

## **AIB MORTGAGE BANK**

**Directors' Report and  
Annual Financial Statements  
For the financial year ended 31 December 2017**

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## Directors' and Other Information

Directors	<p>Dave Keenan Ken Burke Simon Ball Chris Curley Gerry Gaffney James Murphy Catherine Woods</p>	<p>AIB Group Non-Executive Director and Chairman Executive Director (Managing) Independent Non-Executive Director Executive Director Executive Director AIB Group Non-Executive Director Independent Non-Executive Director</p>
Secretary	Emma Murphy	
Registered office	<p>Bankcentre Ballsbridge Dublin 4 Ireland</p>	
Registered number	404926	
Registered auditor	<p>Deloitte Chartered Accountants &amp; Statutory Audit Firm Deloitte &amp; Touche House Earlsfort Terrace Dublin 2 Ireland</p>	
Banker	Allied Irish Banks, p.l.c.	
Solicitor	<p>Helen Dooley Group General Counsel Allied Irish Banks, p.l.c. Bankcentre Ballsbridge Dublin 4 Ireland</p>	
Cover-assets monitor	<p>Mazars Harcourt Centre Block 3 Harcourt Road Dublin 2 Ireland</p>	

## Directors' Report

The Directors of AIB Mortgage Bank (the "Bank") present their Directors Report (the "Report") and audited financial statements for the financial year ended 31 December 2017. A Directors' Responsibility Statement in relation to the financial statements appears on page 49.

### Principal activities

The Bank, a public unlimited company, obtained an Irish banking licence under the Irish Central Bank Act, 1971 (as amended) and was registered as a designated mortgage credit institution under the Asset Covered Securities Act, 2001 on 8 February 2006. The Bank was granted a derogation as permitted under section 1237(5) Companies Act 2014 by the Minister of Jobs, Enterprise and Innovation from the requirement to include 'unlimited company' in its name.

The Bank is a wholly owned subsidiary of Allied Irish Banks, p.l.c. ("AIB"). The ultimate parent company of the Bank and AIB is AIB Group plc. Pursuant to a Scheme of Arrangement between AIB and its shareholders, AIB Group plc became the holding company of AIB and its subsidiaries, including the Bank (together the "AIB Group") on 8 December 2017.

AIB came under the direct supervision of, and is 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 ("CBI") for non-prudential matters, including, consumer protection and the combat of money laundering.

The Bank's principal objective 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 or third parties. The Bank's debt securities are listed on the main securities market of the Irish Stock Exchange.

The Bank commenced trading on 13 February 2006, when AIB transferred its Republic of Ireland branch originated residential mortgage business, amounting to €13.6bn in mortgage loans, to the Bank. On 24 February 2006, a Mortgage-Backed Promissory Note ('MBPN') facility between the Bank and the CBI 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 the Bank, amounting to approximately €4.2bn. 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, an AIB company 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 CBI.

The Bank's activities are financed through the issuance of mortgage covered securities with the balance of funding being provided by AIB. The Bank is also party to the MBPN agreements with the CBI, 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

#### *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 ultimate parent AIB Group plc. 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. As at 1 January 2017, the Bank had only one Independent Non-Executive Director, however, on 27 March 2017 following approval by the European Central Bank and the CBI, Mr Simon Ball was appointed as an Independent Non-Executive Director and at that juncture, the Bank satisfied the requirement to have two Non-Executive Directors. The Board also included three Executive Directors, each of whom were directly involved in the operation of the 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 unrelated to the operations of the Bank.



## Directors' Report (continued)

### Corporate Governance (continued)

#### *The Board of Directors (continued)*

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 Bank benefits as a subsidiary of AIB from the wider AIB governance and operating structure, such as oversight of audit and risk related activities. AIB provides services to the Bank through an Outsourcing and Agency Agreement, a formal managed services agreement, updates in respect of the performance against which are provided to the Board regularly. In the event that material failings or weaknesses in the systems of risk management or internal control are identified, an explanation of the issue and an assessment of its impact is presented with a proposed remediation plan to the Board.

Agreed remediation plans are tracked to conclusion, with status updates provided to the Board. Given the work of the Board and representations made by the Management Team during the year, the Board is satisfied that the necessary actions to address any material failings or weaknesses identified through the operation of the risk management and internal control framework have been taken, or are currently being undertaken.

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 receives regular updates on the Bank's risk profile through the quarterly risk report and, during 2017, considered the outcome of internal and external audit activities.

#### *Corporate Governance/Financial Processes*

The Board, supported by the Audit Committee, rely on AIB's internal control and risk management systems in relation to the financial reporting process. Such systems are designed to manage rather than eliminate the risk of failure to achieve the Bank's financial reporting objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. The Board, through AIB's established processes regarding internal control and risk management systems ensures effective oversight of the financial reporting process. The Bank's overall control system around the financial reporting process includes:

- clearly defined organisation structure and authority levels with reporting mechanisms to the Board;
- a comprehensive set of policies and procedures, in line with AIB, relating to the controls around financial reporting and the process of preparing the financial statements; and
- ensuring the integrity of the financial statements and the accounting policies therein.

The Board evaluates and discusses significant accounting and reporting issues as the need arises.

The Board held 5 meetings during 2017.

The Bank is subject to the provisions of the CBI's Corporate Governance Requirements for Credit Institutions 2015 ("the 2015 Requirements") (available on [www.centralbank.ie](http://www.centralbank.ie)), which imposes minimum core standards upon all credit institutions licensed or authorised by the CBI. The 2015 Requirements were published by the CBI during December 2015 and became effective, and a condition on the Bank's license, on 11 January 2016. Under the 2015 Requirements, the Bank was designated as a "high impact institution" which resulted in a number of significant incremental obligations. The Bank sought and received derogations from a number of those incremental obligations. Following the resignation of an Independent Non-Executive Director on 31 December 2015, the Bank was not in compliance with certain material provisions of the 2015 Requirements and the CBI was notified accordingly. On the appointment of Mr Simon Ball with effect from 27 March 2017, the Bank was compliant with the 2015 Requirements and remained in compliance throughout the remainder of 2017.

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 applicable to debt listings of the Main Securities Market of the Irish Stock Exchange.

#### *Board Committee*

In accordance with section 167 of the Companies Act 2014, the Directors confirm that an Audit Committee ("the Committee") is established. The Board is assisted in the discharge of its duties by this Committee which operates under Terms of Reference approved by the Board. During 2017, the Committee did not have the necessary quorum following Ms. Eileen Kelliher's resignation on 31 December 2015 and so the Board of Directors considered audit related matters during Board meetings up to June 2017.

On 6 June 2017, following the appointment of Mr. Ball to the Board and Committee in March 2017, the first Audit Committee meeting of 2017 was held. During 2017, the Board and, later the Committee, had oversight responsibility for audit matters including:

- the quality and integrity of the Bank's accounting policies, financial statements and disclosure practices;
- 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 (continued)

#### Board Committee (continued)

During 2017, the Board's, and later the Committee's, responsibilities on audit related matters were discharged during meetings via receipt of reports from management including Finance, Internal Audit, Risk and Compliance. Prior to the reconstitution of the Committee, the Board reviewed the Bank's annual financial statements prior to approval, including the Bank's accounting policies and practices. During the remainder of 2017, the Committee met on 3 occasions and amongst other activities the Committee reviewed the effectiveness of internal controls; including the effectiveness of controls operated under the Outsourcing and Agency Agreement; 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 was effective. The Committee ensures that appropriate measures are taken to consider and address any control issues identified by Internal Audit and the Auditor.

#### Results for the year

	2017	2016	
<b>Net interest income ('NII')</b>	<b>€363m</b>	€427m	Reduction in NII, being impact of 2016 and 2017 fixed and variable price reductions and increased funding costs due to the application of a new transfer pricing agreement.
<b>Administrative expenses</b>	<b>€383m</b>	€70m	In 2017, expenses increased by €313m being amounts payable to AIB increased €266m following the implementation of a revised transfer pricing arrangement for 2017 which resulted in additional allocated charges (further details below) and an increase in provisions for customer redress and other costs €47m.
<b>Profit before tax</b>	<b>€98m</b>	€417m	The reduction in profit before tax is largely driven by the transfer pricing change with AIB.
<b>New lending</b>	<b>€1,462m</b>	€1,220m	During 2017 the Bank advanced new lending of €1,462m which was 20% increase on 2016.
<b>Loans &amp; receivables to customers</b>	<b>€18,231m</b>	€18,754m	In 2017 gross mortgage balances fell by €916m, as repayments & restructures exceeded new lending by €670m and sale of a portfolio of impaired loans €244m. This is offset by reduction in provision stock of €389m being provision releases €114m, amounts written off €162m and €113m utilised on the sale of a portfolio of impaired loans.
<b>Loans &amp; receivables to banks</b>	<b>€98m</b>	€470m	€372m lower at 31 December 2017 due to a reduction in derivative collateral balances held with AIB following the maturity of the Series 4 Bond during 2017.
<b>Deposits by banks</b>	<b>€8,145m</b>	€8,972m	Borrowings from AIB fell by €827m during 2017 due to a reduction in loans and receivable from customers and loans and receivables from banks.
<b>Debt securities in issue</b>	<b>€7,490m</b>	€7,665m	€174m lower as the bond maturities exceeded new issues in 2017.
<b>Total Tier 1 ratio (transitional)</b>	<b>33.8%</b>	28.7%	Reduction of €960m in risk weighted assets and Total Tier 1 capital increase of €87m in 2017.

In 2017, following a request from AIB, a review was completed of pricing arrangements between AIB and its' wholly owned subsidiary AIB Mortgage Bank. Arising from this review a new arms' length pricing agreement covering the totality of the relationship with AIB, was signed and implemented during 2017 replacing the previous arrangements which were "grandfathered" under Irish Revenue rules. The new agreement reflects OECD guidelines on transfer pricing which are the internationally accepted principles in this area, and take account of the functions, risks and assets involved.

The impact of implementing the new transfer pricing agreement which attributes an arm's length Return on Equity to the Bank of €86m, is an increase in Administrative expenses for 2017 of €266m, being the primary reason for the reduction in profit after tax to €86m (2016: €365m). The additional charge is in respect of credit management, central function costs, risks borne by and assets provided by AIB in facilitating the operations of the Bank.



## Directors' Report (continued)

### Business review

The Irish economy improved during 2017 including a decreasing unemployment rate standing at 6.2% at the end of December 2017 against 7.2% in 2016 (Source: Central Statistics Office) and decreasing mortgage arrears. Total mortgage market drawdowns in Ireland were €7.3bn in 2017 compared with €5.7bn in 2016. Throughout 2017 there was increased competition in the mortgage market with new entrants and with competitors offering lower interest rates and incentives to new borrowers.

The CSO Residential Property Price Index showed an increase in prices nationally of 12.3% in the 12 months to December 2017 (8.1% in 2016). This was particularly evident outside Dublin where the 2017 annual increase was 13.3% (December 2016 12.0%). Property prices in Dublin increased in the 12 month period by 11.6% (increase of 5.7% in 2016). The residential property price fall from peak (February 2007) was 24.4% Dublin and 28.4% non-Dublin at 31 December 2017 (2016: 33.0% Dublin and 37.0% non-Dublin).

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 4.6% during 2017 to €18.8bn as at 31 December 2017 principally because repayments, loan sales and restructures exceeded loans granted during the year (2016: decrease of 4%).

The Bank's residential mortgage portfolio comprises €15.5bn owner occupier (2016: €15.6bn) and €3.3bn buy-to-let mortgages (2016: €4.1bn). The owner occupier portfolio is comprised of 37% ECB tracker (2016: 41%), 54% variable interest rate (2016: 49%) and 9% fixed rate mortgage loans (2016: 10%). Interest only loans represent 1% of the owner occupier portfolio (2016: 1%). The buy-to-let portfolio is comprised of 61% ECB tracker (2016: 61%), 38% are on variable interest rates (2016: 38%) and 1% are fixed (2016: 1%). Interest only loans make up 6% of the buy-to-let portfolio (2016: 8%).

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, borrower repayment capacity and loan restructures, the Bank's impaired loans have decreased by €0.8bn, or 36%, to €1.4bn, equal to 7% of total loans (2016: €2.2bn, or 11%).

In 2015, the Bank created a provision of €50m related to the expected outflow for customer redress and compensation in respect of tracker mortgages where rates given to customers were either not in accordance with original contract terms or where the transparency of terms did not conform to that which a customer could reasonably expect (Tracker Mortgage Examination). Over the past two years over 1,900 customers were redressed and compensated.

The Bank continues to face challenges like the Tracker Mortgage Examination programme. As they arise, the Bank together with AIB commit the required resources to deal with them in an open and fair way for our customers and stakeholders. That is what is expected of us and it is how the Bank will continue to rebuild trust and public confidence. The Tracker Mortgage Examination programme has been a long programme, which started in 2015 and is now defined by the Central Bank of Ireland Framework. This includes a full independent third party review and an appeals process, which takes time to complete. We believe we have conducted this examination in a fair and transparent manner, most recently agreeing with the Central Bank to include within the Framework a grouping of additional customers who never had a tracker mortgage. However, the scale of this issue has continued to erode trust and confidence in the banking industry as a whole. This is regrettable as we are fully cognisant of our obligations, and being a good corporate citizen is an important objective of the Bank. Customers are assured that payments they receive under the redress and compensation scheme will not compromise their right to appeal so we can reasonably expect that activities might flow on from this for some time. We have made very material progress and expect to conclude the main customer elements by Q2 2018.

It was concluded that a further €42m income statement charge is required for 2017. This amount includes €30m following conclusion of a review in 2017, that c. 900 additional accounts which were no longer on a tracker rate were deemed impacted and c. 4,000 additional accounts which were never on a tracker rate would also be paid compensation, and €12m in respect of previously identified customers that had yet to receive redress and compensation by 31 December 2017.

This brings the year end provision for customer redress and compensation to €40m to cover payments to these additional customers as well as the remaining customers that had yet to receive redress and compensation by 31 December 2017. The final redress and compensation is subject to independent third party assurance and is also subject to assessment and challenge by the Central Bank, notwithstanding the advanced stage of the examination process in the Bank.

In 2015, the Bank also created a provision of €48m with regard to 'Other costs'. A further €5m was charged to the income statement in 2017. Over the past two years €39m was utilised bringing the provision for 'Other costs' to €14m at 31 December 2017.

## Directors' Report (continued)

### Funding activities

There was a favourable technical market backdrop for covered bonds in 2017, with the ECB's covered bond purchase programme (CBPP3) continuing to actively buy bonds in both the primary and secondary markets during the year. CBPP3 is aimed at enhancing the functioning of the monetary policy transmission mechanism, supporting financing conditions in the euro area, and facilitating credit provision to the real economy. As of 23 February 2018, the holdings under CBPP3 were to c. €247bn (2016: €213bn). The ECB announced at its October 2017 meeting that it will scale back asset purchases under its Quantitative Easing (QE) programme from the start of 2018. The ECB also repeated that it intends to keep interest rates at their current very low levels well past the time horizon of the current QE programme. The ECB deposit rate stands at -0.4%.

Covered bond spreads tightened over the course of 2017, supported by CBPP3 buying and a reduction in net supply as issuers utilised other funding sources, such as the ECB's Targeted Long Term Refinancing Operation scheme (TLTROII). The Bank did not issue covered bonds to external market investors in 2017 in line with AIB's overall funding priorities and plan. On the 29 June 2017, the Series 4.1 & 4.2 €1.675bn bond reached its maturity date and was redeemed in full. In addition, on the 22 August 2017, retained bonds Series 11 & 23 for €850m & €400m respectively were redeemed several months in advance of their scheduled maturity.

On the 24 February 2017, retained bonds Series 32 & 33, each for €750m, were issued with 7 year and 10 year maturities respectively and on the 13 July 2017, retained bonds Series 34 & 35, for €500m & €750m were issued with 5 year and 10 year maturities respectively.

At 31 December 2017, the total amount of principal outstanding in respect of mortgage covered securities issued was €7.5bn (31 December 2016: €7.7bn), of which €3.6bn was held by external debt investors (31 December 2016: €5.3bn) and €3.9bn by AIB (31 December 2016: €2.4bn).

A decision to reduce the number of ratings on the bond programme was taken in Q1 2017 by management. The decision to withdraw the Fitch ratings on the covered bond programmes is in line with AIB's and the Bank's cost and efficiency objectives. The Bank's bond programme continues to be rated by Moody's at Aaa and Standard & Poor's at AAA both with a stable outlook. S&P upgraded the programme to AAA in January 2017 following an improvement in AIB's ratings.

The ratings as at 31 December 2017 for the Bank's Covered Bond Programme, AIB and Ireland are shown below:

Rating Agency	AIB Mortgage Bank Covered Bond Programme	AIB Issuer default rating	Ireland (Sovereign)
Moody's	Aaa	Baa2	A2
Standard & Poor's	AAA	BBB-	A+

### Share Capital

The share capital of the Bank is €1,745m (2016: €1,745m), comprised of ordinary shares of €1 each. Information on the structure of the Bank's share capital, including the rights and obligations attaching to each class of shares, is set out in note 23 to the financial statements.

### Capital resources and regulatory capital ratios

The table below shows the components of the Bank's Total Tier 1 and Total capital ratios:

	CRD IV Transitional basis		CRD IV Fully loaded basis	
	31 December 2017	31 December 2016	31 December 2017	31 December 2016
	€ m	€ m	€ m	€ m
Shareholders' Equity	2,393	2,307	2,393	2,307
Regulatory adjustment	(3)	(4)	(13)	(25)
<b>Total Tier 1 capital</b>	<b>2,390</b>	<b>2,303</b>	<b>2,380</b>	<b>2,282</b>
<b>Tier 2 Capital</b>				
Credit provisions	21	10	19	6
Subordinated debt	300	300	300	300
<b>Total Tier 2 capital</b>	<b>321</b>	<b>310</b>	<b>319</b>	<b>306</b>
<b>Total capital</b>	<b>2,711</b>	<b>2,613</b>	<b>2,699</b>	<b>2,588</b>
<b>Risk Weighted Assets</b>				
Credit risk	6,540	7,616	6,540	7,616
Operational risk	535	419	535	419
<b>Total Risk Weighted Assets</b>	<b>7,075</b>	<b>8,035</b>	<b>7,075</b>	<b>8,035</b>
<b>Total Tier 1 capital ratio</b>	<b>33.8%</b>	<b>28.7%</b>	<b>33.6%</b>	<b>28.4%</b>
<b>Total capital ratio</b>	<b>38.3%</b>	<b>32.5%</b>	<b>38.1%</b>	<b>32.2%</b>



## Directors' Report (continued)

### Capital resources and regulatory capital ratios (continued)

The Bank is required to maintain a Core Equity Tier 1 ratio of 6.375% effective from 1 January 2018 (2017: 5.75%). This includes a Pillar 1 requirement of 4.5% and a capital conservation buffer ("CCB") of 1.875% (2016: 1.25%). The minimum requirement for the transitional total capital ratio is 9.875% (2016: 9.25%). The transitional Total Tier 1 and Total capital ratios at 31 December 2017 were 33.8% and 38.3 % respectively (2016: 28.7% and 32.5% respectively). These ratios are significantly in excess of the regulatory requirements.

The Capital Requirements Directive IV ("CRD IV"), which came into force on 1 January 2014, comprises a Capital Requirements Directive and a Capital Requirements Regulation which implements the Basel III capital proposals together with transitional arrangements for some of its requirements. Under the fully loaded CRD IV capital basis the impact of the adjustments for the credit provisions reduces the Total Capital ratio by 0.2% at 31 December 2017 (2016: 0.3%).

The Total Tier 1 and Total capital ratios in the table on the previous page are calculated by dividing the respective capital figure (Total Tier 1 capital or Total capital) by the total risk weighted assets for each basis.

### Risk Management

The Bank adopts the same risk management framework and risk mitigation initiatives as AIB. The risk management framework provides a Group-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 Risk Management, including the principal risks and uncertainties facing the Bank, as required under the terms of the European accounts Modernisation Directive (2003/51/EEC) (implemented in Ireland by the European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005) is set out in the Risk Management Report on pages 11 to 48.

### Outlook and priorities for 2018

The past number of years have seen a stronger than expected recovery by the Irish economy and this was again evident in 2017 as the economy performed ahead of expectations with increased employment levels and exports maintaining their strong upward trend. The unemployment rate fell to 6.2% by the end of 2017 and consumer confidence was close to a 15-year high in H2 2017.

There was a further increase in housing completions in Ireland in 2017 and a corresponding growth in mortgage lending of 29%. Housing completions continue to be well below the required demand level but further growth is expected in 2018.

Brexit remains an area of concern but to date there has been little net impact on the Irish economy. The UK economy has been negatively impacted, however, we will continue to monitor this in the context of the Irish economy, the bank and our customers.

Most forecasters see economic growth in Ireland slowing somewhat to around 4% in 2018, with the uncertainty around Brexit, the slowdown in UK economic activity and the rise of the euro, especially against sterling, all seen as headwinds. However, this would still be a very good performance by the Irish economy. Leading indicators of activity remain strong, pointing to continued good economic growth. The favourable external environment will support exports, with domestic spending underpinned by continuing low interest rates and rising employment and incomes, as well as the ongoing rebound in construction activity. This should result in a further strong rise in new lending activity in 2018.

### Going concern

The Directors of the Bank have prepared the financial statements on a going concern basis.

The Bank is dependent on AIB for continued funding and is therefore dependent on the going concern status of the parent. The financial statements of AIB have been prepared on a going concern basis.

In making its assessment, the Directors of AIB have considered a wide range of information relating to present and future conditions. These have included financial plans covering the period 2018 to 2020 approved by the AIB Board in December 2017, liquidity and funding forecasts, and capital resources projections, all of which have been prepared under base and stress scenarios.

On the basis of the continued availability of funding from AIB to the Bank, the Directors of the Bank believe that it is appropriate to prepare the financial statements on a going concern basis.

## Directors' Report (continued)

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

The Directors and Company Secretary did not hold any interests in the Bank's shares or debentures the beginning of the year, during the year or at the year end.

Shares held by the Directors in ultimate parent company AIB Group plc were below 1% and not disclosable under the Companies Act 2014. There were no changes in the Directors' and Company Secretary's interests between 31 December 2017 and 13 March 2018.

### Share options

Share options were not granted or exercised during the year. Independent Non-Executive Directors do not participate in share option schemes.

### 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 2017. Independent Non-Executive Directors do not participate in long term incentive plans.

### Attendance at scheduled Board Meetings during 2017

Name	Board		Out of Course		Board Audit Committee	
	A	B	A	B	A	B
<b>Directors</b>						
Dave Keenan	4	3	1	1	-	-
Ken Burke	3	3	1	1	-	-
Simon Ball	3	3	1	1	3	3
Chris Curley	3	3	1	1	-	-
Gerry Gaffney	4	3	1	0	-	-
James Murphy	4	4	1	1	3	3
Jim O'Keeffe (resigned 06/04/2017)	1	1	-	-	-	-
Catherine Woods	4	4	1	1	3	3

Column A indicates the number of scheduled meetings held during 2017 which the Director was eligible to attend; Column B indicates the number of meetings attended by each Director during 2017.

### Directors and Secretary

The following were Directors of the Bank during 2017 – Dave Keenan, Ken Burke, Simon Ball, Chris Curley, Gerry Gaffney, James Murphy, Jim O'Keeffe, and Catherine Woods.

The Company Secretary during 2017 was Emma Murphy.

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

Mr Jim O'Keeffe resigned as Managing Director and from the Board on 6 April 2017.

Mr Simon Ball was appointed as a Non-Executive Director of the Board and a member of the Audit Committee on 27 March 2017.

Mr Ken Burke and Mr Chris Curley were appointed as Managing Director and Executive Director respectively on 6 April 2017. Ms Louise Cleary resigned as Company Secretary and Ms Emma Murphy was appointed as Company Secretary on 6 June 2017.

### Directors Remuneration

Details of total remuneration of the Directors in office during 2017 and 2016 are shown in the Remuneration Table in note 7.

### Dividend

There was no interim dividend paid to the shareholder during 2017 and the Board is not recommending the payment of a final dividend for 2017 (2016: no dividend paid).



## Directors' Report (continued)

### Accounting Policies

The principal accounting policies, together with the basis of preparation of the financial statements, are set out in note 1 to the financial statements

### Political Donations

The Directors have satisfied themselves that there were no political contributions during the year that require disclosure under the Electoral Act 1997.

### Branches Outside the State

The Bank has not established any branches outside the State.

### Disclosure Notice under Section 33AK of the Central Bank Act 1942

The Bank did not receive a Disclosure Notice under Section 33AK of the Central Bank Act 1942 during 2017.

### Adequate Accounting Records

The Directors have complied with the requirements of Section 281 to 285 of the Companies Act 2014 with regard to adequate accounting records by allocating personnel with appropriate expertise and by providing adequate resources to the financial function under the Outsourcing and Agency Agreement for the provision of various services including accounting and other financial services to the Bank by AIB. The accounting records of the Company are maintained at the registered office of its ultimate parent at AIB Group plc, Bankcentre, Ballsbridge, Dublin 4.

### Events since the year end

There have been no significant events affecting the Company since the reporting date which require amendment to, or disclosure in, the financial statements.

### Statement of Relevant Audit Information

Each of the Persons who is a Director at the date of approval of this Report confirms that:

- (a) so far as the Director is aware, there is no relevant audit information of which AIB's Auditors are unaware; and
- (b) the Director has taken all steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that AIB's Auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 330 of the Companies Act 2014.

### Independent auditor

Deloitte, Chartered Accountants and Statutory Audit Firm, were appointed as auditors on 28 June 2013 and have expressed their willingness to continue in office under Section 383(2) of the Companies Act, 2014.

On behalf of the Board,



Dave Keenan  
Chairman



Ken Burke  
Managing Director

Date: 13 March 2018

## 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 across AIB. Certain risks can be mitigated by the use of safeguards and appropriate systems and actions which form part of the AIB's risk management framework. The Bank experiences similar risks and uncertainties facing AIB and adopts the same risk mitigation initiatives as AIB.

### 2. Risk management framework

The Bank relies on AIB's framework and its supporting policies, processes and governance. For more information on the operation of the Board of the Bank see page 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 AIB's material risk assessment process and which are relevant to the Bank:

- 3.1 Credit risk;
- 3.2 Restructure execution risk;
- 3.3 Funding and liquidity risk;
- 3.4 Capital adequacy risk;
- 3.5 Market risk;
- 3.6 Operational risk;
- 3.7 Regulatory compliance risk including conduct risk;
- 3.8 People and culture risk;
- 3.9 Business model risk, and
- 3.10 Model risk.

*Note: Regulatory compliance risk and conduct risk are two separate risk types but are grouped together within disclosure 3.7 as they are both managed in line with the processes, procedures and organisational structures for the management of Regulatory compliance risk.*

## Risk Management Report (continued)

### 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 the Republic of Ireland. Credit risk also arises on funds placed with other banks, derivatives relating to interest rate risk management and 'off-balance sheet' commitments.

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.

#### ***Credit risk organisation and structure***

AIB's credit risk management systems operate through a hierarchy of lending authorities. The Bank relies on the AIB 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 AIB Credit Risk function is to provide direction, oversight and challenge of credit risk-taking. The Bank's Risk Appetite Statement sets out the credit risk appetite and framework. Credit Risk appetite is set at Board level and is described, reported and monitored through a suite 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.

#### ***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 their obligations;
- Exposure at default ("EAD") – the exposure to a borrower who is unable to repay their 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, the Bank 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 and 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.

## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### Measurement of credit risk (continued)

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, or loans that are in a post impairment/restructuring phase; 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 continue to be 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.

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	2017 Total € m	Amortised Cost € m	Fair Value € m	2016 Total € m
Derivative financial instruments	-	70	70	-	192	192
Loans and receivables to banks	98	-	98	470	-	470
Loans and receivables to customers	18,231	-	18,231	18,754	-	18,754
Included elsewhere:						
Accrued interest	32	-	32	39	-	39
Other assets	15	-	15	8	-	8
	18,376	70	18,446	19,271	192	19,463
Off balance sheet loan commitments	680	-	680	579	-	579
<b>Maximum exposure to credit risk</b>	<b>19,056</b>	<b>70</b>	<b>19,126</b>	<b>19,850</b>	<b>192</b>	<b>20,042</b>

#### Risk management and mitigation

The Bank has an established credit process through AIB with a framework of a mortgage credit policy and delegated authorities, based on skill and experience, for the management and control of credit risk. A credit risk framework sets out at a high level, how AIB identifies, assesses, approves, monitors, repairs and controls credit risk. It contains minimum standards that are applied across AIB to provide a common and consistent approach to the management 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. This includes cyclical credit reviews, non-standard reviews and bespoke assignments including impairment adequacy reviews as required.

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

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



## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### 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 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 the Bank. All properties are required to be fully insured.

The following tables show the fair value of collateral held for residential mortgages at 31 December 2017 and 31 December 2016:

				2017
	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%	6,514	190	295	6,999
50% - 70%	5,253	138	304	5,695
71% - 80%	2,163	43	145	2,351
81% - 90%	1,501	38	145	1,684
91% - 100%	812	18	136	966
	16,243	427	1,025	17,695
<b>Partially collateralised</b>				
Collateral value relating to loans over 100% LTV	554	19	316	889
<b>Total collateral value</b>	<b>16,797</b>	<b>446</b>	<b>1,341</b>	<b>18,584</b>
<b>Gross residential mortgages</b>	<b>16,898</b>	<b>455</b>	<b>1,425</b>	<b>18,778</b>
Statement of financial position: specific provisions			(396)	(396)
Statement of financial position: IBNR provisions				(151)
<b>Net residential mortgages</b>			<b>1,029</b>	<b>18,231</b>

The decrease in the collateral values for impaired loans reflects the reduction in impaired loans during 2017, largely due to loans curing from impairment, write-offs and the disposal of a buy-to-let distressed mortgage portfolio in the year.

				2016
	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%	5,062	166	246	5,474
50% - 70%	4,803	140	299	5,242
71% - 80%	2,275	52	185	2,512
81% - 90%	1,786	39	193	2,018
91% - 100%	1,156	40	211	1,407
	15,082	437	1,134	16,653
<b>Partially collateralised</b>				
Collateral value relating to loans over 100% LTV	1,631	56	827	2,514
<b>Total collateral value</b>	<b>16,713</b>	<b>493</b>	<b>1,961</b>	<b>19,167</b>
<b>Gross residential mortgages</b>	<b>16,988</b>	<b>511</b>	<b>2,191</b>	<b>19,690</b>
Statement of financial position: specific provisions			(770)	(770)
Statement of financial position: IBNR provisions				(166)
<b>Net residential mortgages</b>			<b>1,421</b>	<b>18,754</b>

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

## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### **Collateral\* (continued)**

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.

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. When assessing the value of residential properties, recent transactional analysis of comparable sales in the area combined with the Central Statistics Office ("CSO") Residential Property Price index in the Republic of Ireland are used.

#### **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.

The Bank uses a range of initiatives to support customers. It 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 Bank 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 Bank and the borrower.

AIB has introduced a Mortgage Arrears Resolution Process ("MARP") for dealing with mortgage customers in difficulty or likely to be in difficulty. The core objectives of this process is 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. It includes long-term forbearance solutions which have been devised to assist existing Republic of Ireland primary residential mortgage customers in difficulty.

Under the definition of forbearance, which complies with the definition of Forbearance prescribed by the EBA, loans subject to forbearance measures remain in forbearance stock for a period of two years from the date forbearance is granted regardless of the forbearance type. Therefore, cases that receive a short-term forbearance measure, such as interest only, and return to a full principal and interest repayment schedule at the end of the interest only period, will remain in the stock of forbearance for at least two years.

The four step process is summarised as follows:

- Communications – We are here to listen, support and provide advice;
- Financial information – To allow us to understand the customer finances;
- Assessment – Using the financial information to assess the customer's situation; and
- Resolution – We work with the customer to find a resolution.

The core objective of the process is to determine sustainable solutions that where possible, help to keep customers in their home. This includes the following longer-term forbearance solutions which have been devised to assist existing Republic of Ireland primary residential mortgage customers in difficulty:

**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;

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



## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### *Forbearance strategies\* (continued)*

**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;

**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; and

**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.

Credit policies are in place which outline the principles and processes underpinning AIB's approach to mortgage forbearance, which the Bank has adopted.

#### *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 AIB'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 AIB'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/or when accounts reach 90 days past due.

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

- A request for a forbearance measure from the borrower;
- Deterioration in the debt service capacity;
- A material decrease in rents received on a buy-to-let property; and
- A material decrease in property value.

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;
- Loss of employment;
- Reduction in net worth;
- Planned sale of property asset did not take place; and
- Disappearance of an active market for refinancing or sale of assets.

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.

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

## Risk Management Report (continued)

### 3.1 Credit risk (continued)

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

##### ***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 estimated 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 €1,000,000 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 for 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 the borrower 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 €1,000,000.

The individually insignificant mortgage provisioning methodology applies to both owner-occupier and buy-to-let exposures.

For individually insignificant mortgages, specific impairment provisions are calculated using an individually insignificant and IBNR mortgage provisioning model. The methodology is based on the calculation of three possible resolution outcomes for each loan: cure; advanced forbearance with loss; and property disposal (forced and voluntary), with different loss rates associated with each. The model parameters are regularly reviewed and updated to reflect current data on loss history and portfolio composition.

The model parameters were refined during the year based on updated market and transactional data.

Key model parameters at 31 December 2017 for owner-occupier mortgages are as follows: cure (19%); and disposal/forbearance (81%), (2016: cure 14% and disposal/forbearance 86%).

The corresponding buy-to-let model parameters at 31 December 2017 are as follows: cure (11%) and disposal/forbearance (89%), (2016: cure 7% and disposal/forbearance 93%).

The cure rate parameter in the individually insignificant model reflects the percentage of loans which were impaired/defaulted but have exited impairment/default after a 12 month satisfactory performance and no loss to the Bank.

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: likelihood of property disposal, haircuts, costs and time to dispose (voluntary and forced); house price fall from peak and loss rate on advanced forbearance.

The model parameters are reviewed at AIB credit committee on a quarterly basis. The main parameter changes for the year ended 31 December 2017 were improvements in the CSO index and the property market fall from peak, an increase in observed cure rates and increases in disposal haircuts and recovery periods. Whilst each parameter is reviewed on an individual basis, the interconnectedness of the parameters within the model is taken into account. Each loan is assigned probability weighted resolution outcomes which determines the loss amounts.

\*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.



## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### Loan loss provisioning (continued)

##### Incurring But Not Reported Provisions (IBNR) (continued)

The residential mortgage portfolio IBNR is calculated using the individually insignificant and IBNR mortgage model described on the previous page. The IBNR is calculated as PD multiplied by LGD, multiplied by Exposure (adjusted for the Emergence Period) with the PD and LGD derived from statistical models. Cured and Forborne non-impaired loans are higher stressed and are therefore, assigned a higher PD. The table below sets out the parameters used in the calculation of IBNR for the residential mortgages portfolio as at 31 December 2017 and 31 December 2016.

Grade	Owner-Occupier			Buy-to-let			2017
	Exposure	Average PD	Average	Exposure	Average PD	Average	
	€ m	%	LGD %	€ m	%	LGD %	
Good upper <sup>(1)</sup>	7,232	0.3	15.4	938	1.3	15.8	
Good lower <sup>(2)</sup>	5,444	0.6	16.5	706	2.8	19.9	
Watch	438	1.4	18.5	89	5.9	19.2	
Vulnerable	1,666	15.2	16.5	839	19.7	24.0	

<sup>(1)</sup> Good upper: Strong credit with no weakness evident. Typically includes elements of the residential mortgages portfolio combined with strong corporate and commercial lending.

<sup>(2)</sup> Good lower: Satisfactory credit with no weakness evident. Typically includes new business written and existing satisfactorily performing exposures across all portfolios.

Included in the above table are the following sub portfolios which carry a higher level of IBNR. It should be noted that due to the small volumes of Buy-To-Let exposures in these categories the average PDs and LGDs can vary significantly – this is the main driver of the change in these values:

Cured	93	22.1	18.2	71	17.4	24.5
Forborne – Non impaired	1,269	15.3	17.0	525	21.9	25.3

Grade	Owner-Occupier			Buy-to-let			2016
	Exposure	Average PD	Average	Exposure	Average PD	Average	
	€ m	%	LGD %	€ m	%	LGD %	
Good upper	6,641	0.3	13.3	940	1.4	17.8	
Good lower	5,633	0.6	14.8	828	3.2	22.4	
Watch	707	1.5	18.1	143	6.1	23.4	
Vulnerable	1,648	15.8	15.3	959	19.8	26.1	

Included in the above table are the following sub portfolios which carry a higher level of IBNR:

Cured	165	24.5	16.1	104	19.7	27.8
Forborne – Non impaired	1,396	14.3	15.9	751	18.5	26.9

The parameters for Cured and Forborne non-impaired, are as follows:

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 and IBNR mortgage model. The mortgage provision model calculates individually insignificant specific provisions and IBNR provisions.

Additional IBNR, where appropriate, determined by management judgement, is applied at a portfolio level and is not included in the analysis above.

## 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; and
- 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 2017, there was no change made to the emergence period for the mortgage portfolio (12 months).

##### ***Approval Process\****

AIB 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 a designated Credit Risk representative 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 AIB's Credit Committee and Board (where applicable). Segment impairments and provisions are ultimately reviewed by AIB's 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 AIB 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, 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.

##### ***Reversal 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 judgement 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 not being 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.

\*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)\**

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.

In assessing the value of collateral for collectively provided impaired mortgage loans in the Republic of Ireland, AIB has used a house price fall from peak of 32% Dublin and 37% 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) (2016: 40% and 44% respectively).

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 1.0% (blended rate of owner-occupier/buy-to-let) or c. €4m. December 2016 equivalent: reduction of 0.5% or c. €3m.

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 2017 is estimated to result in movements in provisions of c. €6m. December 2016 equivalent: €9.3m.

A 1% move in the haircut for a Dublin sale would result in a change of €1.7m in provisions, (€1.1m Individually Insignificant and €0.6m IBNR). December 2016 equivalent: €2.2m (€1.6m II and €0.6m IBNR). A 1% move in the haircut for a sale outside Dublin would result in a change of €4.4m in provisions, (€3.2m II and €1.3m IBNR). December 2016 equivalent: €5.9m (€4.5m II and €1.3m IBNR).

An increase in the assumed repossession rate of 1% for collective mortgage provisions would result in an increase in provisions of 0.3% (blended rate of owner-occupier/buy-to-let) of c. €1.2m. December 2016 equivalent: increase of 0.7% or c. €4m.

\*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)\**

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. €7m.

Individually impaired loans by geographic location and sector*	2017	2016
	€ m	€ m
Republic of Ireland		
Residential mortgages	1,425	2,191
	1,425	2,191

#### Provision cover table

	Impaired Loan Balance € m	Specific Provision € m	Specific Provision Cover %
Residential mortgages – 31 December 2017	1,425	396	27.8
Residential mortgages – 31 December 2016	2,191	770	35.1

The specific provision cover level decreased in 2017. The decrease was primarily due to write offs and the disposal of a buy-to-let distressed mortgage portfolio in the year.

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

## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### Loan loss provisioning (continued)

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.

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

Statement of financial position	2017*			2016*		
	Owner-Occupier	Buy-to-Let	Total	Owner-Occupier	Buy-to-Let	Total
	€ m	€ m	€ m	€ m	€ m	€ m
Total gross residential mortgages	15,488	3,290	18,778	15,630	4,060	19,690
In arrears (> 30 days past due) <sup>(1)</sup>	899	824	1,723	1,192	1,325	2,517
In arrears (> 90 days past due) <sup>(1)</sup>	840	803	1,643	1,130	1,288	2,418
Of which impaired	707	718	1,425	1,001	1,190	2,191
Statement of financial position specific provisions	168	228	396	320	450	770
Statement of financial position IBNR provisions	73	78	151	73	93	166

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

Total impaired loans amounted to €1,425m at 31 December 2017 (2016: €2,191m), of which €744m (2016: €975m) was individually assessed for impairment and €681m (2016: €1,216m) was collectively assessed for impairment.

#### Provision cover percentage\*

	2017*			2016*		
	Owner-Occupier	Buy-to-Let	Total	Owner-Occupier	Buy-to-Let	Total
	%	%	%	%	%	%
Specific provisions as a % of impaired loans cover	23.8	31.8	27.8	32.0	37.8	35.1

The specific provision cover level decreased in 2017. The decrease was primarily due to write offs and the disposal of a distressed mortgage portfolio in the year.

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

## Risk Management Report (continued)

### 3.1 Credit risk (continued)

Income statement <sup>(2)</sup>	2017*			2016*		
	Owner-Occupier	Buy-to-Let	Total	Owner-Occupier	Buy-to-Let	Total
	€ m	€ m	€ m	€ m	€ m	€ m
Income statement: specific provisions	(42)	(58)	(100)	(41)	(32)	(73)
Income statement: IBNR provisions	(11)	(3)	(14)	(11)	25	14
<b>Total impairment provisions</b>	<b>(53)</b>	<b>(61)</b>	<b>(114)</b>	<b>(52)</b>	<b>(7)</b>	<b>(59)</b>

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

The €114m provision writeback was mainly due to the impact of restructuring and loans curing from impairment as a result of improvements in the general economic environment, improved employment opportunities and growth in residential property prices.

#### 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.

	2017*			2016*		
	Owner-Occupier	Buy-to-Let	Total	Owner-Occupier	Buy-to-Let	Total
	€ m	€ m	€ m	€ m	€ m	€ m
<b>Satisfactory</b>	<b>12,677</b>	<b>1,644</b>	<b>14,321</b>	<b>12,259</b>	<b>1,753</b>	<b>14,012</b>
Watch	438	89	527	706	142	848
Vulnerable	1,666	839	2,505	1,664	975	2,639
Impaired	707	718	1,425	1,001	1,190	2,191
<b>Criticised</b>	<b>2,811</b>	<b>1,646</b>	<b>4,457</b>	<b>3,371</b>	<b>2,307</b>	<b>5,678</b>
<b>Gross mortgages</b>	<b>15,488</b>	<b>3,290</b>	<b>18,778</b>	<b>15,630</b>	<b>4,060</b>	<b>19,690</b>
	%	%	%	%	%	%
Criticised loans as % of total mortgages	18	50	24	22	57	29
Impaired loans as % of total mortgages	5	22	8	6	29	11

\*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 table profiles the residential mortgage portfolio that were past due but not impaired at 31 December 2017 and 31 December 2016:

	2017			2016		
	Owner-Occupier	Buy-to-Let	Total	Owner-Occupier	Buy-to-Let	Total
	€ m	€ m	€ m	€ m	€ m	€ m
1 - 30 days	112	46	158	123	61	184
31 - 60 days	39	13	52	43	24	67
61 - 90 days	21	7	28	18	13	31
91 - 180 days	26	14	40	32	24	56
181 - 365 days	28	20	48	31	24	55
Over 365 days	78	51	129	67	51	118
<b>Total past due but not impaired</b>	<b>304</b>	<b>151</b>	<b>455</b>	<b>314</b>	<b>197</b>	<b>511</b>

The majority of the above loans greater than 90 days in arrears are individually managed and tested for impairment but the outcome for these cases is that impairment is not required, primarily due to low LTV's.

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

The following table profiles the residential mortgage portfolio that were impaired at 31 December 2017 and 31 December 2016:

	2017			2016		
	Owner-Occupier	Buy-to-Let	Total	Owner-Occupier	Buy-to-Let	Total
	€ m	€ m	€ m	€ m	€ m	€ m
Not past due	148	124	272	219	215	434
1 - 30 days	35	20	55	47	36	83
31 - 60 days	18	17	35	23	24	47
61 - 90 days	10	10	20	15	18	33
91 - 180 days	25	24	49	31	38	69
181 - 365 days	37	43	80	57	64	121
Over 365 days	434	480	914	609	795	1,404
<b>Total impaired</b>	<b>707</b>	<b>718</b>	<b>1,425</b>	<b>1,001</b>	<b>1,190</b>	<b>2,191</b>

Impaired loans decreased by €766m during 2017 largely due to loans curing from impairment, write-offs and the disposal of a buy-to-let distressed mortgage portfolio in the year. Of the residential mortgage portfolio that was impaired at 31 December 2017, €272m or 19% was not past due (31 December 2016: €434m or 20%), of which €210m (31 December 2016: €325m) was subject to forbearance measures at 31 December 2017.

\*Forms an integral part of the audited financial statements

## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### Forbearance

AIB has introduced a Mortgage Arrears Resolution Process ("MARP") for dealing with mortgage customers in difficulty or likely to be in difficulty. The core objectives of this process is 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. It includes long-term forbearance solutions which have been devised to assist existing Republic of Ireland primary residential mortgage customers in difficulty.

The following tables analyses the movement in stock of loans subject to forbearance by (i) total residential mortgages, (ii) owner-occupier, and (iii) buy-to-let at 31 December 2017 and 31 December 2016:

#### (i) Total mortgage portfolio – subject to forbearance

	2017		2016	
	Number	Balance € m	Number	Balance € m
At 1 January	20,444	3,449	17,430	2,997
Additions	2,005	319	1,914	296
Expired arrangements	(3,528)	(565)	(2,638)	(461)
Payments	-	(215)	-	(190)
Interest	-	59	-	66
Closed accounts <sup>(1)</sup>	(1,870)	(257)	(964)	(117)
Advanced Forbearance Arrangements - Valuation Adjustments	-	(3)	-	(10)
Write-Offs <sup>(2)</sup>	(100)	(84)	(25)	(17)
Adoption of EBA Forbearance definitions	-	-	4,727	885
<b>At 31 December</b>	<b>16,951</b>	<b>2,703</b>	<b>20,444</b>	<b>3,449</b>

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

<sup>(2)</sup> The number of accounts only represents accounts closed in the period primarily as a result of the write-off, while the monetary values also include partial write-offs of accounts which remain open.

Residential mortgages subject to forbearance measures decreased by €746m in 2017 (2016: increase of €452m). This decrease is mainly driven by €565m of mortgages exiting forbearance in the year, having met the forbearance terms, and lower numbers of customers seeking new forbearance solutions which is reflective of improving customer ability to meet their mortgage terms. This has been driven by AIB's strategy to deliver sustainable long-term solutions to customers and support customers in remaining in their family home.



## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### Forbearance (continued)

##### (ii) Residential owner-occupier mortgages – subject to forbearance

	2017		2016	
	Number	Balance € m	Number	Balance € m
At 1 January	11,829	1,990	10,378	1,692
Additions	1,676	280	1,364	217
Expired arrangements	(2,643)	(410)	(1,451)	(249)
Payments	-	(95)	-	(86)
Interest	-	33	-	39
Closed accounts <sup>(1)</sup>	(413)	(53)	(313)	(37)
Advanced Forbearance Arrangements - Valuation Adjustments	-	(2)	-	(9)
Write-Offs <sup>(2)</sup>	(23)	(42)	(7)	(3)
Transfer from owner-occupier to buy-to-let	3	1	(3)	1
Adoption of EBA Forbearance definitions	-	-	1,861	425
<b>At 31 December</b>	<b>10,429</b>	<b>1,702</b>	<b>11,829</b>	<b>1,990</b>

##### (iii) Buy-to-let mortgages – subject to forbearance

	2017		2016	
	Number	Balance € m	Number	Balance € m
At 1 January	8,615	1,459	7,052	1,305
Additions	329	39	550	79
Expired arrangements	(885)	(155)	(1,187)	(212)
Payments	-	(120)	-	(104)
Interest	-	26	-	27
Closed accounts <sup>(1)</sup>	(1,457)	(204)	(651)	(80)
Advanced Forbearance Arrangements - Valuation Adjustments	-	(1)	-	(1)
Write-Offs <sup>(2)</sup>	(77)	(42)	(18)	(14)
Transfer from owner-occupier to buy-to-let	(3)	(1)	3	(1)
Adoption of EBA Forbearance definitions	-	-	2,866	460
<b>At 31 December</b>	<b>6,522</b>	<b>1,001</b>	<b>8,615</b>	<b>1,459</b>

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

<sup>(2)</sup> The number of accounts only represents accounts closed in the period primarily as a result of the write-off, while the monetary values also include partial write-offs of accounts which remain open.



## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### Forbearance (continued)

The following tables further analyse by type of forbearance, (i) total residential mortgages, (ii) owner-occupier, (iii) buy-to-let that were subject to forbearance measures at 31 December 2017 and 31 December 2016:

#### (i) Total residential mortgage portfolio

	2017*					
	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	3,312	572	1,402	255	1,910	317
Reduced payment <sup>(1)</sup>	1,146	249	549	129	597	120
Payment moratorium	1,598	292	253	40	1,345	252
Fundamental Restructures	828	111	422	56	406	55
Low fixed interest rate	216	40	49	8	167	32
Arrears capitalisation	5,449	909	2,384	420	3,065	489
Term extension	1,246	156	152	19	1,094	137
Split mortgage	751	134	208	36	543	98
Sale for loss	361	13	119	7	242	6
Positive equity solution	595	78	28	4	567	74
Restructure	961	67	804	47	157	20
Other <sup>(2)</sup>	488	82	226	38	262	44
<b>Total</b>	<b>16,951</b>	<b>2,703</b>	<b>6,596</b>	<b>1,059</b>	<b>10,355</b>	<b>1,644</b>

	2016*					
	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	3,428	634	1,402	267	2,026	367
Reduced payment <sup>(1)</sup>	1,432	335	750	189	682	146
Payment moratorium	1,154	207	235	38	919	169
Fundamental restructures	1,191	167	374	53	817	114
Low fixed interest rate	245	48	42	8	203	40
Arrears capitalisation	7,418	1,315	3,578	666	3,840	649
Term extension	1,770	236	219	31	1,551	205
Split mortgage	1,042	199	272	59	770	140
Sale for loss	399	17	113	9	286	8
Positive equity solution	716	93	28	3	688	90
Restructure	1,094	107	890	80	204	27
Other	555	91	280	51	275	40
<b>Total</b>	<b>20,444</b>	<b>3,449</b>	<b>8,183</b>	<b>1,454</b>	<b>12,261</b>	<b>1,995</b>

<sup>(1)</sup> Greater than interest only

<sup>(2)</sup> Included in 'Other' are: €35m relating to forbearance solutions whereby it has been agreed that the customers will dispose of the relevant assets but this has not yet completed; €24m relating to negative equity trade downs; and €4m relating to affordable mortgage solutions whereby customers agree to pay an amount that is affordable.

This decrease of €406m in arrears capitalisations in 2017 is largely driven by customer exiting forbearance having met their forbearance terms, and lower numbers of customers seeking new forbearance solutions which is reflective of improved customer ability to meet their mortgage terms.

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

## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### Forbearance (continued)

##### Total residential mortgage portfolio (continued)

AIB's processes for assessing customers and agreeing sustainable forbearance solutions have significantly improved over the last 4 years with the development of a suite of advanced forbearance products.

Interest income on impaired loans amounted to €26m in 2017 (2016: €37m). At 31 December 2017, the net carrying value of impaired loans amounted to €1,029m (€1,425m Impaired Balance - €396m Closing Specific Provision) which included forborne impaired mortgages of €633m. (€905m Forborne Impaired Balance - €273m Forborne Closing Specific Provision).

#### (ii) Owner-occupier mortgages

	2017*					
	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	1,873	317	598	112	1,275	205
Reduced payment <sup>(1)</sup>	700	154	338	84	362	70
Payment moratorium	1,425	261	138	21	1,287	240
Fundamental Restructures	-	-	-	-	-	-
Low fixed interest rate	209	39	49	8	160	31
Arrears capitalisation	3,547	576	1,396	244	2,151	332
Term extension	854	102	93	12	761	90
Split mortgage	638	113	139	22	499	91
Sale for loss	141	7	66	5	75	2
Positive equity solution	578	76	26	4	552	72
Restructure	252	18	181	9	71	9
Other	212	39	39	9	173	30
<b>Total</b>	<b>10,429</b>	<b>1,702</b>	<b>3,063</b>	<b>530</b>	<b>7,366</b>	<b>1,172</b>
	2016*					
	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	1,701	292	514	94	1,187	198
Reduced payment <sup>(1)</sup>	733	172	382	104	351	68
Payment moratorium	965	179	110	18	855	161
Fundamental Restructures	2	-	-	-	2	-
Low fixed interest rate	238	47	42	8	196	39
Arrears capitalisation	4,650	800	1,956	368	2,694	432
Term extension	1,226	159	122	18	1,104	141
Split mortgage	909	163	190	32	719	131
Sale for loss	181	10	67	7	114	3
Positive equity solution	691	90	27	3	664	87
Restructure	299	35	196	22	103	13
Other	234	43	32	9	202	34
<b>Total</b>	<b>11,829</b>	<b>1,990</b>	<b>3,638</b>	<b>683</b>	<b>8,191</b>	<b>1,307</b>

<sup>(1)</sup> Greater than interest only

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

## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### Forbearance (continued)

#### (iii) Buy-to-let mortgages

	2017*					
	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	1,439	255	804	143	635	112
Reduced payment <sup>(1)</sup>	446	95	211	45	235	50
Payment moratorium	173	31	115	19	58	12
Fundamental Restructures	828	111	422	56	406	55
Low fixed interest rate	7	1	-	-	7	1
Arrears capitalisation	1,902	333	988	176	914	157
Term extension	392	54	59	7	333	47
Split mortgage	113	21	69	14	44	7
Sale for loss	220	6	53	2	167	4
Positive equity solution	17	2	2	-	15	2
Restructure	709	49	623	38	86	11
Other	276	43	187	29	89	14
<b>Total</b>	<b>6,522</b>	<b>1,001</b>	<b>3,533</b>	<b>529</b>	<b>2,989</b>	<b>472</b>

	2016*					
	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	1,727	342	888	173	839	169
Reduced payment <sup>(1)</sup>	699	163	368	85	331	78
Payment moratorium	189	28	125	20	64	8
Fundamental restructures	1,189	167	374	53	815	114
Low fixed interest rate	7	1	-	-	-	1
Arrears capitalisation	2,768	515	1,622	298	1,146	217
Term extension	544	77	97	13	-	64
Split mortgage	133	36	82	27	51	9
Sale for loss	218	7	46	2	172	5
Positive equity solution	25	3	1	-	24	3
Restructure	795	72	694	58	101	14
Other	321	48	248	42	73	6
<b>Total</b>	<b>8,615</b>	<b>1,459</b>	<b>4,545</b>	<b>771</b>	<b>4,070</b>	<b>688</b>

<sup>(1)</sup> Greater than interest only

\*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\*

##### 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 2017 and 31 December 2016:

	2017			2016		
	Owner-Occupier	Buy-to-let	Total	Owner-Occupier	Buy-to-let	Total
Loan-to-value (LTV) ratio	€ m	€ m	€ m	€ m	€ m	€ m
Less than 50%	543	206	749	458	204	662
50% - 70%	481	218	699	462	231	693
71% - 80%	201	111	312	243	124	367
81% - 90%	164	103	267	210	140	350
91% - 100%	142	96	238	161	133	294
101% -120%	122	114	236	278	254	532
121% - 150%	27	67	94	124	178	302
Greater than 150%	14	55	69	27	135	162
Unsecured (Zero Collateral)	8	31	39	28	59	87
<b>Total</b>	<b>1,702</b>	<b>1,001</b>	<b>2,703</b>	<b>1,991</b>	<b>1,458</b>	<b>3,449</b>

The degree of negative equity in the residential mortgage portfolio that was subject to forbearance measures at 31 December 2017 has reduced to 10% of the owner-occupier and reduced to 27% of the buy-to-let mortgages compared to 23% and 43% respectively at 31 December 2016, mainly due to the increase in property prices and loan repayments in 2017.

\*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 - 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 2017 and 31 December 2016:

	2017			2016		
	Owner-Occupier	Buy-to-Let	Total	Owner-Occupier	Buy-to-Let	Total
	€ m	€ m	€ m	€ m	€ m	€ m
1 - 30 days	55	28	83	55	41	96
31 - 60 days	21	6	27	25	17	42
61 - 90 days	14	5	19	11	10	21
91 - 180 days	22	10	32	20	18	38
181 - 365 days	20	17	37	22	19	41
Over 365 days	56	30	86	46	27	73
<b>Total past due but not impaired</b>	<b>188</b>	<b>96</b>	<b>284</b>	<b>179</b>	<b>132</b>	<b>311</b>

11% of the residential mortgage portfolio that was subject to forbearance measures was past due but not impaired at 31 December 2017 (9%: 31 December 2016).

##### Forbearance stock – impaired

The following table profiles the residential mortgage portfolio that was subject to forbearance measures and which was impaired at 31 December 2017 and 31 December 2016:

	2017			2016		
	Owner-Occupier	Buy-to-Let	Total	Owner-Occupier	Buy-to-Let	Total
	€ m	€ m	€ m	€ m	€ m	€ m
Not past due	116	94	210	176	149	325
1 - 30 days	30	15	45	38	27	65
31 - 60 days	13	15	28	19	20	39
61 - 90 days	9	7	16	11	14	25
91 - 180 days	20	19	39	26	28	54
181 - 365 days	27	34	61	39	50	89
Over 365 days	218	288	506	286	418	704
<b>Total impaired</b>	<b>433</b>	<b>472</b>	<b>905</b>	<b>595</b>	<b>706</b>	<b>1,301</b>

The proportion of forbearance that is impaired decreased from 38% at 31 December 2016 to 33% at 31 December 2017. The proportion of forbearance impaired loans that were not past due decreased from 25% at 31 December 2016 to 23% at 31 December 2017.

\*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.

The number (stock) of properties as at 31 December 2017 and 31 December 2016 is set out below:

	2017		2016	
	Stock	Balance outstanding € m	Stock	Balance outstanding € m
Owner-occupier	133	31	139	32
Buy-to-let	42	8	76	15
<b>Total</b>	<b>175</b>	<b>39</b>	<b>215</b>	<b>47</b>

The stock of residential properties in possession decreased by 40 properties in 2017. This decrease relates to the disposal of 41 properties (31 December 2016: 39 properties) which were offset by the addition of 33 properties (31 December 2016: 63 properties).

In addition, a further 32 properties were removed from the stock in 2017 as part of the sale of a portfolio of distressed mortgages.

The following tables analyse the disposals of repossessed properties during the years 31 December 2017 and 31 December 2016:

	Number of disposals	2017				
		Balance outstanding at repossession € m	Gross sales proceeds € m	Costs to sell € m	Loss on sale <sup>(1)</sup> € m	Average LTV at sale price %
Owner-occupier	30	7	5	1	3	144%
Buy-to-let	11	2	1	-	1	192%
<b>Total residential</b>	<b>41</b>	<b>9</b>	<b>6</b>	<b>1</b>	<b>4</b>	<b>153%</b>

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

	Number of disposals	2016				
		Balance outstanding at repossession € m	Gross sales proceeds € m	Costs to sell € m	Loss on sale <sup>(1)</sup> € m	Average LTV at sale price %
Owner-occupier	28	6	4	1	3	168%
Buy-to-let	11	2	1	-	1	237%
<b>Total residential</b>	<b>39</b>	<b>8</b>	<b>5</b>	<b>1</b>	<b>4</b>	<b>183%</b>

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

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

The disposal of 41 residential properties resulted in a loss on disposal of €4m at 31 December 2017 (before specific impairment provisions). (2016: 39 disposals, €4m loss on disposal).

## 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 in the Republic of Ireland for October 2017. The CSO Residential Property Price Index for October 2017 reported that national residential property prices were 24% lower than their highest level in early 2007 and reported an annual increase in residential property prices of 12% for the twelve months to October 2017.

#### Actual and average LTV across mortgage portfolios

The following table profiles the residential mortgage portfolio by the indexed loan-to-value ("LTV") ratios and the weighted average indexed LTV ratios at 31 December 2017 and 31 December 2016:

	2017			2016		
	Owner-Occupier	Buy-to-let	Total	Owner-Occupier	Buy-to-let	Total
Loan-to-value (LTV) ratio	€ m	€ m	€ m	€ m	€ m	€ m
Less than 50%	5,901	1,097	6,998	4,551	924	5,475
50% - 70%	4,807	888	5,695	4,377	865	5,242
71% - 80%	1,996	355	2,351	2,092	420	2,512
81% - 90%	1,397	286	1,683	1,637	381	2,018
91% - 100%	775	192	967	1,054	353	1,407
101% - 120%	488	209	697	1,374	501	1,875
121% - 150%	74	122	196	421	314	735
Greater than 150%	38	106	144	94	241	335
Unsecured (Zero Collateral)	12	35	47	30	61	91
<b>Total</b>	<b>15,488</b>	<b>3,290</b>	<b>18,778</b>	<b>15,630</b>	<b>4,060</b>	<b>19,690</b>
Weighted average indexed LTV <sup>(1)</sup>						
Stock of residential mortgages at year end	58%	68%	60%	66%	81%	69%
New residential mortgages during year	67%	55%	67%	68%	56%	67%
Impaired mortgages	74%	90%	82%	93%	104%	99%

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

## Risk Management Report (continued)

### 3.1 Credit risk (continued)

#### Loan-to-value (LTV) (index linked) information (continued)

The weighted average indexed loan-to-value for the total residential mortgage book was 60% at 31 December 2017 compared to 69% at 31 December 2016, with the reduction driven primarily by the increase in property prices in 2017, coupled with amortisation of the loan book and restructuring activities.

#### Neither past due nor impaired\*

The following table profiles the residential mortgage portfolio that was neither past due nor impaired by the indexed loan to value ratios at 31 December 2017 and 31 December 2016.

	2017			2016		
	Owner-Occupier	Buy-to-let	Total	Owner-Occupier	Buy-to-let	Total
Loan-to-value (LTV) ratio	€ m	€ m	€ m	€ m	€ m	€ m
Less than 50%	5,587	927	6,514	4,309	753	5,062
50% - 70%	4,543	710	5,253	4,142	661	4,803
71% - 80%	1,902	261	2,163	1,962	312	2,274
81% - 90%	1,298	203	1,501	1,518	268	1,786
91% - 100%	692	120	812	936	220	1,156
101% - 120%	386	103	489	1,153	261	1,414
121% - 150%	41	48	89	242	110	352
Greater than 150%	22	39	61	44	80	124
Unsecured (Zero Collateral)	6	10	16	7	10	17
<b>Total</b>	<b>14,477</b>	<b>2,421</b>	<b>16,898</b>	<b>14,313</b>	<b>2,675</b>	<b>16,988</b>

#### Past due but not impaired\*

The following table profiles the residential mortgage portfolio that was past due but not impaired at 31 December 2017 and 31 December 2016.

	2017			2016		
	Owner-Occupier	Buy-to-let	Total	Owner-Occupier	Buy-to-let	Total
Loan-to-value (LTV) ratio	€ m	€ m	€ m	€ m	€ m	€ m
Less than 50%	136	53	189	115	51	166
50% - 70%	98	40	138	93	47	140
71% - 80%	27	15	42	34	18	52
81% - 90%	21	17	38	22	17	39
91% - 100%	11	7	18	18	22	40
101% - 120%	8	4	12	20	16	36
121% - 150%	1	5	6	9	13	22
Greater than 150%	1	9	10	2	11	13
Unsecured (Zero Collateral)	1	1	2	1	2	3
<b>Total</b>	<b>304</b>	<b>151</b>	<b>455</b>	<b>314</b>	<b>197</b>	<b>511</b>

Of the residential mortgages that were past due but not impaired at 31 December 2017, 4% of owner-occupier and 13% of buy-to-let mortgages were in negative equity (31 December 2016: 10% and 21% respectively). In terms of the total owner occupier and buy-to-let mortgage portfolio that was past due but not impaired, 7% was in negative equity at 31 December 2017 (31 December 2016: 14%).

\* 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)

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

The following table profiles the residential mortgage portfolio that was greater than 90 days past due and/or impaired by the indexed LTV ratios at 31 December 2017 and 31 December 2016.

Loan-to-value (LTV) ratio	2017			2016		
	Owner-Occupier	Buy-to-let	Total	Owner-Occupier	Buy-to-let	Total
	€ m	€ m	€ m	€ m	€ m	€ m
Less than 50%	244	147	391	186	146	332
50% - 70%	212	159	371	181	183	364
71% - 80%	75	86	161	110	97	207
81% - 90%	86	78	164	103	104	207
91% - 100%	74	68	142	103	123	226
101% - 120%	97	103	200	203	229	432
121% - 150%	32	72	104	174	196	370
Greater than 150%	15	65	80	48	159	207
Unsecured (Zero Collateral)	5	25	30	22	51	73
<b>Total</b>	<b>840</b>	<b>803</b>	<b>1,643</b>	<b>1,130</b>	<b>1,288</b>	<b>2,418</b>

Of the residential mortgages that were greater than 90 days past due and/or impaired at 31 December 2017, the proportion in negative equity (25%) decreased in comparison to 31 December 2016 (45%), reflecting the increases in residential property prices, deleveraging of impaired buy-to-let loans and write-offs applied during the period.

While loans greater than 90 days past due are tested for impairment, in circumstances where the customer has sufficient repayment capacity, including cases in negative equity, the test may conclude that impairment is not required.

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

## Risk Management Report (continued)

### 3.1 Credit risk (continued)

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

The following tables profile the residential mortgage portfolio and impaired residential mortgage portfolio at 31 December 2017 and 2016 by year of origination.

	2017		2017	
	Number	Mortgage portfolio Balance € m	Number	Impaired mortgage portfolio Balance € m
1996 and before	491	9	103	1
1997	223	6	43	1
1998	990	17	92	3
1999	1,381	38	102	6
2000	2,005	71	174	9
2001	2,294	104	142	8
2002	3,883	240	287	22
2003	6,731	501	476	45
2004	9,345	874	840	103
2005	12,652	1,434	1,355	189
2006	16,689	2,343	2,111	338
2007	15,929	2,405	1,828	315
2008	15,584	2,323	1,368	246
2009	10,472	1,516	533	98
2010	6,532	921	146	31
2011	3,038	417	41	7
2012	5,480	765	7	1
2013	4,405	624	2	-
2014	4,541	637	7	1
2015	6,444	969	6	1
2016	7,198	1,173	2	-
2017	8,231	1,391	-	-
<b>Total</b>	<b>144,538</b>	<b>18,778</b>	<b>9,665</b>	<b>1,425</b>

	2016		2016	
	Number	Mortgage portfolio Balance € m	Number	Impaired mortgage portfolio Balance € m
1996 and before	608	12	129	2
1997	808	9	58	1
1998	1,141	25	117	5
1999	1,549	52	140	10
2000	2,215	91	218	13
2001	2,516	126	199	13
2002	4,702	296	394	33
2003	7,353	604	688	74
2004	10,181	1,040	1,190	166
2005	13,799	1,691	1,865	296
2006	18,013	2,728	2,896	539
2007	17,349	2,768	2,419	488
2008	16,526	2,634	1,771	364
2009	11,119	1,689	699	135
2010	6,926	1,018	178	39
2011	3,245	464	48	8
2012	5,855	849	12	2
2013	4,602	681	3	1
2014	4,749	697	6	1
2015	6,641	1,035	4	1
2016	7,329	1,181	-	-
<b>Total</b>	<b>147,226</b>	<b>19,690</b>	<b>13,034</b>	<b>2,191</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

The majority (€10.0bn or 53%) of the €18.8bn residential mortgage portfolio was originated between 2005 and 2009, of which, 12% (€1.2bn) was impaired at 31 December 2017. This cohort was impacted by reduced household income and increased unemployment rates in those years, and where property prices had decreased from a peak in 2007. 10% of the residential mortgage portfolio was originated before 2005 of which 11% was impaired at 31 December 2017, while the remaining 37% of the portfolio was originated since 2010 or after, of which 1% was impaired at 31 December 2017.

#### 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 8*);
- Derivative financial instruments (*note 11*);
- Loans and receivables to banks (*note 12*); and
- Loans and receivables to customers (*note 13*).

### 3.2 Restructure execution risk

AIB is exposed to a number of material risks that have been identified through a Material Risk Assessment process carried out by AIB. One of these material risks is the Restructure Execution Risk and AIB's statement around this risk is outlined below. The Bank aligns itself to AIB's Restructure Execution Risk strategy.

There is a restructure execution risk that AIB's restructuring activity programme for customers in difficulties will not be executed in line with management's expectation.

The Bank has reduced its impaired loans from €2,191m at December 2016 to €1,425m as at 31 December 2017. A significant element of this reduction was through a customer debt restructuring programme. The objective of this process is to assist customers that find themselves in financial difficulties, to deal with them sympathetically and to work with them constructively to explore appropriate solutions. By continuing to work together in this process, AIB and the customer can find a mutually acceptable and alternative way forward. This approach has, and will continue to, materially improve AIB's asset quality and lower its overall risk profile, and strengthen its solvency. AIB continues to have a relatively high level of problem or criticised loans, which are defined as loans requiring additional management attention over and above that normally required for the loan type. AIB has been proactive in managing its criticised loans through the restructuring process. All restructured loans are managed in line with AIB's overall credit management practices.

AIB has credit policies and strategies, implementation guidelines and monitoring structures in place to manage its loan portfolios, including restructured loans. AIB regularly reviews the performance of these restructured loans and has a dedicated team to focus on asset sales within the restructured portfolio.

AIB remains focused on reducing impaired loans to a level more in line with normalised European peer levels and will continue to implement sustainable solutions for customers who engage with the Bank, where feasible. AIB continues to review all options in relation to reducing impaired loans including sales and strategic initiatives.

### 3.3 Funding and liquidity risk

Funding and Liquidity risk is the risk that the Bank will not be able to fund its assets and meet its payment obligations as they come due, without incurring unacceptable costs or losses. Funding is the means by which liquidity is generated, e.g. secured or unsecured, wholesale, corporate or retail. In this respect, funding risk is the risk that a specific form of liquidity cannot be obtained at an acceptable cost.

The objective of liquidity management is to ensure that, at all times, AIB holds sufficient funds to meet its contracted and contingent commitments to customers and counterparties at an economic price.

The Bank's liquidity risk is managed as part of the overall AIB liquidity management. In accordance with the Capital Requirements Regulation ("CRR"), 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. This includes the risk identification and assessment, risk management and mitigation, risk monitoring and reporting processes. Under this centralised approach the management of liquidity and related activities for the Bank is integrated with its parent, AIB.

The means by which these liquidity management activities are performed, and the procedures by which AIB ensures the Bank complies with AIB's Funding and Liquidity Risk Policy are managed through a Service Level Agreement ("SLA").



## Risk Management Report (continued)

### 3.3 Funding and liquidity risk (continued)

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 Asset Covered Securities Acts (“ACS Acts”);
- b) borrowing funds from AIB;
- 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.

The Bank’s Management team monitors the funding and liquidity risks and reports on key developments to the AIB Board on a regular basis via the Chief Risk Officers report.

#### Risk identification and assessment

Funding and Liquidity risk is measured and controlled using a range of metrics and methodologies on a consolidated basis including, Liquidity Stress Testing and ensuring adherence to limits based on the regulatory defined liquidity ratios, the Liquidity Coverage Ratio (“LCR”) and the Net Stable Funding Ratio (“NSFR”). Liquidity stress testing consists of applying severe but plausible stresses to AIB’s liquidity buffer through time in order to simulate a survival period. The simulated survival period is a key risk metric and is controlled using Board approved limits. The LCR is designed to promote short term resilience of a bank’s liquidity risk profile by ensuring that it has sufficient high quality liquid resources to survive an acute stress scenario lasting for 30 days. The NSFR has a time horizon of one year and has been developed to promote a sustainable maturity structure of assets and liabilities.

#### Risk management and mitigation

AIB’s Asset and Liability Committee (“ALCo”) is a sub-committee of the Leadership Team and has a decision making and risk governance mandate in relation to the Bank’s strategic balance sheet management including the management of funding and liquidity risk. The ALCo is responsible for approving the liquidity risk management control structures, for approving liquidity risk limits, for monitoring adherence to these limits and making decisions on risk positions where necessary and for approving liquidity risk measurement methodologies.

AIB operates a three lines of defence model for risk management. In terms for Funding & Liquidity Risk the first line comprises the Finance and Treasury functions. AIB’s Finance department, reporting to the CFO, is the owner of AIB’s Funding and Liquidity plan which sets out the strategy for funding and liquidity management for AIB and is responsible for providing the necessary information for the management of AIB’s liquidity gap and the efficient management of the liquidity buffer by Treasury. This involves the identification, measurement and reporting of funding and liquidity risk and the application of behavioural adjustments to assets and liabilities.

AIB’s Treasury function is responsible for the day to day management of liquidity to meet payment obligations, execution of wholesale funding requirements in line with the Funding and Liquidity Plan and the management of the foreign exchange funding gap.

First line management of funding and liquidity risk consists of:

- firstly, through AIB’s active management of its liability maturity profile, it aims to ensure a balanced spread of repayment obligations with a key focus on periods up to 1 month. Monitoring ratios also apply to longer periods for long term funding stability;
- secondly, AIB aims to maintain a stock of high quality liquid assets to meet its obligations as they fall due. Discounts are applied to these assets based upon their cash-equivalence and price sensitivity; and
- finally, net inflows and outflows are monitored on a daily basis.

The Financial Risk function, reporting to the CRO, provides second line assurance. Financial Risk is responsible for exercising independent risk oversight and control over the Bank’s funding and liquidity management. Financial Risk provides oversight on the effectiveness of the risk and control environment. It proposes and maintains the Funding and Liquidity Framework and Policy as the basis of AIB’s control architecture for funding and liquidity risk activities, including the annual agreement of funding and liquidity risk limits (subject to the Board approved Risk Appetite Statement). The Financial Risk function is also responsible for the integrity of AIB’s liquidity risk methodologies.



## Risk Management Report (continued)

### 3.3 Funding and liquidity risk (continued)

#### **Risk management and mitigation (continued)**

AIB Internal Audit provides third line assurance on Funding and Liquidity Risk.

AIB's Internal Liquidity Adequacy Assessment Process ("ILAAP") encompasses all aspects of funding and liquidity management, including planning, analysis, stress testing, control, governance, policy and contingency planning. The ILAAP considers evolving regulatory standards and aims to ensure that AIB maintains sufficient financial resources of appropriate quality for its funding profile. On an annual basis, the Board attests to AIB's liquidity adequacy via the liquidity adequacy statement as part of the ILAAP.

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

The Bank's funding and liquidity position is reported as part of the overall AIB position to AIB's Asset and Liability Committee ("ALCo"), the AIB Executive Risk Committee ("ERC") and AIB Board Risk Committee ("BRC").

#### **Liquidity risk stress testing**

Stress testing is a key component of the liquidity risk management framework and ILAAP. The Bank, as part of AIB, undertakes liquidity risk stress testing as a key liquidity control. These stress tests include both Bank-specific and systemic risk events and a combination of both. Stressed assumptions are applied to AIB's liquidity buffer and liquidity risk drivers. The purpose of these tests is to ensure the continued stability of AIB's liquidity position, within AIB's pre-defined liquidity risk tolerance levels.

AIB has established the Contingency Funding Plan ("CFP") which is designed to ensure that AIB can manage its business in stressed liquidity conditions and restore its liquidity position should there be a major stress event.

Liquidity stress test results are reported to the ALCo, AIB Leadership Team and AIB Board, and to other committees. If AIB Board approved survival limits are breached, the CFP will be activated. The CFP can also be activated by management decision independently of the stress tests. The CFP is a key element in the formulation of the AIB's Recovery Plan in relation to funding and liquidity.

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

## Risk Management Report (continued)

### 3.3 Funding and liquidity risk (continued)

#### Financial liabilities by contractual maturity\*

This table analyses the gross contractual maturities of financial liabilities including interest payable at the next interest payment date held by the Bank.

						2017
	Repayable on demand	3 months or less but not repayable on demand	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Total
	€ m	€ m	€ m	€ m	€ m	€ m
Deposits by banks	8,145	-	-	-	-	8,145
Customer accounts	3	-	-	-	-	3
Derivative financial instruments	-	-	-	-	8	8
Debt securities in issue	-	-	500	3,715	3,275	7,490
Subordinated liabilities	-	-	-	-	300	300
Other liabilities	-	25	13	29	1	68
<b>Total</b>	<b>8,148</b>	<b>25</b>	<b>513</b>	<b>3,744</b>	<b>3,584</b>	<b>16,014</b>
Off-balance sheet loan commitments	680	-	-	-	-	680

						2016
	Repayable on demand	3 months or less but not repayable on demand	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Total
	€ m	€ m	€ m	€ m	€ m	€ m
Deposits by banks	8,972	-	-	-	-	8,972
Customer accounts	2	-	-	-	-	2
Derivative financial instruments	-	-	-	-	1	1
Debt securities in issue	-	-	2,075	3,815	1,775	7,665
Subordinated liabilities	-	-	-	-	300	300
Other liabilities	-	21	93	56	24	194
<b>Total</b>	<b>8,974</b>	<b>21</b>	<b>2,168</b>	<b>3,871</b>	<b>2,100</b>	<b>17,134</b>
Off-balance sheet loan commitments	579	-	-	-	-	579

#### Encumbrance

The asset encumbrance disclosure for the Bank has been produced in line with the 2014 EBA Guidelines complemented by EBA clarifications on the disclosure of encumbered and unencumbered assets. An asset is defined as encumbered if it has been pledged as collateral and as a result is no longer available to the Bank to secure funding, satisfy collateral needs or to be sold.

The Bank had an encumbrance ratio of 50% at 31 December 2017 (2016: 57%). The encumbrance level is based on the amount of assets that are required in order to meet regulatory and contractual commitments.

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

## Risk Management Report (continued)

### 3.4 Capital adequacy risk\*

Capital adequacy risk is defined as the risk that the Bank or AIB breaches or may breach regulatory capital ratios and internal targets. The key material risks impacting on the capital adequacy position of the Bank or AIB is credit risk, although it should be noted that all material risks can to some degree impact capital ratios. Capital Adequacy Risk is mitigated at AIB level by an evaluation of the adequacy of AIB's capital under both forecast and stress conditions as part of the Internal Capital Adequacy Assessment Process ("ICAAP"). The ICAAP process includes the identification and evaluation of potential capital mitigants. The objectives of the AIB's capital management policy are to comply at all times with all applicable regulatory capital requirements (including requirements at the Bank's level) and to ensure that the Bank has sufficient capital to cover current and potential future risks to its business. Capital adequacy risk for AIBMB is managed within AIB's ICAAP process.

The key stages in the AIB ICAAP process are as follows:

- A Risk Appetite Statement is reviewed and approved by the AIB Board annually which contains lending and other limits to mitigate against the risk of excessive leverage;
- Business Strategy is set consistent with risk appetite which underpins the annual financial planning process.
- Performance against plan and risk appetite is monitored monthly;
- An annual material risk assessment which identifies all relevant (current and anticipated) risks and those that require capital adequacy assessment;
- Financial Planning drives the level of required capital to support growth plans and meet regulatory requirements. Base and stress capital plans are produced as part of the integrated financial planning process;
- Scenario analysis and stress testing is applied to capital plans and to all material risks in order to assess the resilience of AIB and inform capital needs as they arise. Stress testing is also applied to assess the viability of management actions in the ICAAP, the Capital Contingency Plan and the Recovery Plan;
- Reverse stress tests are undertaken to determine scenarios that could lead to a pre-defined breach of capital ratios;
- The final stage of the ICAAP is the creation of base and stressed capital plans over a three year timeframe, comparing the capital requirements to available capital. This is fully integrated with AIB's financial planning process and ensures that AIB has adequate capital resources in excess of minimum regulatory and internal capital requirements.

AIB monitors its capital adequacy on a monthly basis when, a capital reporting pack is presented to senior executive and Board Committees setting out the evolution of AIB's capital position. The Board reviews and approves the ICAAP on an annual basis and is also responsible for signing a Capital Adequacy Statement attesting that the Board has reviewed and is satisfied with the capital adequacy of AIB.

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

## Risk Management Report (continued)

### 3.5 Market risk\*

Market risk refers to the risk of income and capital losses arising from adverse movements in wholesale market prices.

#### Interest Rate Exposure and Sensitivity\*

The net interest rate exposure of the Bank at 31 December 2017 analysed by the earlier of the repricing and the contractual maturity date is illustrated in the following table:

	0≤1mth	1≤3mths	3≤12mths	1≤2yrs	2≤3yrs	3≤4yrs	4≤5yrs	5yrs+	Non-interest bearing	Total
Assets	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m
Loans and receivables to customers	17,476	109	377	216	352	131	105	12	(547)	18,231
Loans and receivables to banks	98	-	-	-	-	-	-	-	-	98
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	70	70
Other assets	-	-	-	-	-	-	-	-	62	62
<b>Total Assets</b>	<b>17,574</b>	<b>109</b>	<b>377</b>	<b>216</b>	<b>352</b>	<b>131</b>	<b>105</b>	<b>12</b>	<b>(415)</b>	<b>18,461</b>
Liabilities	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m
Deposits by banks	8,145	-	-	-	-	-	-	-	-	8,145
Customer accounts	3	-	-	-	-	-	-	-	-	3
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	8	8
Debt securities in issue	3,900	-	500	65	750	500	750	1,025	-	7,490
Subordinated liabilities	300	-	-	-	-	-	-	-	-	300
Other liabilities	-	-	-	-	-	-	-	-	122	122
Shareholders' equity	-	-	-	-	-	-	-	-	2,393	2,393
<b>Total Liabilities</b>	<b>12,348</b>	<b>-</b>	<b>500</b>	<b>65</b>	<b>750</b>	<b>500</b>	<b>750</b>	<b>1,025</b>	<b>2,523</b>	<b>18,461</b>
Derivatives financial instruments (interest rate swaps)	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m
Floating rate interest receivable	(19,447)	-	-	-	-	-	-	-	-	(19,447)
Floating rate interest payable	18,145	109	377	216	352	131	105	12	-	19,447
Fixed rate interest payable	3,590	-	-	-	-	-	-	-	-	3,590
Fixed rate interest receivable	-	-	(500)	(65)	(750)	(500)	(750)	(1,025)	-	(3,590)
<b>Total derivatives</b>	<b>2,288</b>	<b>109</b>	<b>(123)</b>	<b>151</b>	<b>(398)</b>	<b>(369)</b>	<b>(645)</b>	<b>(1,013)</b>	<b>-</b>	<b>-</b>
<b>Interest sensitivity gap</b>	<b>2,938</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(2,938)</b>	<b>-</b>
<b>Cumulative interest sensitivity gap</b>	<b>2,938</b>	<b>2,938</b>	<b>2,938</b>	<b>2,938</b>	<b>2,938</b>	<b>2,938</b>	<b>2,938</b>	<b>2,938</b>	<b>-</b>	<b>-</b>

The impact on net interest income over a twelve month period of a 100 bps downward/upward movement in interest rates on 31 December 2017 would be circa -€121k/€121k respectively.

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



## Risk Management Report (continued)

### 3.5 Market risk\* (continued)

#### Interest Rate Exposure and Sensitivity\* (continued)

The net interest rate exposure of the Bank at 31 December 2016 analysed by the earlier of the repricing and the contractual maturity date is illustrated in the following table:

Assets	0≤1mth	1≤3mths	3≤12mths	1≤2yrs	2≤3yrs	3≤4yrs	4≤5yrs	5yrs+	Non-interest bearing	Total
	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m
Loans and receivables to customers	18,109	135	479	363	176	273	144	11	(936)	18,754
Loans and receivables to banks	470	-	-	-	-	-	-	-	-	470
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	192	192
Other assets	-	-	-	-	-	-	-	-	75	75
<b>Total Assets</b>	<b>18,579</b>	<b>135</b>	<b>479</b>	<b>363</b>	<b>176</b>	<b>273</b>	<b>144</b>	<b>11</b>	<b>(669)</b>	<b>19,491</b>
<b>Liabilities</b>										
Deposits by banks	8,972	-	-	-	-	-	-	-	-	8,972
Customer accounts	2	-	-	-	-	-	-	-	-	2
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	1	1
Debt securities in issue	2,400	-	1,675	500	65	750	500	1,775	-	7,665
Subordinated liabilities	300	-	-	-	-	-	-	-	-	300
Other liabilities	-	-	-	-	-	-	-	-	244	244
Shareholders' equity	-	-	-	-	-	-	-	-	2,307	2,307
<b>Total Liabilities</b>	<b>11,674</b>	<b>-</b>	<b>1,675</b>	<b>500</b>	<b>65</b>	<b>750</b>	<b>500</b>	<b>1,775</b>	<b>2,552</b>	<b>19,491</b>

#### Derivatives financial instruments

<b>(interest rate swaps)</b>										
Floating rate interest receivable	(20,321)	-	-	-	-	-	-	-	-	(20,321)
Floating rate interest payable	18,740	135	479	363	176	273	144	11	-	20,321
Fixed rate interest payable	5,265	-	-	-	-	-	-	-	-	5,265
Fixed rate interest receivable	-	-	(1,675)	(500)	(65)	(750)	(500)	(1,775)	-	(5,265)
<b>Total derivatives</b>	<b>3,684</b>	<b>135</b>	<b>(1,196)</b>	<b>(137)</b>	<b>111</b>	<b>(477)</b>	<b>(356)</b>	<b>(1,764)</b>	<b>-</b>	<b>-</b>

#### Interest sensitivity gap

Interest sensitivity gap	3,221	-	-	-	-	-	-	-	(3,221)	
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#### Cumulative interest sensitivity gap

Cumulative interest sensitivity gap	3,221	3,221	3,221	3,221	3,221	3,221	3,221	3,221	-	
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The impact on net interest income over a twelve month period of a 100 bps downward/upward movement in interest rates on 31 December 2016 would be circa -€203k/€203k respectively.

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

## Risk Management Report (continued)

### 3.5 Market risk\* (continued)

Interest rate risk in the banking book ("IRRBB") is the current or prospective risk to both the earnings and capital of the Bank as a result of adverse movements in interest rates being applied to positions held in the banking book. Changes in interest rates impact the underlying value of the assets, liabilities and off-balance sheet instruments and, hence, its economic value (or capital position). Similarly, interest rate changes will impact the Bank's net interest income through interest-sensitive income and expense effects.

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. The Bank is not allowed to engage in proprietary trading under the conditions of the Asset Covered Securities Act and its license.

The interest rate exposure of the Bank relating to its Irish residential lending is managed using two interest rate swaps with AIB, 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 AIB 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 Bank to terminate the swaps without cost on any reset date.

There is some residual interest rate risk in the Bank. This interest rate risk is transferred to and managed by AIB Treasury, subject to Capital and Liquidity review and oversight by ALCo. Treasury proactively manages the market risk on AIB's balance sheet, Market risk is managed against a range of limits approved at ALCo, which incorporate forward-looking measures such as VaR limits and stress test limits and financial measures such as 'stop-loss' and embedded value limits. AIB Treasury documents an annual Risk Strategy and Appetite Statement as part of the annual financial planning cycle which ensures Treasury's market risk aligns with AIB's strategic business plan.

The total nominal values of the swaps are set out in note 11 to the financial statements. The Bank is not exposed to any other market risks, i.e. foreign exchange rates or equity prices.

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

## Risk Management Report (continued)

### 3.6 Operational risk\*

Operational risk is the risk arising from inadequate or failed internal processes, people and systems or from external events. This includes legal risk – the potential for loss arising from the uncertainty of legal proceedings and potential legal proceedings, but excludes strategic and reputational risk. In essence, operational risk is a broad canvass of individual risk types which include products, projects, people and property, continuity and resilience, information and security and outsourcing and which the Bank and AIB actively seek to mitigate against.

Risk and Control Assessment (“RCA”) is a core process in the identification and assessment of operational risk across AIB, including the Bank. The process serves to ensure that key risks are proactively identified, evaluated, monitored and reported, and that appropriate action is taken. Self-assessment of risks is completed at business unit level and is recorded on SHIELD which is AIB’s Governance, Risk & Compliance (GRC) System. SHIELD, was introduced during 2017 and it provides the customer facing business areas, Risk, Compliance and Internal Audit with one consistent view of the Risks, Controls, Actions and Events across AIB.

The 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.

The key people, systems and processes supporting the Bank are provided by AIB and this relationship is governed by an Outsourcing and Agency Agreement. AIB’s operational risk framework applies across all areas of AIB including the Bank. AIB’s Operational Risk function is responsible for overseeing the management of operational risk across AIB. A key focus of operational risk management in the 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.

The primary objective of the operational risk management reporting and control process within AIB is to provide timely and pertinent operational risk information to management so as to enable corrective action to be taken and to resolve material incidents which have already occurred. A secondary objective is to provide a trend analysis on operational risk and operational risk event data for AIB.

Business units are required to review and update their assessment of operational risks on a regular basis. Operational risk teams undertake review and challenge assessments of the business unit risk assessments. In addition, assurance teams which are independent of the business, undertake reviews of the operational controls as part of a combined regulatory/compliance/operational risk programme.

### 3.7 Regulatory compliance risk including conduct 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, standards and codes of conduct applicable to its activities.

The level of regulatory risk remained high in 2017 as the regulatory landscape for the banking sector continued to evolve with a continuing focus on supporting the stability of the banking system and ensuring the provision of customer focussed financial services. The Bank is committed to proactively identifying regulatory and compliance obligations arising in its operating markets in Ireland, and ensuring the timely implementation of regulatory change. Throughout 2017, projects were mobilised within AIB to prepare for the regulatory change horizon as outlined in AIB’s annual report: Governance and Oversight – Supervision and Regulation.

The level of regulatory change is expected to continue in 2018.

Conduct Risk is defined as the risk that inappropriate actions, or inaction by AIB cause poor and unfair outcomes for its customers or market instability. A mature Conduct Risk Framework, aligned with AIB’s Strategy, is embedded in the organisation and provides oversight of conduct risks at Leadership Team and Board level. This includes the embedding of a customer centric culture aligned to AIB’s Brand Values and Code of Conduct and the promotion of good conduct throughout the organisation.

The Bank’s regulatory compliance risk is managed as part of the overall AIB Regulatory Compliance Framework. This includes risk identification and assessment, risk management and mitigation, and risk monitoring and reporting processes. Conduct Risk is managed in line with the processes, procedures and organisational structures for the management of Regulatory Compliance risk within AIB.

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



## Risk Management Report (continued)

### 3.8 People and culture risk\*

People and culture are essential components in realising an organisation's strategic ambitions. An effective culture is built around a general principle of people "doing the right thing" for all stakeholders, including customers, employees and regulators. The majority of business activities of the Bank are outsourced to AIB under an Outsourcing and Agency Agreement.

People and culture Risk is the risk to achieving AIB's strategic objectives as a result of an inability to recruit, retain or develop resources, or as a result of behaviours associated with low levels of employee engagement. It also includes the risk that the business, financial condition and prospects of AIB are materially adversely affected as a result of inadvertent or intentional behaviours or actions taken or not taken by employees that are contrary to the overall strategy, culture and values of AIB.

AIB identifies and reviews employee satisfaction & engagement, indicators of culture, through the AIB staff engagement programme, iConnect, which is facilitated by Gallup on an annual basis. In 2017, AIB launched its 'Purpose', which is supported and embedded by a clear set of 'customer first' values. These values drive and influence activities of all employees, guiding AIB's dealings with customers, each other and all stakeholders.

AIB's Code of Conduct, incorporating the Risk Culture Principles, places great emphasis on the integrity of employees and accountability for both actions taken and inaction. The Code sets out how employees are expected to behave in terms of the business, customer and employee.

AIB has made significant steps in increasing engagement and awareness of the AIB's Risk management activities by embedding the Risk Appetite Statement in Policies and Frameworks of AIB. The Risk Appetite Statement contains clear statements of intent as to AIB's appetite for taking and managing risk, including people & culture risk. It ensures that AIB monitors and reports against key people and culture metrics when tracking people & culture risk and change.

Internal Audit include people & culture risk on their annual plan of activities, the outputs of which are reviewed by the Board.

### 3.9 Business model risk\*

Business model risk is defined as the risk of not achieving the agreed strategy or approved business plan either as a result of an inadequate implementation plan, or failure to execute the implementation plan as a result of inability to secure the required investment, or due to factors in the economic, political or competitive environment. Business model risk also includes the risk of implementing an unsuitable strategy, or maintaining an obsolete business model, in light of known internal and external factors.

AIB identifies and assesses business model risk as part of its integrated planning process, which encapsulates strategic, business and financial planning. AIB's business and financial planning process supports AIB's strategy. Every year, AIB prepares three- year business plans based on macro-economic and market forecasts across a range of scenarios.

AIB's plan is supported by detailed business unit plans, encapsulating the operations and activities of the Bank. Each business unit plan is aligned to AIB's strategy and risk appetite. The business plan typically describes the market in which the segment operates, market and competitor dynamics, business strategy, financial assumptions underpinning the strategy, actions/investment required to achieve financial outcomes and any risks/opportunities to the strategy.

At a strategic level, AIB manages business model risk within its risk appetite framework, by setting limits in respect of measures such as financial performance, portfolio concentration and risk-adjusted return. At a more operational level, the risk is mitigated through periodic monitoring of variances to plan at AIB and Bank level. Where performance against plan is outside agreed tolerances or risk appetite metrics, proposed mitigating actions are presented and evaluated, and tracked thereafter.

Performance against plan is monitored at Bank level by the Bank's executive management and Board on a quarterly basis. At an overall AIB level, performance against plan is monitored as part of the AIB CFO Report which is discussed at Leadership Team and Board on a monthly basis.

### 3.10 Model risk\*

Model Risk is defined as the risk of adverse consequences from risk-based business and strategic decisions founded on incorrect or misused model assumptions, outputs and reports. Model risk is comprised of two elements, firstly, operational risk- the risk of losses relating to the development, implementation or improper use of models for decision making (e.g. product pricing, evaluation of financial instruments, monitoring of risk limits) and secondly, capital impact which is the risk relating to the underestimation of own funds requirements by models used within AIB for those purposes.

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



## Risk Management Report (continued)

### 3.10 Model risk\* (continued)

The Board of AIB has ultimate accountability for ensuring that the models used by AIB are fit for purpose and meet all jurisdictional regulatory and accounting standards. AIB is also responsible for ensuring that there are appropriate policies in place relating to capital assessment, measurement and allocation. Operating to the principles outlined in the Model Risk Framework (the Framework) supports AIB's strategic objectives and provides comfort to the AIB Board on the integrity and completeness of the model risk governance.

AIB mitigates model risk by having a framework, policies and standards in place in relation to model development, operation, and validation together with suitable resources. The Framework, which is aligned to AIB Risk Appetite Framework and the Risk Management Framework, describes the key processes undertaken and reports produced in support of the Framework.

Models are built and validated by suitably qualified analytical personnel, informed by relevant business and finance functions. Models are built using the best available data, both internal and external, using international industry standard techniques. All models are validated by an appropriately qualified team, which is independent of the model build process.

The Model Risk Committee acts as a subcommittee of AIB's Asset and Liability Committee and reviews and approves the use, or recommends to a higher governance authority, the use of AIB credit, operational and financial risk models. It also monitors and maintains oversight of the performance of these models.

AIB Internal Audit act as the "third line of defence" providing independent assurance to the Audit Committee and the Board of AIB on the adequacy, effectiveness and sustainability of the governance, risk management and control framework supporting model risk through their periodic review of the Model Risk Management processes.

During 2017 AIB constructed its suite of expected credit loss models to meet the requirements of IFRS 9 'Financial Instruments'.

As a material risk, the status of model risk is reported on a monthly basis in the Chief Risk Officer report.

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

## Directors' Responsibility Statement

The Directors' are responsible for preparing the Directors' report and the annual financial statements in accordance with applicable Irish law and regulations.

Irish company law requires the Directors to prepare financial statements for each financial year. Under the law, the Directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union. Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the assets, liabilities and financial position of the Bank as at the financial year end date and of the profit or loss of the Bank for the financial year and otherwise comply with the Companies Act 2014.

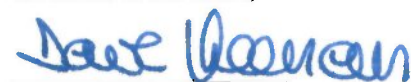
In preparing these financial statements, the Directors are required to:

- select suitable accounting policies for the Bank financial statements and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether the financial statements have been prepared in accordance with applicable accounting standards, identify those standards, and note the effect and the reasons for any material departure from those standards; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Directors are responsible for ensuring that the Bank keeps or causes to be kept adequate accounting records which correctly explain and record the transactions of the Bank, enable at any time the assets, liabilities, financial position and profit or loss of the Bank to be determined with reasonable accuracy, enable them to ensure that the financial statements and Directors' Report comply with the Companies Act 2014 and the listing rules of the ISE, and enable the financial statements to be audited. They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

On behalf of the Board,



Dave Keenan  
Chairman



Ken Burke  
Managing Director

Date: 13 March 2018

# Independent Auditors' Report to the Members of AIB Mortgage Bank

## Report on the audit of the financial statements

### Opinion on the financial statements of AIB Mortgage Bank (the 'Company')

In our opinion the Company financial statements:

- give a true and fair view of the assets, liabilities and financial position of the Company as at 31 December 2017 and of the profit of the Company for the financial year then ended; and
- have been properly prepared in accordance with the relevant financial reporting framework and, in particular with the requirements of the Companies Act 2014.

The financial statements we have audited 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 1 to 33, including a summary of significant accounting policies as set out in note 1.

The relevant financial reporting framework that has been applied in their preparation is the Companies Act 2014 and International Financial Reporting Standards (IFRS) as adopted by the European Union ("the relevant financial reporting framework").

### Basis for our opinion

We conducted our audit in accordance with International Standards on Auditing (Ireland) (ISAs (Ireland)) and applicable law. Our responsibilities under those standards are described below in the "Auditor's responsibilities for the audit of the financial statements" section of our report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Ireland, including the Ethical Standard issued by the Irish Auditing and Accounting Supervisory Authority (IAASA), as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Summary of our audit approach

Summary of our audit approach	
<b>Key audit matters</b>	The key audit matters that we identified in the current year were: <ul style="list-style-type: none"> <li>– Loan impairment and restructuring; and</li> <li>– Provisions for customer redress.</li> </ul>
<b>Materiality</b>	We determined materiality for the Company to be €23m which is 5% of profit before tax excluding amounts payable to Allied Irish Banks, p.l.c. (note 7) ('Materiality Benchmark').
<b>Significant changes in our approach</b>	There were no significant changes in our approach which we feel require disclosure.

### Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (Ireland) require us to report to you where:



- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.



## Independent Auditors' Report to the Members of AIB Mortgage Bank (continued)

### Key audit matters



Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current financial year and include the most significant assessed risks of material misstatement (whether or not due to fraud) we identified, including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Loan impairment and restructuring	
<b>Key audit matter</b> 	<p>There is a risk that provisions for impairment of loans and receivables of €547m (2016: €936m) do not represent an appropriate estimate of the losses incurred. This includes the risk that the estimate of cashflows on restructuring cases is not appropriately measured. The determination of appropriate provisions requires a significant amount of management judgment over key assumptions and relies on available data.</p> <p>The Company has disclosed in note 1.17, as required by IAS 8, estimated information regarding the possible transition effect of the adoption of IFRS 9 from 1 January 2018.</p> <p>Please also refer to note 1.9 (Accounting Policy – Impairment of financial assets), note 2 – Critical accounting judgements and estimates and note 8 - Provisions for impairment on loans and receivables.</p>
<b>How the scope of our audit responded to the key audit matter</b> 	<p>We undertook an assessment of the provisioning practices to compare them with the requirements of IFRS.</p> <p>We evaluated the design and tested the operating effectiveness of controls over:</p> <ul style="list-style-type: none"> <li>• impairment identification and calculation;</li> <li>• credit management processes;</li> <li>• new lending;</li> <li>• restructuring transactions;</li> <li>• front line credit monitoring and assessment;</li> <li>• collective and latent impairment models, including source data controls and calculations; and</li> <li>• the work of the credit review function.</li> </ul> <p>Our testing of controls included an evaluation of IT system controls, management review controls and governance controls.</p> <p>In examining both sample loan cases and models, we challenged management on the judgments made regarding the application of triggers, status of restructures, collateral valuation and realisation time frames; and examined the credit risk functions analysis of data at a portfolio level.</p> <p>We tested samples of the data used in the models, management adjustments, together with the calculations involved and the output from the models.</p> <p>Where appropriate, this work involved assessing third party valuations of collateral, internal valuation guidelines derived from benchmark data, external expert reports on borrowers' business plans and enterprise valuations. This allowed us to determine whether appropriate valuation methodologies were employed and assess the objectivity of the external experts used.</p> <p>We evaluated the disclosures made in the financial statements. In particular, we focused on challenging management that the disclosures were sufficiently clear in highlighting the significant uncertainties that exist in respect of loan impairment provisioning and the sensitivity of the provisions to changes in the underlying assumptions.</p> <p>We have examined the disclosure required under IAS 8 of the estimated transition effect of IFRS 9.</p> <p>Based on the evidence obtained, we found that the data and assumptions used by management in loan impairment provisioning are within a range we consider to be reasonable.</p>



## Independent Auditors' Report to the Members of AIB Mortgage Bank (continued)

### Key audit matters (continued)

Provisions for customer redress	
<b>Key audit matter description</b> 	<p>The risk that the recognition, measurement and disclosure of provisions for customer redress of €54m (2016: €50m) are inappropriate for breach of contract and/or regulation including provisions for Tracker Mortgage Examinations.</p> <p>The measurement of provisions for these issues is highly judgemental and involves the use of several management assumptions including the identification of relevant impacted customers and related redress costs. There is also a risk that these known and emerging issues may not be appropriately disclosed in the financial statements.</p> <p>Please refer to note 1.10 (Accounting Policy – Non-credit risk provisions), note 2 – Critical accounting judgements and estimates and note 21 – Provisions for liabilities and commitments.</p>
<b>How the scope of our audit responded to the key audit matter</b> 	<p>We have evaluated the design and tested the operating effectiveness of the Company's controls over the identification and measurement of the provision and the disclosure of exposures.</p> <p>We challenged the assumptions, regarding the interpretation of contract terms, the numbers of customers affected and the costs arising from the issue, used in the provisioning models. We reviewed the correspondence with regulators and legal advice. We also considered regulatory developments and management's interactions with regulators.</p> <p>Given the inherent uncertainty in the calculation of conduct provisions and their judgemental nature, we evaluated the disclosures made in the financial statements. We challenged management on these disclosures, in particular that they are sufficiently clear in highlighting the exposures that remain and the significant uncertainties that exist in respect of the provisions.</p> <p>Based on the evidence obtained, we found that the assumptions used by management in measurement of provisions for customer redress and related matters are within a range we consider to be reasonable.</p>

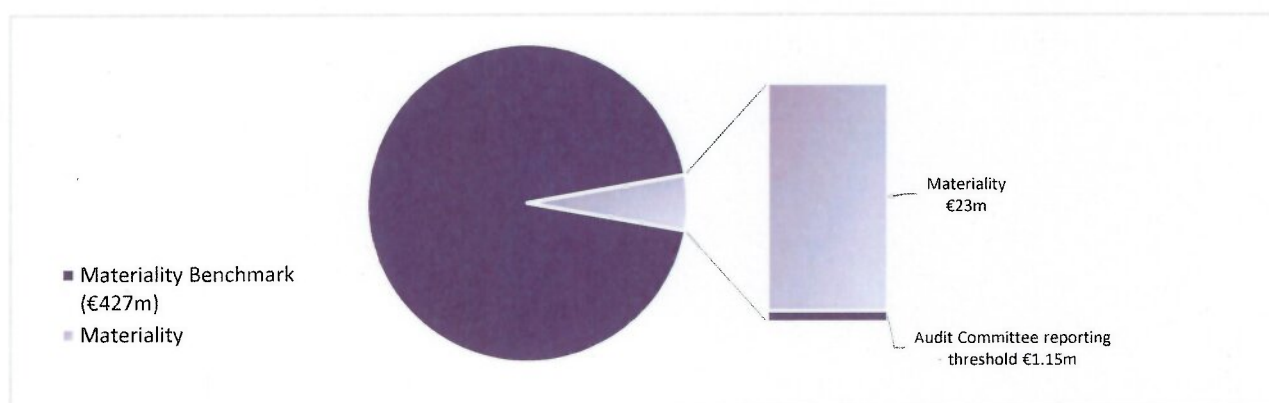
Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

# Independent Auditors' Report to the Members of AIB Mortgage Bank (continued)

## Our application of materiality

We define materiality as the magnitude of misstatement that makes it probable that the economic decisions of a reasonably knowledgeable person, relying on the financial statements, would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the Company to be €23m which is 5% of profit before tax excluding amounts payable to Allied Irish Banks, p.l.c. (note 7) ('Materiality Benchmark'). We have considered the Materiality Benchmark to be the critical component for determining materiality. We used this measure as the best measure for assessing financial performance and in order to reduce the potential for volatility in materiality year-on year. This is a generally accepted auditing practice. We have considered quantitative and qualitative factors such as understanding the entity and its environment, history of misstatements, complexity of the company and the reliability of control environment."



We agreed with the Audit Committee that we would report to them any audit differences in excess of €1.15 million, as well as differences below that threshold which, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

## An overview of the scope of our audit

We determined the scope of our audit by obtaining an understanding of the Company and its environment, including the controls operating within the Company, and assessing the risks of material misstatement related to the financial statements of the Company. The risks of material misstatement that had the greatest effect on our audit are identified as key audit matters in the table above.

## Other information

The directors are responsible for the other information. The other information comprises the information included in the Annual Financial Report other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

## Independent Auditors' Report to the Members of AIB Mortgage Bank (continued)

### Responsibilities of the directors

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view and otherwise comply with the Companies Act 2014, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

### Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (Ireland) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs (Ireland), we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of the auditor's report. However, future events or conditions may cause the entity (or where relevant, the Company) to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that the auditor identifies during the audit.

This report is made solely to the Company's members, as a body, in accordance with Section 391 of the Companies Act 2014. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.



## Independent Auditors' Report to the Members of AIB Mortgage Bank (continued)

### Report on other legal and regulatory requirements

#### Opinion on other matters prescribed by the Companies Act 2014

Based solely on the work undertaken in the course of the audit, we report that:

- We have obtained all the information and explanations which we consider necessary for the purposes of our audit.
- In our opinion the accounting records of the Company were sufficient to permit the financial statements to be readily and properly audited.
- The Company Statement of Financial Position is in agreement with the accounting records.
- In our opinion the information given in the directors' report is consistent with the financial statements and the directors' report has been prepared in accordance with the Companies Act 2014.

#### Corporate Governance Statement

We report, in relation to information given in the Corporate Governance Statement on pages 3 to 5 that, in our opinion the information given in the Corporate Governance Statement pursuant to subsections 2(c) and (d) of section 1373 Companies Act 2014 is consistent with the company's statutory financial statements in respect of the financial year concerned and such information has been prepared in accordance with section 1373 of the Companies Act 2014.

Based on our knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in this information.

In our opinion, based on the work undertaken during the course of the audit, the information required pursuant to section 1373(2)(a),(b),(e) and (f) of the Companies Act 2014 is contained in the Corporate Governance Statement.

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

Based on the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified material misstatements in the directors' report.

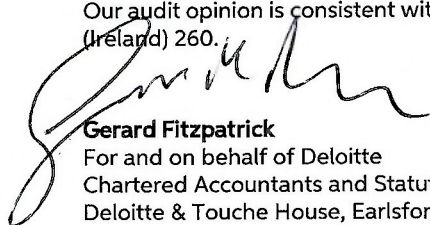
We have nothing to report in respect of the provisions in the Companies Act 2014 which require us to report to you if, in our opinion, the disclosures of directors' remuneration and transactions specified by law are not made.

#### Other matters which we are required to address

Following the recommendation of the Audit Committee of AIB Mortgage Bank, we were appointed at the Annual General Meeting on 28 June 2013 to audit the financial statements for the financial year ended 31 December 2013 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 5 years, covering the years ending 2013 to 2017.

The non-audit services prohibited by IAASA's Ethical Standard were not provided and we remained independent of the Company in conducting the audit.

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISA (Ireland) 260.



**Gerard Fitzpatrick**  
For and on behalf of Deloitte  
Chartered Accountants and Statutory Audit Firm  
Deloitte & Touche House, Earlsfort Terrace, Dublin 2

Date: 13/3/2018

**Notes:** An audit does not provide assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial statements since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in Ireland governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.



## Income Statement

For the financial year ended 31 December 2017

	Note	2017 € m	2016 € m
Interest income and similar income	3	532	606
Interest expense and similar charges	4	(169)	(179)
<b>Net interest income</b>		<b>363</b>	<b>427</b>
Net trading income	5	1	-
Other operating income	6	3	1
<b>Total operating income</b>		<b>367</b>	<b>428</b>
Administrative expenses	7	(383)	(70)
<b>Operating (loss)/ profit before impairment writebacks and taxation</b>		<b>(16)</b>	<b>358</b>
Writeback for impairment of loans and receivables to customers	8	114	59
<b>Operating profit before taxation</b>		<b>98</b>	<b>417</b>
Income tax charge	9	(12)	(52)
<b>Profit for the financial year</b>		<b>86</b>	<b>365</b>

The operating profit arises from continuing operations.

## Statement of Comprehensive Income

For the financial year ended 31 December 2017

	2017 € m	2016 € m
Profit for the financial year	86	365
Other comprehensive income for the financial year	-	-
<b>Total comprehensive income for the financial year</b>	<b>86</b>	<b>365</b>

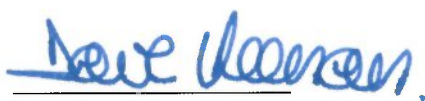
The notes on pages 60 to 95 are an integral part of these financial statements.

## Statement of Financial Position

As at 31 December 2017

	Note	2017 € m	2016 € m
<b>Assets</b>			
Non-current assets held for sale	10	1	2
Derivative financial instruments	11	70	192
Loans and receivables to banks	12	98	470
Loans and receivables to customers	13	18,231	18,754
Other assets	14	47	47
Deferred taxation	15	14	26
<b>Total assets</b>		<b>18,461</b>	<b>19,491</b>
<b>Liabilities</b>			
Deposits by banks	16	8,145	8,972
Customer accounts	17	3	2
Derivative financial instruments	11	8	1
Debt securities in issue	18	7,490	7,665
Other liabilities	19	38	123
Accruals and deferred income	20	30	71
Provisions for liabilities and commitments	21	54	50
Subordinated liabilities	22	300	300
<b>Total liabilities</b>		<b>16,068</b>	<b>17,184</b>
<b>Shareholders' equity</b>			
Issued share capital presented as equity	23	1,745	1,745
Capital reserves	24	580	580
Revenue reserves		68	(18)
<b>Shareholders' equity</b>		<b>2,393</b>	<b>2,307</b>
<b>Total liabilities and shareholders' equity</b>		<b>18,461</b>	<b>19,491</b>

The notes on pages 60 to 95 are an integral part of these financial statements



Dave Keenan  
Chairman



Ken Burke  
Managing Director



Catherine Woods  
Independent Non-Executive Director



Emma Murphy  
Company Secretary

Date: 13 March 2018

## Statement of Cash Flows

For the financial year ended 31 December 2017

	Note	2017 € m	2016 € m
<b>Cash flows from operating activities</b>			
Operating profit for the year before taxation		98	417
Adjustments for:			
- Change in provisions for liabilities and commitments	21	4	(48)
- Writeback for impairment on loans and receivables	8	(114)	(59)
- Interest paid on subordinated liabilities		1	2
		(11)	312
<b>Changes in operating assets and liabilities</b>			
Change in accruals and deferred income	20	(41)	2
Change in derivative financial instruments	11	129	57
Change in customer accounts	17	1	1
Change in other assets	14	-	6
Change in assets held for sale	10	1	-
Change in other liabilities	19	(85)	(63)
Change in loans and receivables to customers	13	637	676
<b>Net cash flows from operations before taxation</b>		631	991
Taxation paid		-	-
<b>Net cash flows from operations</b>		631	991
<b>Net cash flow from investing activities</b>		-	-
<b>Cash flows from financing activities</b>			
Change in debt securities in issue	18	(175)	1,750
Change in deposits by banks	16	(827)	(2,678)
Interest paid on subordinated liabilities		(1)	(2)
<b>Net cash flows from financing activities</b>		(1,003)	(930)
<b>Net increase/(decrease) in cash and cash equivalents</b>		(372)	61
Cash and cash equivalents at 1 January		470	409
<b>Cash and cash equivalents at 31 December *</b>	26	98	470

\*Cash and cash equivalent balances include funds held as collateral for derivatives with AIB of €63m in 2017 (2016: €435m) and Cash Substitution Pool Assets with Barclays Bank p.l.c. of €35m in 2017 (2016: €35m). See note 12.

The notes on pages 60 to 95 are an integral part of these financial statements.

## Statement of Changes in Shareholders' Equity

For the financial year ended 31 December 2017

	Ordinary Share Capital € m	Capital Reserves € m	Revenue Reserves € m	Total Shareholders' Equity € m
<b>At 1 January 2017</b>	<b>1,745</b>	<b>580</b>	<b>(18)</b>	<b>2,307</b>
Total comprehensive income for the period	-	-	86	86
<b>At 31 December 2017</b>	<b>1,745</b>	<b>580</b>	<b>68</b>	<b>2,393</b>
At 1 January 2016	1,745	580	(383)	1,942
Total comprehensive income for the period	-	-	365	365
At 31 December 2016	1,745	580	(18)	2,307



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## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES

The accounting policies applied in the preparation of the financial statements for the financial year ended 31 December 2017 are set out below.

#### 1.1. Reporting entity

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. The Bank's registered office is Bankcentre, Ballsbridge, Dublin 4, and it is registered under the company number 404926. It is a wholly owned subsidiary of Allied Irish Banks, p.l.c. ("AIB") which is a wholly owned subsidiary of AIB Group plc, and is regulated by the SSM (Single Supervisory Mechanism). 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 branch network in the Republic of Ireland or may be purchased from AIB and other members of AIB or third parties.

#### 1.2. 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 financial year ended 31 December 2017. 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 Act 2014 applicable to companies reporting under IFRS and the European Communities (Credit Institutions: Financial Statements) Regulations, 2015, and the Asset Covered Securities Acts 2001 and 2007.

#### 1.3. 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; determination of the fair value of certain financial assets and liabilities, and provisions for liabilities and commitments. 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 note 2 of the financial statements.

##### *Going concern*

The financial statements for the financial year ended 31 December 2017 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. The period of assessment used by the Directors is twelve months from the date of approval of these annual financial statements.

The Bank is dependent on its parent AIB for continued funding and is therefore dependent on the going concern status of the parent.

The financial statements of AIB for the financial year ended 31 December 2017 have been prepared on a going concern basis as the Directors of AIB are satisfied, having considered the risks and uncertainties impacting AIB, that it has the ability to continue in business for the period of assessment. The period of assessment used by the Directors of AIB is twelve months from the date of approval of its annual financial statements.

## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

#### 1.3. Basis of preparation (continued)

##### *Going concern (continued)*

In making its assessment, the Directors of AIB have considered a wide range of information relating to present and future conditions. These have included financial plans covering the period 2018 to 2020 approved by the Board in December 2017, liquidity and funding forecasts, and capital resources projections, all of which have been prepared under base and stress scenarios.

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

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

In relation to liquidity and funding, the Directors of AIB 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 AIB during the period of assessment.

On the basis of the above, the Directors of AIB 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 AIB's ability to continue as a going concern over the period of assessment.

##### *Conclusion*

On the basis of the continued availability of funding from AIB to the 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*

During the year to 31 December 2017, AIB adopted amendments to standards and interpretations which had an insignificant impact on these financial statements.

#### 1.4. 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. Fees and commissions payable to third parties in connection with lending arrangements, where these are direct and incremental costs related to the issue of a financial instrument, are included in interest income as part of the effective interest rate.

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.



## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

#### 1.5. 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.

#### 1.6. 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. See accounting policy 1.14 for detailed disclosure of the valuation techniques used.

#### 1.7. 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 the income statement. See accounting policy 1.14 for detailed disclosure of the valuation techniques used.

#### 1.8. 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 hedging instrument in a qualifying 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.

## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

#### 1.8. Derivatives and hedge accounting (continued)

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.

See accounting policy 1.14 for detailed disclosure of the valuation techniques used.

#### 1.9. 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.

## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

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

##### *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 Bank. 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 Bank 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.

##### *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.



## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

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

##### ***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 of the Risk Management Report. 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 Application Guidance 8 of IAS 39 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.



## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

#### 1.10. 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.

#### 1.11. 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 financial year using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous financial 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.

#### 1.12. 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.

#### 1.13. Shareholders' 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. On extinguishment of equity instruments, gains or losses arising are recognised net of tax directly in the statement of changes in equity.

##### *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 cash contribution from AIB.

##### *Revenue reserves*

Revenue reserves represent retained earnings of the Bank.

#### 1.14. Determination of fair value of financial instruments

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 Bank considers the impact of non-performance risk when valuing its financial liabilities.

## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

#### 1.14. Determination of fair value of financial instruments (continued)

Financial instruments are initially recognised at fair value and, with the exception of financial assets at fair value through profit or loss, the initial carrying amount is adjusted for direct and incremental transaction costs. In the normal course of business, the fair value on initial recognition is the transaction price (fair value of consideration given or received). If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is determined by a quoted price in an active market for the same financial instrument, or by a valuation technique which uses only observable market inputs, the difference between the fair value at initial recognition and the transaction price is recognised as a gain or loss. If the fair value is calculated by a valuation technique that features significant market inputs that are not observable, the difference between the fair value at initial recognition and the transaction price is deferred. Subsequently, the difference is recognised in the income statement on an appropriate basis over the life of the financial instrument, but no later than when the valuation is supported by wholly observable inputs; the transaction matures; or is closed out.

Subsequent to initial recognition, the methods used to determine the fair value of financial instruments include quoted prices in active markets where those prices are considered to represent actual and regularly occurring market transactions. Where quoted prices are not available or are unreliable because of market inactivity, fair values are determined using valuation techniques. These valuation techniques maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The valuation techniques used incorporate the factors that market participants would take into account in pricing a transaction. Valuation techniques include the use of recent orderly transactions between market participants, reference to other similar instruments, option pricing models, discounted cash flow analysis and other valuation techniques commonly used by market participants.

Quoted prices in active markets are used where those prices are considered to represent actual and regularly occurring market transactions for financial instruments in active markets.

Valuations for negotiable instruments such as debt and equity securities are determined using bid prices for asset positions and offer prices for liability positions.

Where securities are traded on an exchange, the fair value is based on prices from the exchange. The market for debt securities largely operates on an 'over the counter' basis which means that there is not an official clearing or exchange price for these security instruments. Therefore, market makers and/or investment banks ('contributors') publish bid and offer levels which reflect an indicative price that they are prepared to buy and sell a particular security. The Bank's valuation policy requires that the prices used in determining the fair value of securities quoted in active markets must be sourced from established market makers and/or investment banks.

#### Valuation techniques

In the absence of quoted market prices, and in the case of over-the-counter derivatives, fair value is calculated using valuation techniques. Fair value may be estimated using quoted market prices for similar instruments, adjusted for differences between the quoted instrument and the instrument being valued. Where the fair value is calculated using discounted cash flow analysis, the methodology is to use, to the extent possible, market data that is either directly observable or is implied from instrument prices, such as interest rate yield curves, equity and commodity prices, credit spreads, option volatilities and currency rates. In addition, the Bank considers the impact of own credit risk and counterparty risk when valuing its derivative liabilities.

The valuation methodology is to calculate the expected cash flows under the terms of each specific contract and then discount these values back to a present value. The assumptions involved in these valuation techniques include:

- The likelihood and expected timing of future cash flows of the instrument. These cash flows are generally governed by the terms of the instrument, although management judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt. In addition, future cash flows may also be sensitive to the occurrence of future events, including changes in market rates; and
- Selecting an appropriate discount rate for the instrument, based on the interest rate yield curves including the determination of an appropriate spread for the instrument over the risk-free rate. The spread is adjusted to take into account the specific credit risk profile of the exposure.

All adjustments in the calculation of the present value of future cash flows are based on factors market participants would take into account in pricing the financial instrument.

## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

#### 1.14. Determination of fair value of financial instruments (continued)

Certain financial instruments (both assets and liabilities) may be valued on the basis of valuation techniques that feature one or more significant market inputs that are not observable. When applying a valuation technique with unobservable data, estimates are made to reflect uncertainties in fair values resulting from a lack of market data, for example, as a result of illiquidity in the market. For these instruments, the fair value measurement is less reliable. Inputs into valuations based on non-observable data are inherently uncertain because there is little or no current market data available from which to determine the price at which an orderly transaction between market participants would occur under current market conditions. However, in most cases there is some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments will be based on some market observable inputs even where the non-observable inputs are significant. All unobservable inputs used in valuation techniques reflect the assumptions market participants would use when fair valuing the financial instrument.

The Bank tests the outputs of the valuation model to ensure that it reflects current market conditions. The calculation of fair value for any financial instrument may require adjustment of the quoted price or the valuation technique output to reflect the cost of credit risk and the liquidity of the market, if market participants would include one, where these are not embedded in underlying valuation techniques or prices used.

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.

#### Transfers between levels of the fair value hierarchy

The Bank recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change occurred.

#### 1.15. Non-current assets held for sale

A non-current asset is classified as held for sale if it is expected that its carrying amount will be recovered principally through sale rather than through continuing use, it is available for immediate sale and sale is highly probable within one year. For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset.

On initial classification as held for sale, generally, non-current assets are measured at the lower of previous carrying amount and fair value less costs to sell with any adjustments taken to the income statement. The same applies to gains and losses on subsequent re-measurement. Financial assets within the scope of IAS 39 continue to be measured in accordance with that standard.

Impairment losses subsequent to classification of assets as held for sale are recognised in the income statement. Subsequent increases in fair value less costs to sell of assets that have been classified as held for sale are recognised in the income statement, to the extent that the increase is not in excess of any cumulative impairment loss previously recognised in respect of the asset. Assets classified as held for sale are not depreciated.

Gains and losses on re-measurement and impairment losses subsequent to classification as non-current assets held for sale are shown within continuing operations in the income statement.

Non-current assets held for sale are presented separately on the Statement of Financial Position. Prior periods are not reclassified.

#### 1.16. Foreign currency translation

Items included in the financial statements of each of the Bank's entities are measured using their functional currency, being the currency of the primary economic environment in which the entity operates.

#### Transactions and balances

Foreign currency transactions are translated into the respective entity's functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rate prevailing at the period end. Foreign exchange gains and losses resulting from the settlement of such transactions and from the re-translation at period end exchange rates of the amortised cost of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.



## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

#### 1.17. Prospective accounting changes

The following new standards and amendments to existing standards which have been 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 new standards and amendments. The new accounting standards and amendments which are more relevant to the Bank are detailed below:

##### (a) Annual improvements to cycles/other

The IASB has published a number of minor amendments to IFRSs through both standalone amendments and through the Annual Improvements to IFRS Standards 2014-2016 cycle and 2015-2017 cycle. Whilst certain of these have yet to be endorsed by the EU, they are expected to be effective from either 1 January 2018 or 1 January 2019, depending on the amendment.

These amendments are expected to have an insignificant effect on the financial statements.

##### (b) IFRIC 23 Uncertainty over Income Tax Treatments

IFRIC 23 Interpretation on 'Uncertainty over Income Tax Treatments' which was issued in June 2017 clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments that have yet to be accepted by the tax authorities.

The Interpretation specifically addresses the following:

- Whether an entity considers uncertain tax treatments separately;
- The assumptions an entity makes about the examination of tax treatments by taxation authorities;
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- How an entity considers changes in facts and circumstances.

Effective date: Annual periods beginning on or after 1 January 2019.

IFRIC 23 is expected to have an insignificant effect on the financial statements.

##### (c) IFRS 15 Revenue from Contracts with Customers

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.

An AIB-wide project has been rolled out where the various types of revenue streams have been identified and analysed. However, due to the nature of these revenue streams, no significant change to the Bank's financial statements has been highlighted as a result of the analysis. Accordingly, it is expected that any impact will be minimal on retained earnings on transition at 1 January 2018.

On transition, while the Bank will apply this standard retrospectively, it will exercise certain practical expedients as allowed by the standard. Prior periods will not be restated and the opening balance of retained earnings will be adjusted for any prior period impacts. Additionally, for contracts completed before the earliest period presented, the Bank will not be restating the opening balance of retained earnings.

Effective date: Annual periods beginning on or after 1 January 2018.

##### (d) IFRS 16 Leases

IFRS 16 Leases, which was issued in January 2016, replaces IAS 17 Leases. The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Under IFRS 16, a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. Lessor accounting remains largely unchanged and the distinction between operating and finance leases is retained.

Effective date: Annual periods beginning on or after 1 January 2019.

IFRS 16 is expected to have an insignificant effect on the financial statements.



## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

#### 1.17. Prospective accounting changes (continued)

##### (e) IFRS 9 Financial Instruments

With effect from 1 January 2018, IFRS 9 Financial Instruments replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 includes a revised classification and measurement model, a forward looking 'expected credit loss' impairment methodology and modifies the approach to hedge accounting. The key changes under the standard are:

##### Classification and measurement

- Financial assets are classified on the basis of the business model within which they are held and their contractual cash flow characteristics. The classification and measurement categories are amortised cost, fair value through other comprehensive income and fair value through profit and loss;
- A financial asset is measured at amortised cost if two criteria are met: a) the objective of the business model is to hold the financial asset for the collection of the contractual cash flows, and b) the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest ("SPPI");
- If a financial asset is eligible for amortised cost measurement, an entity can elect to measure it at fair value if it eliminates or significantly reduces an accounting mismatch;
- Interest is calculated on the gross carrying amount of a financial asset, except where the asset is credit impaired in which case interest is calculated on the carrying amount after deducting the impairment provision;
- There is no separation of an embedded derivative where the instrument is a financial asset;
- Equity instruments must be measured at fair value, however, an entity can elect on initial recognition to present fair value changes, including any related foreign exchange component on non-trading equity investments directly in other comprehensive income. There is no subsequent recycling of fair value gains and losses to profit or loss; however, dividends from such investments will continue to be recognised in profit or loss;
- The classification of financial liabilities is essentially unchanged, except that, for certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income;

##### Impairment

- Requires accelerated recognition of expected credit losses using a three stage approach. For financial assets where there has been no significant increase in credit risk since origination, a provision for 12 months expected credit losses is required. For financial assets where there has been a significant increase in credit risk or where the asset is credit impaired, a provision for full lifetime expected losses is required;
- The assessment of whether credit risk has increased significantly since origination is performed for each reporting period by considering the change in risk of default occurring over the remaining life of the financial instrument, rather than by considering an increase in expected credit loss;
- The assessment of credit risk, and the estimation of expected credit loss, are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of expected credit loss should take into account the time value of money. As a result, the recognition and measurement of impairment is more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month expected credit loss and the population of financial assets to which lifetime expected credit loss applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

##### Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks. The standard does not explicitly address macro hedge accounting strategies, which are being considered in a separate project. To remove the risk of any conflict between existing macro hedge accounting practice and the new general hedge requirements, IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting.

Set out on the next page is a summary of the impacts of IFRS 9 together with policy choices selected by AIB where relevant.

## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

#### 1.17. Prospective accounting changes (continued)

##### (e) IFRS 9 Financial Instruments (continued)

##### Classification and measurement

Classification and measurement of financial assets will not result in any significant changes for the Bank.

In general:

- loans and advances to banks and customers that are currently classified as ‘loans and advances’ under IAS 39 will be measured at amortised cost under IFRS 9;
- debt securities classified as available for sale under IAS 39 will be measured at fair value through other comprehensive income;
- debt securities classified as ‘held to maturity’ under IAS 39 will be measured at amortised cost; and
- all equity securities held at 31 December 2017 will be measured under IFRS 9 at fair value through profit or loss. Under IAS 39, all equity securities were classified as available for sale with fair value movements reported in ‘other comprehensive income’.

The business model assessment which was carried out on the portfolio did not result in any change to the current IAS 39 measurement basis at AIB level.

In relation to SPPI testing which was carried out on the financial instruments portfolio, a small number of instruments, mainly loans and advances to customers failed the SPPI test. Accordingly, such instruments will be measured at fair value through profit or loss in accordance with IFRS 9. Fair value movements on these instruments will be shown in profit and loss. The impact on transition to this new measurement basis is not significant and estimated to be immaterial.

The Bank has not currently opted to designate any financial assets at fair value through profit or loss as permitted by IFRS 9 when certain conditions are met.

The Bank’s classification of financial liabilities is unchanged. The Bank measures financial liabilities at amortised cost subsequent to initial recognition. Given that the Bank does not fair value its own debt, there is no impact as a result of changes required under IFRS 9.

There are governance structures for the validation of its business models on an on-going basis and for ensuring that financial instruments failing the SPPI test are correctly identified at initial recognition.

##### Impairment

In preparing for the implementation of IFRS 9 on 1 January 2018, the Programme designed and documented accounting policy changes, set out the principles for the Impairment Framework, identified and remediated data gaps, developed risk modelling options and methodologies for the calculation of the impairment allowance and built expected credit loss (‘ECL’) models, tested policy proposals and processes which were developed, validated outputs, and set up governance structures and processes for both implementation, transition and ‘business as usual’ under the new standard. The principles addressed in the Impairment Framework are informed by both external and internal sources of information, amongst them, the IFRS 9 standard, Basel Committee pronouncements and AIB Group: Provisions Credit Methodology (‘PCM’ – April 2016). The principles define various criteria within the ECL cycle, inter alia, stage transfer criteria, significant increase in credit risk, default definition and write-off policy.

The model development process required extensive engagement throughout the AIB from the Risk Analytics Model team through to front line business areas.

In calculating the ECL for the loans and advances to customers’ portfolio, the impairment models take into consideration common credit risk characteristics such as credit grade, collateral, industry and geographical region. The actual loss experience is adjusted to reflect current conditions and AIB’s view of economic conditions over the life of the loans within portfolios. A number of forward looking macro-economic scenarios have been developed to which have been allocated probability weightings. A minimum of three and a maximum of five scenarios will be used for IFRS 9 purposes. These macro-economic scenarios are subject to AIB’s existing governance process covering the development and approval of scenarios for planning and stress testing.

The models are components of the ECL calculation and are relevant to the exposures captured in IFRS 9 stages 1, 2 and 3.

- The PD model estimates the probability of an account defaulting within 12 months from observation or over its residual life where significant increase in credit risk has occurred.
- The LGD model estimates the loss on an exposure if the account were to default within the following 12 months or over the residual contractual maturity.
- The Prepayment model estimates the probability of prepaying over the remaining life of mortgages.
- The Exposure at default model (‘EAD’) calculates the expected EAD at date of default in the next 12 months or over the life of the loan where significant credit deterioration has occurred.

## Notes to the Financial Statements (continued)

### 1. ACCOUNTING POLICIES (continued)

#### 1.17. Prospective accounting changes (continued)

##### (e) IFRS 9 Financial Instruments (continued)

##### Impairment (continued)

Models have been developed for:

- (i) Personal loans and overdrafts;
- (ii) Personal mortgages;
- (iii) Small-sized SMEs;
- (iv) Commercial real estate;
- (v) Medium-sized SMEs and corporates.

For non-retail stage 3 customers, AIB uses a discounted cash flow model as the primary input to calculate ECL. Macro-economic scalars from similar portfolios are applied to the resultant outputs to uplift the base case to reflect a probability weighted loss outcome.

In determining whether credit risk has increased significantly since initial recognition, where contractual payments are more than 30 days past due, AIB will presume this to be the case. Likewise, where contractual payments are more than 90 days past due, AIB will presume that the financial asset is credit impaired.

Financial assets held within the bank and sovereign portfolios are practically all investment grade. The standard contains an important practical expedient that, if a financial instrument has low credit risk, then an entity is allowed to assume at the reporting date that no significant increase in credit risk has occurred. Accordingly, AIB will recognise an impairment allowance based on 12 month ECLs for such low risk instruments.

##### Hedge accounting

IFRS 9 includes an accounting policy choice which allows entities remain with IAS 39 hedge accounting requirements until macro hedge accounting is addressed by the IASB as part of a separate project. AIB will exercise this policy choice and continue to account under IAS 39. However, it will implement the revised hedge accounting disclosures required by the amendments to IFRS 7.

##### Assessment of IFRS 9 impacts for AIB Mortgage Bank

An AIB Group Programme ("the Programme"), led jointly by Risk and Finance, commenced work during 2015 to oversee delivery of the requirements for implementation of IFRS 9. This Programme is currently transitioning to 'business as usual' and the varying aspects of IFRS 9 are operational with effect from 1 January 2018, i.e. the date of initial application.

The Bank is not restating prior periods (as allowed in IFRS 9, paragraph 7.2.15). However, as required by this paragraph, if prior periods are not restated, the Bank is recognising any difference arising between IAS 39 carrying amounts and IFRS 9 carrying amounts at 1 January 2018 in opening retained earnings (or in other comprehensive income, as applicable) at 1 January 2018.

The business model assessment test was performed as at the date of initial application. This classification applied retrospectively. The Bank assessed whether the financial assets met the conditions for recognising a change in the classification/measurement basis at that date.

Impairment losses were measured at the date of initial application under the 'expected credit loss model' set out in IFRS 9.

Based on assessments undertaken to date, the total estimate of the possible impact net of tax on transition is €11m representing a reduction in revenue reserves and other comprehensive income, principally due to the impairment requirements.

The Bank will continue to refine this estimate during the transition period as new processes and systems are deployed and embedded.

Effective date: Annual periods beginning on or after 1 January 2018.



## Notes to the Financial Statements (continued)

### 2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

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 and 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 judgement involves making estimates concerning the likelihood of future events, the actual results could differ from those estimates.

The accounting policies that are deemed critical to the Bank's results and financial position, in terms of the materiality of the items to which the policy is applied and the estimates that have a significant impact on the financial statements are set out in this section. In addition, estimates with a significant risk of material adjustment in the next year are also discussed.

#### **(a) Going concern**

The financial statements for the financial year ended 31 December 2017 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. The period of assessment used by the Directors is twelve months from the date of approval of these annual financial statements.

The Bank is dependent on its parent, AIB for continued funding and is therefore dependent on the going concern status of the parent.

As such, the financial statements of AIB for the financial year ended 31 December 2017 have been prepared on a going concern basis as the Directors of AIB are satisfied, having considered the risks and uncertainties impacting AIB, that it has the ability to continue in business for the period of assessment.

In making its assessment for AIB, the Directors of AIB have considered a wide range of information relating to present and future conditions. These have included financial plans covering the period 2018 to 2020 approved by AIB Board in December 2017, liquidity and funding forecasts, and capital resources projections, all of which have been prepared under base and stress scenarios.

On the basis of the continued availability of funding from AIB to the 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 note 1.9. The provisions for impairment on loans and receivables at 31 December 2017 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.

Credit risk is identified, assessed and measured through the use of credit rating and scoring tools. The ratings influence the management of individual loans. Special attention is paid to lower quality rated loans and when appropriate, loans are transferred to specialist units to help avoid default, or where in default, to help minimise loss. The credit rating triggers the impairment assessment and if relevant the raising of specific provisions on individual loans where there is doubt about their recoverability.

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 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 Credit Committee, prior to AIB 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.

#### **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.



## Notes to the Financial Statements (continued)

### 2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

#### **(b) Loan impairment (continued)**

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 20 to 22 of the Risk Management 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. There may be factors in the portfolio that have not been a feature of the past and changes in credit grading profiles and grading movements may lag the change in the credit profile of the customer. In addition, current estimates of loss within the non-impaired portfolio and the period of time it takes following a loss event for an individual loan to be recognised as impaired ('emergence period') are subject to a greater element of estimation due to the speed of change in the economies in which AIB operates. 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 20 to 22 of the Risk Management 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) Fair value of financial instruments**

The Bank's accounting policy for provisions for fair value of financial instruments is set out in note 1.14.

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.

#### **(d) Provisions for liabilities and commitments**

The Bank's accounting policy for provisions for liabilities and commitments is set out in note 1.10.

The Bank recognises liabilities where it has present legal or constructive obligations as a result of past events and it is more likely than not that these obligations will result in an outflow of resources to settle the obligations and the amount can be reliably estimated. Details of the Bank's liabilities and commitments are shown in note 21 to the financial statements.

The recognition and measurement of liabilities, in certain instances, may involve a high degree of uncertainty, and thereby, considerable time is expended on research in establishing the facts, scenario testing, assessing the probability of the outflow of resources and estimating the amount of any loss. This process will, of its nature, require significant management judgement and will require revisions to earlier judgements and estimates as matters progress towards resolution. However, at the earlier stages of provisioning, the amount provided for can be very sensitive to the assumptions used and there may be a wide range of possible outcomes in particular cases. Accordingly, in such cases, it is often not practicable to quantify a range of possible outcomes. In addition, it is also not practicable to measure ranges of outcomes in aggregate in a meaningful way because of the diverse nature of these provisions and the differing fact patterns.

## Notes to the Financial Statements (continued)

### 3. INTEREST INCOME AND SIMILAR INCOME

	2017 € m	2016 € m
Interest on loans and receivables to customers	460	491
Interest earned from AIB	72	115
	<b>532</b>	<b>606</b>

Interest receivable from AIB is €72m (2016: €115m) and relates to mortgage covered securities hedges (bond swaps).

### 4. INTEREST EXPENSE AND SIMILAR CHARGES

	2017 € m	2016 € m
Interest payable to AIB	79	41
Interest on debt securities in issue	90	138
	<b>169</b>	<b>179</b>

Included in the interest payable to AIB is interest payable on one month Euribor plus 95 bps (2016: one month Euribor) funding and other additional funding costs of €69m (2016: €28m), and also interest payable on loan portfolio swaps of €10m (2016: €13m).

### 5. NET TRADING INCOME

	2017 € m	2016 € m
Debt securities and interest rate contracts	1	-
	<b>1</b>	<b>-</b>

### 6. OTHER OPERATING INCOME

	2017 € m	2016 € m
Loss on disposal of issued paper	(2)	-
Profit on disposal of loan book	4	-
Recovery on restructured loans	1	1
	<b>3</b>	<b>1</b>

## Notes to the Financial Statements (continued)

### 7. ADMINISTRATIVE EXPENSES

	2017	2016
	€ m	€ m
Amounts payable to AIB	329	63
Other administrative expenses	54	7
	<b>383</b>	<b>70</b>

In 2017, a review was completed of pricing arrangements between AIB and the Bank. Arising from this review a new pricing agreement was signed and implemented during 2017. The new agreement reflects OECD guidelines on transfer pricing which are the internationally accepted principles in this area, and take account of the functions, risks and assets involved. The impact of implementing the new transfer pricing agreement which attributes an arm's length Return on Equity to the Bank of €86m, is an increase in amounts payable to AIB for 2017 of €266m, being the primary reason for the reduction in profit after tax to €86m (2016: €365m). The additional charge is in respect of credit management, central function costs, risks borne by and assets provided by AIB in facilitating the operations of the Bank.

Other administration expenses consists of statutory payments (regulatory payments/levies) €7m (2016: €7m), and provisions for liabilities & commitments €47m which related to customer redress and other costs (2016: €1m provision for liabilities & commitments writeback). See also note 21 provisions for liabilities and commitments.

For the financial year ended 31 December 2017 the monthly average number of employees was 2 (2016: 2). As at 31 December 2017, the Bank had 2 employees (2016: 2).

In addition a small number of AIB employees maintain a parallel employment relationship with the Bank, in order to facilitate delivery of outsourced service activities under the Outsourcing and Agency Agreement with AIB. These parallel employments are unremunerated. These employees of AIB in the Republic of Ireland have a primary employment relationship with AIB, which maintains day-to-day control over them and remains responsible for the payment of their remuneration as well as accounting for tax and other payroll deductions.

#### Personnel expenses

	2017	2016
	€ m	€ m
Wages and salaries	0.2	0.2
Social insurance costs	-	-
Other retirement costs	-	-
Other compensation costs	-	-
	<b>0.2</b>	<b>0.2</b>

Personnel expenses capitalised during the financial year were Nil (2016: Nil). Personnel expenses borne by AIB are allocated to the Bank under an Outsourcing and Agency Agreement.

#### Auditors' remuneration (excluding VAT)

	2017	2016
	€ '000	€ '000
Statutory Audit of entity financial statements	80	80
Other assurance services	-	-
Tax advisory services	-	-
Other non-audit services	10	20
	<b>90</b>	<b>100</b>

The disclosure of Auditors' remuneration is in accordance with Section 322 of the Companies Act 2014 which mandates fees in particular categories and that fees paid to the Bank's Auditor (Deloitte) 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.

## Notes to the Financial Statements (continued)

### 7. ADMINISTRATIVE EXPENSES (continued)

#### Director's remuneration

	2017 € '000	2016 € '000
Fees	18	10
	18	10

No additional remuneration has been made to any individuals employed directly by AIB for roles discharged as directors of the Bank. The non-Executive Directors fees are non-pensionable.

The Directors do not participate in share option plans, therefore there were no gains on exercise of share options during the financial year in accordance with Section 305(1) of the Companies Act 2014.

There were no amounts paid (2016: Nil) to persons connected with a director in accordance with Section 306(1) of the Companies Act 2014.

### 8. PROVISIONS FOR IMPAIRMENT OF LOANS AND RECEIVABLES

	2017			2016		
	Specific € m	IBNR € m	Total € m	Specific € m	IBNR € m	Total € m
Balance at start of year	770	166	936	957	152	1,109
(Credit)/charge to income statement	(100)	(14)	(114)	(73)	14	(59)
Provisions in respect of loans and receivables sold	(112)	(1)	(113)	-	-	-
Amounts written off	(162)	-	(162)	(114)	-	(114)
Balance at end of year	396	151	547	770	166	936

By geographical location and industry sector	2017 € m	2016 € m
Republic of Ireland		
Home Mortgages	547	936



## Notes to the Financial Statements (continued)

### 9. TAXATION

	2017 € m	2016 € m
Tax losses utilised during the year (note 15)	(12)	(52)
<b>Total tax charge for the period</b>	<b>(12)</b>	<b>(52)</b>

The tax charge €12m (2016: €52m) for the year is at an effective rate of 12.5%, the standard Irish corporation tax rate.

	2017 € m	%	2016 € m	%
Operating profit before taxation	98		417	
Corporation tax charge (12.5%)	(12)	12.5	(52)	12.5
<i>Effects of:</i>				
Income taxed at higher rates	-	-	-	-
<b>Tax charge</b>	<b>(12)</b>	<b>12.5</b>	<b>(52)</b>	<b>12.5</b>

### 10. NON-CURRENT ASSETS HELD FOR SALE

	2017 € m	2016 € m
Reposessed assets	1	2
	1	2

## Notes to the Financial Statements (continued)

### 11. DERIVATIVE FINANCIAL INSTRUMENTS

Set out below are details on fair values and derivative information for the 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. AIB is the counterparty to all derivative contracts noted below.

	Contract/ Notional Amount	2017 Fair Value Asset	Fair Value Liability	Contract/ Notional Amount	2016 Fair Value Asset	Fair Value Liability
	€ m	€ m	€ m	€ m	€ m	€ m
<b>Derivatives classified as trading</b>						
Interest rate swaps	19,447	-	(1)	20,321	-	(1)
<b>Derivatives classified as hedging (Debt Securities)</b>						
Interest rate swaps	3,590	70	(7)	5,265	192	-
<b>Total derivatives</b>	<b>23,037</b>	<b>70</b>	<b>(8)</b>	<b>25,586</b>	<b>192</b>	<b>(1)</b>

In relation to Debt Securities there was a net trading gain of €1m (2016: €0.1m).

The following table represents the underlying principal and gross replacement costs of the Bank's derivatives as at 31 December 2017 and 31 December 2016.

	Residual Maturity 2017				Residual Maturity 2016			
	Within 1 yr	1 to 5 yrs	Over 5 yrs	Total	Within 1 yr	1 to 5 yrs	Over 5 yrs	Total
	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m
<b>Underlying principal amount</b>								
Interest rate contracts	19,947	2,065	1,025	23,037	20,321	3,490	1,775	25,586
<b>Positive fair value</b>								
Interest rate contracts	9	52	9	70	84	71	37	192

## Notes to the Financial Statements (continued)

### 12. LOANS AND RECEIVABLES TO BANKS

	2017 € m	2016 € m
<b>Funds placed with AIB</b>		
Analysed by remaining maturity:		
3 months or less	63	435
<b>Funds placed with Barclays Bank, p.l.c.</b>		
Analysed by remaining maturity:		
3 months or less	35	35
	<b>98</b>	<b>470</b>

The balances with AIB include a balance of €63m (2016: €435m) 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. Cash substitution pool assets are an Asset Covered Securities Act concept whereby certain assets can be held as part of the Cover Assets Pool. The Bank's credit rating at 31 December 2017 with Standard & Poor's was AAA. The Barclays bank credit rating at 31 December 2017 with Standard & Poor's was A.

### 13. LOANS AND RECEIVABLES TO CUSTOMERS

	2017 € m	2016 € m
Analysed by remaining maturity:		
Repayable on demand	1,519	2,279
3 months or less	9	14
1 year or less but over 3 months	38	65
5 years or less but over 1 year	477	471
Greater than 5 years	16,735	16,861
	<b>18,778</b>	<b>19,690</b>
Provision for impairment of loans and receivables (note 8)	(547)	(936)
	<b>18,231</b>	<b>18,754</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 €27m (2016: €37m) 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*

	2017 € m	2016 € m
Republic of Ireland		
Home Mortgages (net of provision)	18,231	18,754

## Notes to the Financial Statements (continued)

### 14. OTHER ASSETS

	2017 € m	2016 € m
Accrued interest	32	39
Other assets	15	8
	47	47

### 15. DEFERRED TAXATION

	2017 € m	2016 € m
Deferred tax assets:		
Unutilised tax losses	14	26
Total gross deferred tax assets	14	26
Deferred tax liabilities:		
Total gross deferred tax liabilities	-	-
Net deferred tax assets	14	26

#### Analysis of movements in deferred taxation

	2017 € m	2016 € m
At 1 January	26	78
Income statement (note 9)	(12)	(52)
At 31 December	14	26

At 31 December 2017 deferred tax assets on tax losses totalled €14m (2016: €26m). The tax losses arise in the Irish tax jurisdiction and their utilisation is dependent on the generation of future taxable profits. The movement in deferred taxation during 2017 represents the utilisation of tax losses. Deferred tax asset is expected to be utilised within 2 years.

### 16. DEPOSITS BY BANKS

	2017 € m	2016 € m
AIB	8,145	8,972
	8,145	8,972

The Bank has a borrowing facility with its parent company, AIB, under which the parent company provides the balance of funding after the Bank has availed of other sources of funds.

### 17. CUSTOMER ACCOUNTS

	2017 € m	2016 € m
Current accounts	3	2
	3	2

The customer account balance reflects €2.6m (2016: €2.1m) credits on customer mortgage accounts due to short-term receipts such as payments received in the course of property disposals or mortgage redemptions.



## Notes to the Financial Statements (continued)

### 18. DEBT SECURITIES IN ISSUE

	2017 € m	2016 € m
<i>Mortgage covered securities in issue to external investors of €3.6bn (2016: €5.3bn) and in issue to AIB of €3.9bn (2016: €2.4bn) by remaining maturity:</i>		
1 year or less	500	2,075
5 years or less but over 1 year	3,715	3,815
Greater than 5 years	3,275	1,775
<b>Carrying Value of Debt Securities<sup>(1)</sup></b>	<b>7,490</b>	<b>7,665</b>
<i>Mortgage covered securities in issue to external investors and internal issuances at nominal value:</i>		
External investors	3,590	5,265
AIB	3,900	2,400
	<b>7,490</b>	<b>7,665</b>

<sup>(1)</sup> The fair value of hedged liability positions is disclosed in Other Liabilities for 2017 and 2016. (See Note 19)

The 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 2017, the Cover Assets Pool amounted to €13.8bn (2016: €13.9bn), comprising of €13.8bn (2016: €13.9bn) of mortgage credit assets (mortgage loan accounts) and €0.04bn (2016: €0.04bn) of substitution assets (cash on deposit with suitably rated credit institutions). 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	Number of Mortgaged Properties	Total Loan Balances	Number of Mortgaged Properties
		2017 (1 & 2) € m	2017	2016 (1 & 2) € m	2016
€0	€100,000	2,101	40,455	2,045	39,686
€100,000	€200,000	5,323	36,575	5,232	35,905
€200,000	€500,000	5,594	20,670	5,754	21,166
Over €500,000		780	1,047	832	1,110
		<b>13,798</b>	<b>98,747</b>	<b>13,863</b>	<b>97,867</b>

<sup>(1)</sup> 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.

<sup>(2)</sup> There could be one or more loan accounts per mortgaged property. The Cover Assets Pool contains 109,927 loan accounts (2016: 109,283) secured on 98,747 properties (2016: 97,867).

## Notes to the Financial Statements (continued)

### 18. DEBT SECURITIES IN ISSUE (continued)

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

Geographical Area	Number of Mortgaged Properties		Number of Mortgaged Properties	
	2017		2016	
Dublin	26,864	27%	26,596	27%
Outside Dublin	71,883	73%	71,271	73%
	98,747	100%	97,867	100%

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

As at 31 December 2017, there were no mortgage loan accounts (2016: 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 financial year ended 31 December 2017, one mortgage loan account (2016: 1) in the Cover Assets Pool had been in default with arrears greater than €1,000.

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

During the financial year ended 31 December 2017, 31 non-performing mortgage loan accounts (2016: 48) were removed in total from the Cover Assets Pool (For this purpose, non-performing is defined as credit grade 7 and 8, i.e. has the same meaning 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 170 accounts (2016: 157) as at 31 December 2017 was €100,854 (2016: €111,470). €35,692 of this represented non-payment of interest. None of the accounts in question were written off as at 31 December 2017 as they were in arrears for less than three months.

#### (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 2017 was €1,749m (2016: €1,659m), of which €1,412m (2016: €1,316m) represented repayment of principal and €337m (2016: €343m) 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 2017 there were no loan accounts (2016: Nil) in the Cover Assets Pool that were secured on commercial properties.

### 19. OTHER LIABILITIES

	2017	2016
	€ m	€ m
Fair value of hedged liability positions	34	123
Deferred compensation on sale of loan book	2	-
Sundry creditors	2	-
	38	123

## Notes to the Financial Statements (continued)

### 20. ACCRUALS AND DEFERRED INCOME

	2017	2016
	€ m	€ m
Interest payable on mortgage covered securities	30	71
	30	71

### 21. PROVISIONS FOR LIABILITIES AND COMMITMENTS

	2017
	€ m
At 1 January 2017	50
Amounts charged to income statement	47
Amounts written back to income statement	(1)
Provisions utilised	(42)
At 31 December 2017 <sup>(1)</sup>	54
	2016
	€ m
At 1 January 2016	98
Amounts charged to income statement	-
Amounts written back to income statement	(1)
Provisions utilised	(47)
At 31 December 2016 <sup>(1)</sup>	50

<sup>(1)</sup> The total provisions for liabilities and commitments expected to be settled within one year amount to €54m (2016: €50m).

#### Provisions for customer redress and other costs

In 2015, the Bank created a provision of €50m related to the expected outflow for customer redress and compensation in respect of tracker mortgages where rates given to customers were either not in accordance with original contract terms or where the transparency of terms did not conform to that which a customer could reasonably expect (Tracker Mortgage Examination). Over the past two years over 1,900 customers were redressed and compensated.

It was concluded that a further €42m income statement charge is required for 2017. This amount includes €30m following conclusion of a review in 2017, that c. 900 additional accounts which were no longer on a tracker rate were deemed impacted and c. 4,000 additional accounts which were never on a tracker rate would also be paid compensation, and €12m in respect of previously identified customers that had yet to receive redress and compensation by 31 December 2017.

This brings the year end provision for customer redress and compensation to €40m to cover payments to these additional customers as well as the remaining customers that had yet to receive redress and compensation by 31 December 2017. The final redress and compensation is subject to independent third party assurance and is also subject to assessment and challenge by the Central Bank, notwithstanding the advanced stage of the examination process in the Bank.

In 2015, the Bank also created a provision of €48m with regard to 'Other costs'. A further €5m was charged to the income statement in 2017. Over the past two years €39m was utilised bringing the provision for 'Other costs' to €14m at 31 December 2017.

## Notes to the Financial Statements (continued)

### 22. SUBORDINATED LIABILITIES

	2017 € m	2016 € 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 the 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 the 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 the Bank and creditors of the Bank whose claims are subordinated to the claims of depositors and other unsubordinated creditors of the Bank but excluding *paripassu* Subordinated Creditors and those creditors of the Bank whose claims rank or are expressed to rank junior to the claims of AIB.

### 23. ISSUED SHARE CAPITAL PRESENTED AS EQUITY

	2017 € m	2016 € m
Authorised:		
3,000,000,000 ordinary shares of €1.00 each		
(2016: 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		
(2016: 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.

### 24. CAPITAL RESERVES

	2017 € m	2016 € m
Opening balance	580	580
Closing balance	<b>580</b>	580

Capital reserves represent cash contribution from AIB.



## Notes to the Financial Statements (continued)

### 25. CAPITAL MANAGEMENT

#### Capital regulation

The Capital Requirements Directive IV ("CRD IV"), which came into force on 1 January 2014, consists of the Capital Requirements Regulation ("CRR") and the Capital Requirements Directive ("CRD"), and is designed to strengthen the regulation of the banking sector and to implement the Basel III agreement in the EU legal framework. CRD IV measures include:

- a single set of harmonised prudential rules which enhanced requirements for quality and quantity of capital; and
- CRD IV also harmonises the deductions from own funds in order to determine the amount of regulatory capital that is prudent to recognise for regulatory purposes. Some of the provisions of CRD IV were introduced on a phased basis from 2014, these typically followed 20% in 2014, 40% in 2015 etc. until 2018. The main exception to this relates to the deduction for the deferred tax asset which is deducted at 10% per annum and commenced in 2015.

AIB commenced reporting to its regulator under the transitional CRD IV rules during 2014. The transitional capital ratios presented on page 7 take account of these phasing arrangements. The fully loaded capital ratios represent the full implementation of CRD IV.

The Single Supervisory Mechanism ("SSM"), comprising the European Central Bank ("ECB") and the national competent authorities of EU countries was established in 2014. The SSM places the ECB as the central prudential supervisor of financial institutions in the Eurozone, including AIB. The aims of the SSM are to ensure the safety and soundness of the EU banking system and to increase financial integration and stability in the EU.

### 26. STATEMENT OF CASH FLOWS

#### Analysis of Cash and Cash Equivalents

	2017 € m	2016 € m
Loans and receivables to banks (note 12)	98	470
	98	470

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

### 27. SEGMENTAL INFORMATION

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

### 28. COMMITMENTS

At 31 December 2017 the Bank had €680m (2016: €579m) of approved mortgage loan applications that had not been drawn down as at the year end.

## Notes to the Financial Statements (continued)

### 29. 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 notes 1.6, 1.7, 1.8 and 1.14.

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. 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 inputs.

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 and valuation methodologies are validated by the Risk function within AIB.

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 2017.

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.

#### **Financial instruments measured at fair value but with fair value information presented separately in the notes to the financial statements**

##### **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 practicably available, or rates currently offered by other financial institutions for placements with similar characteristics.

## Notes to the Financial Statements (continued)

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

#### ***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.

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 mortgages, 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 2017 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 where 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 2017:

## Notes to the Financial Statements (continued)

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

The following table sets out the carrying value of financial instruments at the 31 December 2017 and 2016.

	2017				
	Carrying amount in the statement of financial position				
	At fair value through profit and loss		At amortised cost		Total
	Held for trading	Fair value hedge derivatives	Loans and receivables	Other	
	€ m	€ m	€ m	€ m	€ m
<b>Financial assets measured at fair value</b>					
Interest rate derivatives	-	70	-	-	70
<b>Financial assets not measured at fair value</b>					
Loans and receivables to banks	-	-	98	-	98
Loans and receivables to customers	-	-	18,231	-	18,231
Other financial assets	-	-	-	47	47
	-	70	18,329	47	18,446
<b>Financial liabilities measured at fair value</b>					
Interest rate derivatives	8	-	-	-	8
<b>Financial liabilities not measured at fair value</b>					
Deposits by banks	-	-	-	8,145	8,145
Debt securities in issue	-	-	-	7,490	7,490
Subordinated liabilities	-	-	-	300	300
Other financial liabilities	-	-	-	30	30
Customer accounts	-	-	-	3	3
	8	-	-	15,968	15,976

	2016				
	Carrying amount in the statement of financial position				
	At fair value through profit and loss		At amortised cost		Total
	Held for trading	Fair value hedge derivatives	Loans and receivables	Other	
	€ m	€ m	€ m	€ m	€ m
<b>Financial assets measured at fair value</b>					
Interest rate derivatives	-	192	-	-	192
<b>Financial assets not measured at fair value</b>					
Loans and receivables to banks	-	-	470	-	470
Loans and receivables to customers	-	-	18,754	-	18,754
Other financial assets	-	-	-	47	47
	-	192	19,224	47	19,463
<b>Financial liabilities measured at fair value</b>					
Interest rate derivatives	1	-	-	-	1
<b>Financial liabilities not measured at fair value</b>					
Deposits by banks	-	-	-	8,972	8,972
Debt securities in issue	-	-	-	7,665	7,665
Subordinated liabilities	-	-	-	300	300
Other financial liabilities	-	-	-	71	71
Customer accounts	-	-	-	2	2
	1	-	-	17,010	17,011



## Notes to the Financial Statements (continued)

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

The following table sets out the carrying value of financial instruments across the three levels of the fair value hierarchy at the 31 December 2017 and 2016:

				2017
	Fair value hierarchy			
	Level 1	Level 2	Level 3	Total
	€ m	€ m	€ m	€ m
<b>Financial assets measured at fair value</b>				
Interest rate derivatives	-	70	-	70
<b>Financial assets not measured at fair value</b>				
Loans and receivables to banks	-	-	98	98
Loans and receivables to customers	-	-	17,027	17,027
Other financial assets	-	-	47	47
	-	70	17,172	17,242
<b>Financial liabilities measured at fair value</b>				
Interest rate derivatives	-	8	-	8
<b>Financial liabilities not measured at fair value</b>				
Deposits by banks	-	-	8,145	8,145
Debt securities in issue	7,806	-	-	7,806
Subordinated liabilities	-	225	-	225
Other financial liabilities	-	-	30	30
Customer accounts	-	-	3	3
	7,806	233	8,178	16,217
				2016
	Fair value hierarchy			
	Level 1	Level 2	Level 3	Total
	€ m	€ m	€ m	€ m
<b>Financial assets measured at fair value</b>				
Interest rate derivatives	-	192	-	192
<b>Financial assets not measured at fair value</b>				
Loans and receivables to banks	-	-	470	470
Loans and receivables to customers	-	-	17,198	17,198
Other financial assets	-	-	47	47
	-	192	17,715	17,907
<b>Financial liabilities measured at fair value</b>				
Interest rate derivatives	-	1	-	1
<b>Financial liabilities not measured at fair value</b>				
Deposits by banks	-	-	8,972	8,972
Debt securities in issue	7,875	-	-	7,875
Subordinated liabilities	-	78	-	78
Other financial liabilities	-	-	71	71
Customer accounts	-	-	2	2
	7,875	79	9,045	16,999

## Notes to the Financial Statements (continued)

### 30. RELATED PARTY TRANSACTIONS

#### (a) Transactions with AIB

The Bank is a subsidiary of AIB. Banking transactions are entered into between the 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 3 and note 4 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. The Bank is also party to the Mortgage-Backed Promissory Note Framework Agreements with the CBI, however this type of funding has not been utilised since 2011.

In 2017, following a request from AIB, a review was completed of pricing arrangements between AIB and its' wholly owned subsidiary AIB Mortgage Bank. Arising from this review a new arms' length pricing agreement covering the totality of the relationship with AIB, was signed and implemented during 2017 replacing the previous arrangements which were "grandfathered" under Irish Revenue rules. The new agreement reflects OECD guidelines on transfer pricing which are the internationally accepted principles in this area, and take account of the functions, risks and assets involved.

The impact of implementing the new transfer pricing agreement which attributes an arm's length Return on Equity to the Bank of €86m, is an increase in Administrative expenses for 2017 of €266m, being the primary reason for the reduction in profit after tax to €86m (2016: €365m). The additional charge is in respect of credit management, central function costs, risks borne by and assets provided by AIB in facilitating the operations of the Bank.

	2017 €m	2016 €m
<b>Loans and receivables to banks</b>	<b>63</b>	<b>435</b>
<b>Deposits by banks</b>	<b>8,145</b>	<b>8,972</b>
<b>Included in the income statement</b>		
Interest income on loans	72	115
Interest expense on loans	(79)	(41)
Administrative expenses	(329)	(63)
<b>Derivative financial instruments</b>		
<b>Interest rate swaps</b>		
Assets (Fair value)	70	192
Liabilities (Fair value)	(8)	(1)
Net Trading Income	(88)	(59)

#### (b) IAS 24 Related Party Disclosures

The following disclosures are made in accordance with the provisions of IAS 24 Related Party Disclosures. Under IAS 24, Key Management Personnel are defined as comprising Executive, Non-Executive Directors and Senior Executive Officers. As at 31 December 2017 the Bank has 14 KMP (2016: 6 KMP).

##### (i) Compensation of Key Management Personnel ("KMP")

Compensation of Key Management Personnel, namely Executive and Non-Executive Directors and Senior Executive Officers, in office during the year is paid by AIB and allocated to the Bank under the Outsourcing and Agency Agreement. See note 7: Administration Expenses.

##### (ii) Transactions with Key Management Personnel ("KMP")

Loans to KMP and their close family members 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 the 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 made on terms available to other employees in the Bank generally, in accordance with established policy, within limits set on a case by case basis.

## Notes to the Financial Statements (continued)

### 30. RELATED PARTY TRANSACTIONS (continued)

#### (b) IAS 24 Related Party Disclosures (continued)

##### (ii) Transactions with Key Management Personnel ("KMP") (continued)

The aggregate amounts outstanding, in respect of all loans, quasi loans and credit transactions between the Bank and the KMP, as defined above, together with members of their close families and entities influenced by them are shown in the following table:

	2017 € '000	2016 € '000
Loans outstanding		
At 1 January	59	69
Loans issued during the year	-	-
Loan repayments during the year/change of KMP/other	411	(10)
At 31 December	470	59

The balances outlined above include loans, quasi loans and credit transactions held by the connected persons of Key Management Personnel identified as such during the reporting period. In instances where the Key Management Personnel were identified post 1 January, no balance has been reported as at 1 January.

#### (c) Companies Act 2014 disclosures

##### (i) Loans to Directors

The following information is presented in accordance with the Companies Act 2014. For the purposes of the Companies Act disclosures, Director means the Board of Directors and any past Directors who are Directors during the relevant period. There were 7 Directors in office during the year, 2 of whom availed of credit facilities (2016: 1). Both Directors who availed of credit facilities had balances outstanding at 31 December 2017 (2016: 1).

Details of transactions with Directors for the year ended 31 December 2017 are as follows:

	Balance at 31 December 2016 €'000	Amounts advanced during 2017 €'000	Amounts repaid during 2017 €'000	Balance at 31 December 2017 €'000
<b>Catherine Woods</b>				
Loans	59	-	10	49
Interest charged during 2017	-	-	-	1
Maximum debit balance during 2017**	-	-	-	59
<b>Chris Curley</b>				
Loans	291	-	23	268
Interest charged during 2017	-	-	-	9
Maximum debit balance during 2017**	-	-	-	291

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 on all of these loans or facilities has been paid.

Ken Burke, Simon Ball, Gerry Gaffney, Dave Keenan and James Murphy had no facilities with the Bank during 2017.

## Notes to the Financial Statements (continued)

### 30. RELATED PARTY TRANSACTIONS (continued)

#### (c) Companies Act 2014 disclosures (continued)

##### (ii) Connected persons

The aggregate of loans to connected persons of Directors in office at 31 December 2017, as defined in Section 220 of the Companies Act 2014, are as follows (aggregate of 8 persons; 2016: 4 persons):

	Balance at 31 December 2016	Balance at 31 December 2017
	€ 000	€ 000
Loan	186	605
Overdraft/Credit Card	-	-
Total	186	605
Interest Charged during 2017*	5	10
Maximum debit balance during 2017**	217	667

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

\*Amounts advanced and repaid are not shown for overdraft/credit card facilities as these are revolving in nature (i.e. they may be drawn, repaid and redrawn up to their limit over the course of the year).

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

##### (iii) Aggregate balance of loans and guarantees held by Directors and their connected persons

The aggregate balance of loans and guarantees held by Directors and their connected persons as at 31 December 2017 represents less than 0.05% of the net assets of the Bank (2016: 0.02%).

#### (d) Summary of relationship with the Irish Government

The Bank considers that the State is a related party under IAS 24 as it is in a position to exercise significant influence over AIB.

##### Ordinary Shares

At 31 December 2017, the State held 71.12% of the ordinary shares of AIB Group plc (31 December 2016: 99.9% of the ordinary shares of AIB). Further information on the initial public offering from June 2017 is available in note 52 of the 2017 AIB Annual Report.

##### 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.

### 31. NON-ADJUSTING EVENTS AFTER REPORTING PERIOD

No significant non-adjusting events have taken place since 31 December 2017.

### 32. PARENT COMPANY

The Bank is a wholly owned subsidiary of Allied Irish Banks, p.l.c. ("AIB"). The ultimate parent company of the Bank and AIB is AIB Group plc. Pursuant to a Scheme of Arrangement between AIB and its shareholders, AIB Group plc became the holding company of AIB and its subsidiaries, including the Bank (together the "AIB Group") on 8 December 2017. AIB Group plc is now the ultimate parent company of AIB Mortgage Bank. The financial statements of AIB and of the ultimate parent company are available from AIB Group plc, Bankcentre, Ballsbridge, Dublin 4. Alternatively, information can be viewed by accessing AIB's website at [www.aibgroup.com](http://www.aibgroup.com).

### 33. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors on 13 March 2018.