000,000,000 ordinary shares of €1.00 each (2013: 3,000,000,000 ordinary shares of €1.00 each)		
	<b>3,000</b>	3,000
Issued and fully paid up: 1,745,000,000 ordinary shares of €1.00 each (2013: 1,745,000,000 ordinary shares of €1.00 each)		
	<b>1,745</b>	1,745

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.

**18. CAPITAL RESERVES**

	<b>2014</b> <b>€m</b>	2013 €m
Opening balance	<b>580</b>	580
Closing balance	<b>580</b>	580

Capital reserves represent cash contribution from Allied Irish Banks, p.l.c.

**NOTES TO THE FINANCIAL STATEMENTS (continued)****19. CAPITAL MANAGEMENT****Capital regulation**

The European Union ("EU") adopted legislative package, known as CRD IV, came into force on 1 January 2014, with some of the new provisions being phased-in from 2014. CRD IV consists of the Capital Requirements Regulation ("CRR") which is directly applicable across firms in the EU, and the new Capital Requirements Directive ("CRD"), which must be implemented by member states of the European Economic Area through national law.

CRD IV is designed to strengthen the regulation of the banking sector and to implement the Basel III agreement in the EU legal framework. On 31 March 2014, the Minister for Finance signed into Irish law two regulations to give effect to CRD IV. The European Union (Capital Requirements) Regulations 2014 give effect to CRD IV and the European Union (Capital Requirements) (No.2) Regulations 2014 give effect to a number of technical requirements in order that the CRR can operate effectively in Irish law. These new regulations include enhanced requirements for quality and quantity of capital. It also harmonises the deduction from own funds in order to determine the amount of regulatory capital that is prudent to recognise for regulatory purposes.

A new system of financial supervision, the Single Supervisory Mechanism ("SSM"), comprising the European Central Bank ("ECB") and the national competent authorities of EU countries has been established. The SSM places the ECB as the central prudential supervisor of financial institutions in the Eurozone, including AIB, and in those non-euro EU countries that choose to join the SSM. On 4 November 2014, the ECB commenced its supervisory role under the SSM. The aims of the SSM are to ensure the safety and soundness of the European banking system and to increase financial integration and stability in Europe. Although the ECB has been conferred with the task of ensuring financial stability, some functions such as consumer protection, supervision of payment services and the combat of money laundering remain at national level.

The ECB has advised AIB Mortgage Bank that it must at all times satisfy the own funds requirements that apply pursuant to Article 92 of the CRR. This equates to a Common Equity Tier 1 (CET1) ratio of 4.5%, a tier 1 capital ratio of 6% and a total capital ratio of 8%.

*Capital resources and regulatory capital ratios*

The table below shows AIB Mortgage Bank's capital resources as at 31 December 2014 and 31 December 2013.

<b>Basel II as reported</b>		<b>CRD IV Transitional basis</b>	
<b>31 December 2013</b>		<b>31 December 2014</b>	<b>Pro-forma 1 January 2014</b>
€m		€m	€m
1,040	<b>Core/Common equity tier 1 capital</b>	1,405	1,040
	Gross common equity tier 1		
-	Regulatory adjustments	-	-
1,040	<b>Core/Common equity tier 1 capital</b>	1,405	1,040
	<b>Tier 2 capital</b>		
300	Subordinated debt	300	300
78	Credit provisions	68	75
-	Regulatory adjustments	-	-
378	<b>Total Tier 2 capital</b>	368	375
1,418	<b>Total capital</b>	1,773	1,415
8.4%	<b>Core tier 1/common equity tier 1 ratio</b>	12.5%	8.6%
11.5%	<b>Total capital ratio</b>	15.8%	11.7%

The CET1 transitional ratio, at 12.5%, is significantly in excess of the minimum CET1 regulatory requirements. The capital figures reflect the audited 2014 year end profit for the Bank. The quarterly SSM regulatory capital reporting will include these profits in due course.



**NOTES TO THE FINANCIAL STATEMENTS (continued)****20. STATEMENT OF CASH FLOWS**

	2014 €m	2013 €m
Loans and receivables to banks (note 8)	469	463

Loans and Receivables to Banks include funds placed on short-term deposit which are treated as cash/ cash equivalents within the cash flow statement.

**21. SEGMENTAL INFORMATION**

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

**22. CONTINGENT LIABILITIES AND COMMITMENTS**

At 31 December 2014 the Bank had €349m (2013: €221m) of approved mortgage loan applications that had not been drawn down as at the year end.

**23. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The term 'financial instruments' includes both financial assets and financial liabilities. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. The Banks' accounting policy for the determination of fair value of financial instruments is set out in accounting policy number 16(d).

Readers of these financial statements are advised to use caution when using the data in the following table to evaluate the Bank's financial position or to make comparisons with other institutions. Fair value information is not provided for items that do not meet the definition of a financial instrument such as shareholders' equity. 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 2014.

The valuation of financial instruments, including loans and receivables, involves the application of judgement and estimation. Market and credit risks are key assumptions in the estimation of the fair value of loans and receivables. During the year, the Bank has observed an improvement in the credit quality of borrowers and reduction in impaired loans and defaults. The Bank has estimated the fair value of its loans to customers taking into account market risk and the changes in credit quality of its borrowers.

Fair values are based on observable market prices, where available, and on valuation models or techniques where the lack of market liquidity means that observable prices are unavailable. The fair values of financial instruments are measured according to the following fair value hierarchy:

**Level 1** – financial assets and liabilities measured using quoted market prices from an active market (unadjusted).

**Level 2** – financial assets and liabilities measured using valuation techniques which use quoted market prices from an active market or measured using quoted market prices unadjusted from an inactive market.

**Level 3** – financial assets and liabilities measured using valuation techniques which use unobservable market data.

All financial instruments are initially recognised at fair value. Financial instruments held for trading and financial instruments in fair value hedge relationships are subsequently measured at fair value through profit or loss.

All valuations are carried out within the Finance function of AIB Group and valuation methodologies are validated by the independent Risk function within AIB Group.

**NOTES TO THE FINANCIAL STATEMENTS (continued)****23. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)**

The methods used for calculation of fair value are as follows:

*Financial instruments measured at fair value in the financial statements**Derivative financial instruments*

Where derivatives are traded on an exchange, the fair value is based on prices from the exchange. The fair value of over the counter derivative financial instruments is estimated based on standard market discounting and valuation methodologies which use reliable observable inputs including yield curves and market rates. These methodologies are implemented by the Finance function and validated by the Risk function. Where there is uncertainty around the inputs to a derivatives' valuation model, the fair value is estimated using inputs which provide the Bank's view of the most likely outcome in a disposal transaction between willing counterparties in a functioning market. Where an unobservable input is material to the outcome of the valuation, a range of potential outcomes from favourable to unfavourable is estimated.

Counterparty credit and own credit is an input into the valuation of uncollateralised customer derivatives.

*Loans and receivables to banks*

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

*Loans and receivables to customers*

The Bank provides lending facilities of varying rates and maturities to personal customers. Valuation techniques are used in estimating the fair value of loans, primarily using discounted cash flows and applying market rates where practicable.

In addition to the assumptions set out above under valuation techniques regarding cash flows and discount rates, a key assumption for loans and receivables is that the carrying amount of variable rate loans (excluding mortgage products) approximates to market value where there is no significant credit risk of the borrower. The fair value of variable rate mortgage products including tracker mortgages is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in the portfolio. For fixed rate loans, the fair value is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in that portfolio. For the overall loan portfolio, an adjustment is made for credit risk which at 31 December 2014 took account of the Banks' expectations on credit losses over the life of the loans.

*Deposits by banks*

The fair value of current accounts and deposit liabilities which are repayable on demand, or which re-price frequently, approximates to their book value. The fair value of all other deposits and other borrowings is estimated using discounted cash flows applying either market rates, where applicable, or interest rates currently offered by the Bank.

*Debt securities in issue*

The estimated fair value of subordinated liabilities and other capital instruments, and debt securities in issue, is based on quoted prices were available, or where these are unavailable, are estimated using valuation techniques using observable market data for similar instruments. Where there is no market data for a directly comparable instrument, management judgement, on an appropriate credit spread to similar or related instruments with market data available, is used within the valuation technique. This is supported by cross referencing other similar or related instruments.

*Other financial assets and other financial liabilities*

This caption includes accrued interest receivable and payable and the carrying amount is considered representative of fair value.

The following table sets out the carrying value of financial instruments across the three levels of the fair value hierarchy at 31 December 2014:

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 23. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

	2014						Fair Value hierarchy			
	Carrying amount in statement of financial position									
	At fair value through profit and loss		At fair value through equity	At amortised cost		Total				
	Held for trading	Fair value hedge derivative	Cash flow hedge derivatives	Loans and receivables	Other		Level 1	Level 2	Level 3	Total
Financial assets measured at fair value	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Derivative financial instruments										
Interest Rate Derivatives	-	329	-	-	-	329	-	329	-	329
<b>Financial assets not measured at fair value</b>										
Loans and receivables to banks <sup>(1)</sup>	-	-	-	469	-	469	-	-	469	469
Loans and receivables to customers	-	-	-	19,920	-	19,920	-	-	17,583	17,583
Other financial assets	-	-	-	-	50	50	-	-	50	50
	-	329	-	20,389	50	20,768	-	329	18,102	18,431
<b>Financial liabilities measured at fair value</b>										
Derivative financial instruments										
Interest Rate Derivatives	1	-	-	-	-	1	-	1	-	1
<b>Financial liabilities not measured at fair value</b>										
Deposits by banks	-	-	-	-	13,966	13,966	-	-	13,966	13,966
Debt securities in issue	-	-	-	-	5,182	5,182	5,261	-	-	5,261
Subordinated liabilities	-	-	-	-	300	300	-	78	-	78
Other financial liabilities	-	-	-	-	64	64	-	-	64	64
	1	-	-	-	19,512	19,513	5,261	79	14,030	19,370

No transfers in or out of Level 3 have occurred during 2014.

<sup>(1)</sup> A reclassification between levels has taken place to be in line with AIB Group treatment.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 23. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

	2013									
	Carrying amount in statement of financial position						Fair Value hierarchy			
	At fair value through profit and loss		At fair value through equity	At amortised cost		Total				
	Held for trading	Fair value hedge derivative	Cash flow hedge derivatives	Loans and receivables	Other		Level 1	Level 2	Level 3	Total
Financial assets measured at fair value	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Derivative financial instruments										
Interest Rate Derivatives	-	310	-	-	-	310	-	310	-	310
<b>Financial assets not measured at fair value</b>										
Loans and receivables to banks <sup>(1)</sup>	-	-	-	463	-	463	-	-	463	463
Loans and receivables to customers	-	-	-	20,792	-	20,792	-	-	17,786	17,786
Other financial assets	-	-	-	-	34	34	-	-	34	34
	-	310	-	21,255	34	21,806	-	310	18,490	18,800
<b>Financial liabilities measured at fair value</b>										
Derivative financial instruments										
Interest Rate Derivatives	3	-	-	-	-	3	-	3	-	3
<b>Financial liabilities not measured at fair value</b>										
Deposits by banks	-	-	-	-	16,883	16,883	-	-	16,883	16,883
Debt securities in issue	-	-	-	-	3,522	3,522	3,468	-	-	3,468
Subordinated liabilities	-	-	-	-	300	300	-	78	-	78
Other financial liabilities	-	-	-	-	55	55	-	-	55	55
	3	-	-	-	20,760	20,763	3,468	81	16,938	20,487

No transfers in or out of Level 3 have occurred during 2013.

<sup>(1)</sup> A reclassification between levels has taken place to be in line with AIB Group treatment.

**NOTES TO THE FINANCIAL STATEMENTS (continued)****24. RELATED PARTY TRANSACTIONS***(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, deposits and derivatives on an arm's length basis. Interest paid to AIB and interest received from AIB is disclosed in Note 1 and Note 2 to the accounts. Most of the Bank's activities are outsourced to AIB under an Outsourcing and Agency Agreement. AIB as Service Agent for the Bank, originates residential mortgage loans through its retail branch network and intermediary channels 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 with the balance of funding being provided by AIB Group. The Bank is also party to the Mortgage-Backed Promissory Note Framework Agreements with the Central Bank of Ireland, however this type of funding has not been utilised since 2011.

*(b) Transactions with key management personnel*

Loans to Key management personnel, namely Executive and Non-Executive Directors and Senior Executive Officers, in office during the year are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons of similar standing not connected with AIB Mortgage Bank, and do not involve more than the normal risk of collectability or present other unfavourable features. Loans to executive directors and senior executive officers are also made in the ordinary course of business, on terms available to other employees in AIB Mortgage Bank generally, in accordance with established policy, within limits set on a case by case basis.

Details of transactions with Key management personnel, and connected parties where indicated, for the years ended 31 December 2014 and 2013 are as follows:

*(i) Current Directors*

	Balance at 31 December 2013 €000	Balance at 31 December 2014 €000
<b>Eileen Kelliher</b>		
Loans	282	264
Interest charged during 2014		3
Maximum debit balance during 2014*		282
<b>Catherine Woods</b>		
Loans	88	79
Interest charged during 2014		1
Maximum debit balance during 2014*		88

Gerry Gaffney, Dave Keenan, James Murphy and Jim O'Keeffe had no facilities with AIB Mortgage Bank during 2014.

*(ii) Former Directors who were in office during the year*

Ivor Larkin had no facilities with the AIB Mortgage Bank during 2014.

*(iii) Senior Executive Officers in office during the year*

Senior Executive Officers in office during the year had no facilities with the AIB Mortgage Bank during 2014.

\* The maximum debit balance figure is calculated by aggregating the maximum debit balance drawn on each facility during the year.

*(iv) Aggregate amounts outstanding at year-end*

	<b>Loans, overdrafts/credit cards</b>	
	Balance at 31 December 2013 €000	Balance at 31 December 2014 €000
Directors (2014: 2 persons; 2013: 2 persons)	370	343

*(v) Connected Persons*

There were no loans to connected persons of directors in office as at 31 December 2014 (2013: Nil), as defined in Section 26 of the Companies Act 1990 and in accordance with conditions attached to AIB Mortgage Bank banking licence.

No impairment charges or provisions have been recognised in respect of any of the above loans or facilities and all interest that has fallen due has been paid.

**NOTES TO THE FINANCIAL STATEMENTS (continued)****24. RELATED PARTY TRANSACTIONS (continued)***(c) Funding Support*

As at 31 December 2014 the mortgage covered securities issued to AIB Mortgage Bank were €2.8bn (2013: €4.8bn). Of these, €1.1bn (2013: €1.2bn) were first repoed for a value of €1.0bn (2013: €1.1bn) with Allied Irish Banks, p.l.c. and then were subject to a sale and repurchase agreement with the ECB, to provide liquidity for AIB Group.

As at 31 December 2014 the mortgage covered securities issued to Allied Irish Banks, p.l.c. were €1.2bn (2013: nil).

The AIB Mortgage Bank Mortgage-Backed Promissory Note facility with the Central Bank, for normal ECB open market operations, is unavailable since December 2010 due to ratings downgrade by Moody's of Allied Irish Banks, p.l.c. The AIB Mortgage Bank Mortgage-Backed Promissory Note facility with the Central Bank, outside of normal ECB open market operations, has not been used since April 2011.

*(d) Interest rate risk hedging*

The Bank manages the interest rate risk through two different types of interest rate swaps with Allied Irish Banks p.l.c. The first type is used to hedge interest rate risk on loan accounts both 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. The notional amount of the swaps used to hedge the interest rate risk on loan accounts at 31 December 2014 was €22.3bn (2013: €23.3bn).

The second type of interest rate swaps are vanilla interest rate swaps used to hedge the mortgage covered securities, converting interest payable from a fixed rate basis to a floating rate basis. The notional amount of the swaps used to hedge the interest rate risk on mortgage covered securities at 31 December 2014 was €3.8bn (2013: €3.3bn).

*(e) Summary of the AIB Group relationship with the Irish Government*

The Irish Government, as a result of both its investment in AIB's 2009 Preference shares and AIB's participation in Government guarantee schemes, became a related party of AIB in 2009. Following the various ordinary/CNV share issues to the NPRFC during 2010 and 2011, AIB is under the control of the Irish Government.

AIB enters into normal banking transactions with the Irish Government and many of its controlled bodies on an arm's length basis. In addition, other transactions include the payment of taxes, pay related social insurance, local authority rates, and the payment of regulatory fees, as appropriate. Following the crisis in the Irish banking sector and the stabilisation measures adopted since 2008, the involvement of the Irish Government in AIB and in other Irish banks has been and continues to be considerable. This involvement is outlined below.

*Rights and powers of the Irish Government and the Central Bank of Ireland.*

The Irish Minister for Finance ('the Minister') and the Central Bank of Ireland ("the Central Bank") have significant rights and powers over the operations of AIB (and other financial institutions) arising from the various stabilisation measures. These rights and powers relate to, inter alia:

- The acquisition of shares in other institutions;
- Maintenance of solvency ratios and compliance with any liquidity and capital ratios that the Central Bank, following consultation with the Minister, may direct;
- The appointment of non-executive directors and board changes;
- The appointment of persons to attend meetings of various committees;
- Restructuring of executive management responsibilities, strengthening of management capacity and improvement of governance;
- Declaration and payment of dividends;
- Restrictions on various types of remuneration;
- Buy-backs or redemptions by AIB Group of its shares;
- The manner in which AIB Group extends credit to certain customer groups; and
- Conditions regulating the commercial conduct of Allied Irish Banks, p.l.c, having regard to capital ratios, market share and the Group's balance sheet growth. In addition, various other initiatives such as strategies/codes of conduct for dealing with mortgage and other consumer/business loan arrears are set out in the Risk section of this report.

The relationship of the Irish Government with AIB is outlined under the following headings:

- Guarantee schemes;
- Funding support;
- PCAR/PLAR;
- Credit Institutions (Stabilisation) Act 2010:
  - (i) Direction Order;
  - (ii) Transfer Order;
  - (iii) Subordinated Liabilities Order;
- Central Bank and Credit Institutions (Resolution) Act 2011; and
- Relationship framework which was signed in March 2012.

Since 31 December 2013, there have been no significant changes to the various aspects of this relationship.

*Guarantee schemes*

The European Communities (Deposit Guarantee Schemes) Regulations 1995 have been in operation since 1995. These regulations guarantee certain retail deposits up to a maximum of €100,000. In addition, since September 2008, the Irish Government has guaranteed relevant deposits and debt securities of AIB through the Credit Institutions (Financial Support) Scheme 2008 ('the CIFS scheme') which expired in September 2010 and the Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 ("ELG Scheme") which expired on 28 March 2013 for all new liabilities and is outlined below.

**NOTES TO THE FINANCIAL STATEMENTS (continued)****24. RELATED PARTY TRANSACTIONS (continued)***(e) Summary of the AIB Group relationship with the Irish Government (continued)**- ELG Scheme*

On 21 January 2010, Allied Irish Banks, p.l.c., including its international branches and subsidiaries, AIB Group (UK) p.l.c., AIB Bank (CI) Limited and Allied Irish Banks North America Inc., became participating institutions for the purposes of the Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 the ('ELG Scheme'). The Minister stands as guarantor of all guaranteed liabilities of a participating institution. The ELG Scheme is intended to facilitate the ability of participating credit institutions in Ireland to issue certain debt securities and take deposits with a maturity of up to five years for pre-defined periods. On 28 March 2013, the ELG Scheme ended for all new liabilities. After this date, no new liabilities are guaranteed under this scheme.

Eligible liabilities under the ELG scheme comprise the following:

- all deposits to the extent not covered by the deposit protection schemes in Ireland or in any other jurisdiction;
- senior unsecured certificates of deposit;
- senior unsecured commercial paper ;
- other senior unsecured bonds and notes; and
- other forms of senior unsecured debt which may be specified by the Minister consistent with European Union State aid rules and the European Commission's Banking Communication (2008/C 270/02) and subject to prior consultation with the European Commission.

Dated subordinated debt and asset-covered securities issued after a covered institution joined the ELG Scheme are not guaranteed under the ELG Scheme. The total liabilities guaranteed under the ELG Scheme at 31 December 2014 amounted to €3billion (€7.8billion at 31 December 2013).

*- Funding support*

AIB received funding from the Central Bank throughout the year through the ECB Monetary Policy Operation Sale and Repurchase Agreements. The total funding amounted to €3.4 billion at 31 December 2014 (2013: €12.7 billion). These agreements were for maturities of between 7 days and 3 months apart from the €11.25 billion in the three year LTRO which will mature in January and February 2015. The interest rates on these facilities are set by the Central Bank and advised to AIB.

*- PCAR/PLAR*

On 31 March 2011, the Central Bank of Ireland published the 'Financial Measures Programme Report' which detailed the outcome of its review of the capital (PCAR) and funding requirements (PLAR) of the domestic Irish banks. The PCAR/PLAR assessments followed the announcement of the EU-IMF Programme for Ireland in November 2010, in which the provision of an overall amount of €85 billion in financial support for the sovereign was agreed in principle. Up to €35 billion of this support was earmarked for the banking system, €10 billion of which was for immediate recapitalisation of the banks with the remaining €25billion to be provided on a contingency basis. Arising from the 2011 PCAR and PLAR assessments, AIB, including EBS, was required to raise €14.8 billion in total capital (including €1.6 billion in contingent capital), all of which was subsequently raised.

*- Credit Institutions (Stabilisation) Act 2010*

The Credit Institutions (Stabilisation) Act 2010, which was enacted in December 2010, ceased to have effect on 31 December 2014. During the period when the Act was effective, the Minister invoked certain of his powers under the Act in relation to AIB as follows:

- A Direction Order in December 2010;
- A Transfer Order in February 2011;
- A Subordinated Liabilities Order in April 2011; and
- Acquisition of EBS Limited (EBS").

On 31 March 2011, the Minister proposed the combination of AIB and EBS (formerly EBS Building Society) to form one of the two Pillar banks. On 26 May 2011, AIB entered into an agreement with EBS, the Minister and the NTMA to acquire EBS for a consideration of € 1 (one euro). The acquisition was effective from 1 July 2011.

*- Central Bank and Credit Institutions (Resolution) Act 2011*

The Central Bank and Credit Institutions (Resolution) Act 2011 was signed into law on 20 October 2011 and became effective on 28 October 2011. This legislation provides the Central Bank with additional powers to achieve an effective and efficient resolution regime for credit institutions that are failing or likely to fail and that is effective in protecting the Exchequer and the stability of the financial system and the economy. The Act gives the Central Bank power to take control of banks, appoint managers to run them and remove directors, staff and consultants, and to move their deposits and loans to other banks. On 28 September 2012, the Minister made the Credit institutions Resolution Fund Levy Regulations, 2012 providing for contributions, by authorised credit institutions, to a Credit Institutions Resolution Fund pursuant to Section 15 of the Central Bank and Credit Institutions (Resolution) Act 2011. This Resolution Fund has been designed to provide a source of funding for the resolution of financial instability in, or of an imminent serious threat to the financial stability of an authorised credit institution. The Act provides for the establishment of "Bridge-Banks" for the purpose of holding assets or liabilities which have been transferred under a transfer order. Bridge-Banks are only intended to hold such assets or liabilities on a temporary basis pending onward transfer as soon as possible. The Central Bank is empowered to make special management orders in relation to an authorised credit institution, or in relation to a subsidiary or holding company of the authorised credit institution in certain circumstances. The Act also provides powers to the Central Bank regarding the liquidation of authorised credit institutions. Authorised credit institutions may also be directed to prepare a recovery plan setting out actions that could be taken to facilitate the continuation or secure the business or part of the business of that institution.

## **NOTES TO THE FINANCIAL STATEMENTS (continued)**

### **24. RELATED PARTY TRANSACTIONS (continued)**

*(e) Summary of the AIB Group relationship with the Irish Government (continued)*

#### *- Relationship framework*

In order to comply with the contractual commitments imposed on AIB in connection with its recapitalisation by the Irish State and with the requirements of EU state aid applicable in respect of that recapitalisation, a relationship framework was entered into between the Minister and AIB in March 2012. This provides the framework under which the relationship between the Minister and AIB is governed. Under the relationship framework, the authority and responsibility for strategy and commercial policies (including business plans and budgets) and conducting AIB's day-to-day operations rest with the Board of AIB and its management team. However, the Board is required to obtain the prior written consent of the Minister, or to consult with the Minister, in respect of certain material matters, such as material disposals.

### **25. SUBSEQUENT EVENTS**

No events have occurred post year end which would require adjustment to or disclosure in these financial statements.

### **26. APPROVAL OF FINANCIAL STATEMENTS**

The financial statements were approved by the Directors on 18 March 2015.