EBS MORTGAGE FINANCE UNLIMITED

DIRECTORS' REPORT AND ANNUAL FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

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COMPANY INFORMATION

DIRECTORS

Denis Holland	Chairman - Non Executive Director	
Fidelma Clarke	Executive Director	
Audrey Collins	Executive Director	
Bill Cunningham	Independent Non Executive Director	
Gerry Murray	Executive Director	(resigned 22 July 2011)
Dara Deering	Managing Director - Executive Director	(resigned 4 January 2012)
Emer Finnan	Group Non Executive Director	(resigned 20 December 2011)
Fergus Murphy	Group Non Executive Director	(resigned 21 March 2012)

SECRETARY Helen Dooley

REGISTERED OFFICE
2 Burlington Road
Dublin 4

REGISTERED NUMBER 463791

SOLICITORS
McCann FitzGerald
Riverside One
Sir John Rogerson's Quay
Dublin 2

BANKERS
EBS Limited
2 Burlington Road
Dublin 4

BNP Paribas Ireland
5 George's Dock
IFSC
Dublin 1

INDEPENDENT AUDITOR
KPMG
Chartered Accountants and Registered Auditor
1 Harbourmaster Place
International Financial Services Centre
Dublin 1

COVER - ASSET MONITOR
Mazars
Harcourt Centre
Block 3
Harcourt Road
Dublin 2

EBS MORTGAGE FINANCE UNLIMITED

DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2011

The Directors present their report and audited accounts for the year ended 31 December 2011. A statement of Directors' responsibilities in relation to the financial statements appears on page 10.

ACTIVITIES OF THE COMPANY

EBS Mortgage Finance ('the Bank'), an 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 30 October 2008. The Bank is a wholly owned subsidiary of EBS Limited ('EBS' or 'parent') and a member of the EBS Group (the 'Group'). The EBS Group is a wholly owned subsidiary of Allied Irish Banks p.l.c., ('AIB p.l.c.' or 'AIB Group'). The Bank is regulated by the Central Bank of Ireland.

Prior to EBS becoming part of the AIB Group, EBS traded as EBS Building Society (the 'Society') for over 75 years. In 2010, the Society was recapitalised by the Minister for Finance (the 'Minister') by an amount of €875m (through the issue of special investment shares for €625m and a promissory note for €250m). In March 2011, the Minister announced that the Society was to be acquired by AIB p.l.c. to form one of the two "pillar banks" in Ireland, and accordingly on 1 July 2011 the Society was demutualised pursuant to an acquisition conversion scheme under the Building Societies Act 1989 (as amended). The effect of this was that the Society became a limited company and obtained a banking licence from the Central Bank of Ireland ('Central Bank'). The special investment shares that had been invested in the Society by the Irish Government were converted into €625m of ordinary shares held by the Minister. The Minister then transferred the entire issued share capital (€625m ordinary shares) in EBS to AIB p.l.c. on 1 July 2011. Under and in accordance with the Building Societies Act 1989 (as amended), on the conversion of the Society to EBS, the business, property, rights and liabilities of the Society, vested in EBS Limited. AIB p.l.c. operates EBS as a standalone, separately branded subsidiary with its own distribution network.

The purpose of the Bank is to issue Mortgage Covered Securities in accordance with the Asset Covered Securities Act, 2001 and the Asset Covered Securities (Amendment) Act 2007 (the 'Asset Covered Securities Acts'). The Bank does not sell mortgage loans directly to the public. It has an origination agreement with EBS whereby EBS continues to sell mortgage loans directly to the public and subsequently transfers loan portfolios to the Bank for an appropriate consideration.

The Bank was incorporated on 30 October 2008 and commenced trading on 1 December 2008. During the period from this date to the end of 2010, EBS sold €5.9bn of residential loans to the Bank and in turn the Bank issued a series of covered bonds. On 1 November 2011, EBS sold a further €2.4bn of mortgage loans to the Bank and the Bank subsequently issued three floating rate mortgage covered securities with a total nominal value of €1.25bn. The bonds were subscribed for in full by EBS. At the end of 2011, the total nominal value of covered bonds issued was €3.6bn of which €1.05bn (2010:€1.05bn) were subscribed for by external bondholders and remainder were subscribed for in full by EBS.

A number of the Bank's operational and support activities are outsourced to EBS under a Managed Services Agreement. EBS, as service provider for the Bank, originates residential mortgage loans through its retail network in the Republic of Ireland, services the mortgage loans, and provides inter-company funding as well as a range of other support services. Bank employees perform those specialist roles which arise as a result of the specific designation of the Bank as a designated mortgage credit institution.

Governance is exercised through a Board of Directors comprising 2 executive and 2 non-executive directors. All executive directors are employees of EBS.

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

The Bank is a covered institution within the meaning of the Government Guarantee Scheme ('the Scheme') and stood specified under the Credit Institutions (Financial Support) (Specification of Institutions) Order 2008 (Statutory Instrument No. 416 of 2008) ('CIFS') for the period 30 September 2008 to 29 September 2010. The Bank is not a participating institution under the Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 which came into effect on 9 December 2009.

As a separately licensed credit institution, the Bank's corporate governance practices also reflect the relevant provisions of the Central Bank Code. Corporate Governance in the Bank is exercised through a Board of Directors and a senior management. The Board's policy is to comply with the highest standards of corporate governance as set out in the Central Bank Code. The Bank is required to submit a compliance statement to the Central Bank confirming compliance with the Central Bank Code during 2011.

DIRECTORS' REPORT (continued)

The Bank is currently a participating institution under the National Asset Management Agency Act 2009. However, there were no mortgage loans transferred under the terms of the Act.

RESULTS FOR THE YEAR ENDED 31 DECEMBER 2011

The Income Statement for the year ended 31 December 2011 and the Statement of Financial Position at that date are set out on pages 36 and 38.

The Bank reported a loss before taxation of €79.5m for year ended 31 December 2011 (31 December 2010: Profit before taxation €12.6m). The reported loss is mainly attributable to higher impairment charges on loans and advances to customers of €128.4m in 2011 compared to €26.7m in 2010.

Net Interest Income

Net interest income is down €3.2m or 5.7%.

Total interest income amounted to €236.0m in 2011 (2010: €184.4m). Interest income mainly comprises of interest income from mortgage assets of €224.1m (2010: €177.2m) which increased by 26% from 2010. This is mainly due to the additional interest earned in 2011 in respect of the €2.4bn of residential mortgages purchased from EBS in November 2011, combined with an overall increase in mortgage interest rates during 2011. Interest income also includes income derived as a result of amortisation of fair value discount on loans and advances to customers of €11.1m (2010: €5.6m), income earned on deposits with credit institutions of €0.7m (2010: €1.4m) and income earned from cash on deposit with the Central Bank of €0.1m (2010:€0.2m).

Total interest expense amounted to €183.2m (2010: €128.4m). Interest expense consists of interest on inter-company funding from EBS of €72.7m (2010: €73.8m) which decreased mainly as a result of a lower inter-company interest rate margin on the inter-company loan provided by EBS. Interest expense also includes interest on debt securities of €67.1m (2010: €51.9m) which increased as a result of the interest rate movements during the year and three new covered bonds issued in November 2011. The other components of interest expense are amortisation of fair value discount on debt securities in issue of €39.5m (2010: €2.7m) and acceleration of fair value premium on loans and advances to customers of €3.9m (2010: nil). Amortisation of fair value discount on debt securities in issue increased due to the amortisation of fair value discount on €1.3bn of debt securities issued in December 2010 and €1.25bn issued in November 2011.

Net interest income was €52.8m (2010: €56.0m) for the year generating a net interest margin of 84bps (2010: 106bps).

Net trading income

Net trading income is up €11.9m.

Net trading income of €2.0m (2010: expense €9.9m) comprises net interest receivable or payable on derivatives (interest rate swaps) held at fair value through the Income Statement and hedge ineffectiveness. The movement year on year is mainly due to the movement in interest rates.

Operating Expenses

Operating expenses are down by €0.9m.

Operating expenses which comprise direct costs and a service fee charge from EBS amounting to €5.9m (2010: €6.9m). The decrease of 13% is mainly due to the Government Guarantee Scheme fees under CIFS which were not incurred in 2011 (2010: €1.1m).

Credit provision

The impairment provision charge in 2011 is €128.4m up from €26.7m in 2010.

Total provisions (excluding unearned income provisions) held at December 2011 amount to €171.5m (2010: €42.1m)
Total provisions (including unearned income provisions) held at December 2011 amount to €172.0m (2010: €42.2m) of which €165.1m were specific and €6.9m were collective. This provided 234bps coverage on total loans (2010: 78bps).

The impairment charge has increased principally due to:

- Aligning our impairment provisioning policies and procedures with that contained in the 'Impairment Provisioning and Disclosure Guidelines' issued by the Central Bank of Ireland in December 2011.
- An increase in impaired loan balances to €959.5m at December 2011 from €360.1m at December 2010. The increase in impaired balances is due to (i) the deterioration in the underlying book and more significantly (ii) implementation of a more conservative definition of impaired loans. This is discussed in more detail in Risk Management Report.
- Continued decrease in residential and commercial property prices, and
- A decrease in the expected cure rate.

Further detail can be found in the Risk Management Report. The impairment charges on loans and advances to customers are detailed in note 10.

DIRECTORS' REPORT (continued)

Loans and advances to customers

Loans and advances to customers as at 31 December 2011 amounted to €7.2bn (2010: €5.4bn). The increase from 2010 is due to the purchase of mortgage assets to the value of €2.4bn from EBS on 1 November 2011.

Funding

The funding of the mortgage assets from EBS is in part through an inter-company loan facility from EBS, which amounted to €3.6bn at 31 December 2011 (2010: €2.9bn).

Debt securities in issue

During the year the Bank issued three bonds with a total nominal value of €1.25bn These bonds were subscribed for in full by EBS. The bonds were recognised on the Statement of Financial Position at a value of €1.01bn representing the Day 1 fair value of the bonds as required under the International Financial Reporting Standards. The discount is being amortised through the Income Statement over the life of the bonds.

As at 31 December 2011, the total amount of principal outstanding in respect of mortgage covered securities was €3,600m (2010: €2,350m) of which €1,050m (2010: €1,050m) was held by third parties and €2,550m (2010: €1,300m) by EBS.

Share Capital

The share capital of the Bank consists of 476,540,000 €1 ordinary shares issued to EBS (2010: 316,540,000 €1 ordinary shares). On 21 December 2011, the Bank issued an additional 160,000,000 €1 ordinary shares to EBS for cash.

Capital ratios

For 2011, the capital ratios are calculated in accordance with the Capital Requirements Directive.

	2011 €m	2010 €m
Core Tier 1 Capital	428,439	337,672
Non Core Tier 1 Capital	-	-
Tier 1 Capital	428,439	337,672
Tier 2 Capital	8,501	34,050
Total Capital	**436,940**	**371,722**
Risk Weighted Assets	3,802,613	2,805,838
Total Capital Ratio	11.49%	13.25%
Tier 1 Ratio	11.27%	12.03%
Core Tier 1 Ratio	11.27%	12.03%

At 31 December 2011 the total capital ratio was 11.49% (2010: 13.25%) and the tier 1 ratio was 11.27% (2010: 12.03%). Both of these are above Regulatory Capital minimum. Further information in relation to Regulatory Capital is set out in note 23.

PLAR/PCAR

In January 2011, the Central Bank initiated a Financial Measures Programme, which incorporated the PCAR and PLAR exercises. The PCAR exercise enabled the Central Bank to perform a thorough assessment of the Group's asset quality and earnings together with incorporating incremental three year projected provisions estimates based on BlackRock Solutions identified stress loan losses. An additional element of conservatism was also applied through the requirement to achieve a 10.5% Core Tier 1 capital ratio and a 6.0% Core Tier 1 ratio under stress as well as an additional protective buffer.

It was announced on 31 March 2011 that the EBS Group required €1.2bn of capital to meet the new target Core Tier 1 capital ratio of 10.5% under base and 6.0% under stress on the basis of the combined results of the PCAR assumptions and three year projected provisions from BlackRock, before the addition of a conservative capital buffer. The additional capital buffer of €0.3bn was determined with €0.1bn representing equity and €0.2bn representing contingent capital. This brought the total capital requirement for the Group to €1.5bn. The Minister for Finance confirmed on 31 March 2011 that all banks would be recapitalised to the PCAR levels. The PLAR exercise outlined the measures to be implemented to steadily deleverage the banking system and reduce reliance on the funding from monetary authorities. The PLAR exercise established a target funding and loan to deposit ratio for the aggregate domestic banking system, including EBS, of 122.5% and consequently in order to reach the targeted ratio the EBS Group is required to deleverage €2.5bn of non core assets (comprising the commercial and unencumbered buy to let books) over the period to 2013.

Following the acquisition of EBS by AIB p.l.c. on 1 July 2011 the €1.5bn of capital announced for EBS was provided to AIB p.l.c. by the Irish Government from the National Pensions Reserves Fund and the Minister in July 2011. In addition the PLAR target will now be achieved at an AIB Group level.

A separate PCAR and PLAR exercise was not carried out by the Bank, however, as a subsidiary of EBS it was included in the overall Group assessment. The Bank is reliant on EBS for capital and funding and similarly EBS is reliant on AIB p.l.c. for capital and funding.

On 16 December 2011 EBS issued €300m of ordinary shares to AIB p.l.c. for cash. Subsequently on 21 December 2011 the Bank issued €160m €1 ordinary shares to EBS for cash.

BUSINESS REVIEW AND FUTURE DEVELOPMENTS

The residential mortgage market is a key component of the overall EBS strategy and access to funding is a key requirement to deliver on this strategy. As a result EBS established the covered bond bank, EBS Mortgage Finance, in 2008 with the purpose of enabling funding to be raised in the form of covered bonds and to strengthen the liquidity position of the EBS Group.

Market conditions in certain European covered bond jurisdictions supported the issue of bonds in primary markets during 2011 e.g. Germany, France, Norway, Sweden however this was not the case in Ireland and other peripheral European countries. The ongoing financial difficulties affecting the Irish banking sector and macro economy as a whole progressively resulted in downgrades to Ireland's sovereign rating, institutional bank ratings and ultimately covered bond ratings by some rating agencies. Over the course of 2011 the Bank's covered bond programme rating was downgraded by Moody's Investor Services from A2 to Baa3, with the Fitch Ratings position unchanged at A-. The Bank was unable to issue any additional bonds to investors during 2011.

As part of its mandate to support the EBS Group's liquidity position the Bank did issue covered bonds amounting to €1.25bn during 2011. The bonds which meet the ECB eligibility criteria for use as collateral in their open market operations were subscribed for in full by EBS and used to access such funding from the ECB.

On 1 November 2011 the Bank purchased residential mortgage assets with a total debt value of €2.4bn from EBS at a fair value consideration amount of €2.2bn.

On 28 February 2012 the Bank and the Central Bank of Ireland entered into a Framework Agreement in Respect of Special Mortgage Backed Promissory Notes. No notes have been issued with regard to this agreement to date.

The residential mortgage market has continued to experience low levels of demand due to weak consumer sentiment, continued reduction in house prices and a lack of credit supply. This has resulted in 2011 mortgage volumes continuing to remain at low levels. The housing market has now contracted for five years consecutively. According to the CSO house price index, average residential property prices reduced by 16.7% in 2011 and 47% from peak. Further reductions are anticipated in 2012. Supply of mortgage lending, much like 2010, has been supplied in the main by AIB Group and Bank of Ireland. A lower interest rate environment and reduction in house prices means that affordability levels for new home buyers continued to improve however constraints on banks lending appetite and ongoing concerns regarding Ireland's economic outlook point towards a subdued mortgage market in 2012.

RISK MANAGEMENT

The risk management framework provides a firm-wide definition of risk and lays down the principles of how risk is to be identified, assessed, measured, monitored and controlled / mitigated and the associated allocation of capital against same. The Bank categorises risks under a number of headings namely, strategic, operational, compliance and financial (including credit, liquidity and market) risks. Together, these form the Bank's Risk Universe. This helps the Bank to assess and manage risk on an enterprise wide, holistic basis. The Risk Universe is continuously reviewed and updated reflecting the changing risk environment and was reviewed by the Board during 2011.

Each of these risks are fully described in the Risk Management Report.

Also further information in relation to the Risk factors affecting the Group are set out in the Risk Management Report.

FUTURE DEVELOPMENTS IN THE BUSINESS

We expect the operating environment to remain difficult throughout 2012. The Irish economy continues to face difficult challenges. While critical elements of the economy such as the export sector are performing strongly, and Government finances have stabilised, the current phase of economic contraction, falling employment and property asset values have yet to stabilise.

GOING CONCERN

The Bank's activities are subject to risk factors as set out in the Risk Management Report. The continued financial crisis has increased these risk factors.

The financial statements have been prepared on a going concern basis.

DIRECTORS' REPORT (continued)

In making its going concern assessment, the Bank's Directors have considered the economic, political and market risks and uncertainties currently impacting Irish financial institutions, including EBS Group (the 'Group'). In particular these relate to challenges in terms of liquidity, funding and capital. The Bank is dependent on the financial support from its parent, EBS Limited, who in turn is dependent on the ultimate parent, AIB p.l.c, to meet its capital requirements and ultimately its funding requirements. Since 1 July 2011 EBS Group has received the full support of AIB p.l.c. in meeting the necessary capital and funding requirements and for the full year 2011 the Bank has received the full support of EBS in meeting it's necessary capital and funding requirements.

The financial statements have been prepared on a going concern basis on the basis of the assessment of the above mentioned risks and the commitment from AIB p.l.c. to support the funding and capital needs of the EBS Group and similarly the commitment from EBS to support the funding and capital needs of the Bank. In making this assessment the Directors have considered the basis on which EBS concluded that it is appropriate to prepare its own financial statements for the year ended 31 December 2011 on a going concern basis. An extract of the going concern note in the EBS Group Financial Statements is included in Note 1.

The Directors recognise that given the significant Irish and European economic, political and market risks and uncertainties that currently impact Irish Financial institutions, including the Bank, EBS and AIB Group, and the Bank's dependence on EBS for capital and funding, there is material uncertainty that may cast significant doubt on the Bank's ability to continue as a going concern. In considering the position of the Bank the most relevant mitigants considered by the Board of Directors are:

- The injection of capital by the Irish Government into AIB Group of €14.8bn in July 2011 as required under the Financial measures programme published by the Central bank in March 2011.
- The injection of €300m of capital from AIB p.l.c. into EBS in December 2011 and subsequently the injection of €160m of capital from EBS in to the Bank in December 2011.
- The position of AIB p.l.c. as one of the two pillar banks in Ireland and the continued support of the Irish government and ECB to continue to provide liquidity to banks in Ireland, including AIB Group.
- The assurance obtained by AIB p.l.c. from the Central Bank regarding the continued availability of the required liquidity from the Eurosystem during the period of assessment for the going concern statement.
- The fact that AIB p.l.c. has formally committed to support the funding and capital needs of the EBS Group and the fact that EBS has committed to support the funding and capital needs of the Bank for a period of at least 12 months from the date these financial statements are approved by the Board.

Conclusion

On the basis of the above, the Directors believe that it is appropriate to prepare the financial statements on a going concern basis having concluded that there are mitigants in place to the aforementioned risks and uncertainties related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern over the period of assessment.

OVER COLLATERALISATION AND ASSET COVERED SECURITIES LEGISLATION

A significant level of over collateralisation ('OC') is held in the covered asset pool in order to provide adequate protection to bondholders in the event of higher defaults and reducing asset values. The Bank has, as required, increased the nominal OC level during the period in response to the fall in asset values such that the prudent value of the collateral pool as measured in the regulatory OC value of the cover pool exceeds minimum regulatory, contractual and rating agency requirements. The Directors are satisfied that existence and level of over collateralisation provides the Bank with access to sufficient liquidity to enable repayments to be made when they fall due.

The Asset Covered Securities Act also provides protection to the Bondholders in preference to any other creditors in both the Bank and the Group. The Directors are also satisfied that the Bank is protected under the legislation such that it in the event of any parental insolvency that the liabilities due to the Bondholders as secured creditors can be met in priority to un-secured creditors.

DIRECTORS

The Directors at the date of this report are listed on page 3 and have served throughout the reporting period, unless otherwise stated.

DIVIDENDS

The Directors do not recommend payment of a dividend in the year to 31 December 2011 (2010: Nil).

DIRECTORS' REPORT (continued)

DIRECTORS' AND SECRETARY'S INTEREST IN SHARES

The beneficial interest of the Directors and the Secretary in office at 31 December 2011 and of their spouses and minor children in the shares of group companies are set out below. The shares referred to are €0.01 ordinary shares in AIB, p.l.c., the ultimate holding company.

Ordinary Shares

	31 December 2011	1 July 2011
Directors:		
Denis Holland	-	-
Fidelma Clarke	-	-
Audrey Collins	-	-
Bill Cunningham	-	-
Gerry Murray	-	-
Emer Finnan	-	-
Dara Deering	-	-
Fergus Murphy	-	-
Secretary:		
Helen Dooley	-	818

Share options

There are no Directors' and Secretary's options to subscribe for ordinary shares in AIB p.l.c. outstanding at 31 December 2011. The Register of Directors' and Secretary's Interests may be inspected at the Bank's registered office.

The Directors and Secretary and their spouses and minor children have no other interests in the shares of AIB p.l.c.

EVENTS SINCE THE YEAR END

In the directors' view, there have been no events since the year end that have had a material effect on the financial position of the Bank.

BOOKS OF ACCOUNT

The Directors are responsible for ensuring that proper books and accounting records, as outlined in Section 202 of the Companies Act 1990, are kept by the Group. To achieve this, the Directors have employed accounting personnel with appropriate experience who report to the Board and ensure that the requirements of Section 202 of the Companies Act 1990 are complied with. Those books and accounting records are maintained at the registered office by providing adequate resources to the finance function at 2 Burlington Road, Dublin 4.

INDEPENDENT AUDITOR

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

STATEMENT OF DIRECTORS' RESPONSIBILTIES

The Directors are responsible for preparing the Bank's financial statements in accordance with applicable Irish law. Under that law the Directors are required to prepare the financial statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU and applicable law.

The Bank's financial statements are required by law and IFRS as adopted by the EU to present fairly the financial position and performance of the Bank; the Companies Acts 1963 to 2009 provide in relation to such financial statements that references in the relevant part of the Act and to financial statements giving a true and fair view are references to their achieving a fair presentation.

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

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state that the financial statements comply with IFRS as adopted by the EU as applied in accordance with the Companies Acts 1963 to 2009; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Directors are responsible for keeping proper books of account that disclose with reasonable accuracy at any time the financial position of the Bank enable them to ensure that its financial statements comply with the Companies Acts 1963 to 2009. They are also responsible for taking such steps as are reasonably open to them to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Bank's corporate and financial information included on the AIB Group's and EBS Group'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

Date: 14 May 2012

RISK MANAGEMENT REPORT

1. Introduction *

Since 1 July 2011, EBS Group ('EBS') has been in the process of aligning and integrating its risk management structures and frameworks with AIB Group. The Bank, as a wholly owned subsidiary of the EBS Group ('EBS') has adopted a risk management structure and controls framework consistent with that of EBS.

EBS and its subsidiaries (which includes the Bank) defines risk as failure to foresee or manage events which may result in unnecessary material financial loss or damage to the company's reputation, or failure to maximise opportunities or capitalise on corporate strengths. EBS recognises that the effective management of risk and its system of internal control is essential to the minimisation of volatility against forecasted financial performance, the preservation of customer value and the achievement of EBS' strategic objectives. The primary focus of the risk management framework is to ensure that the EBS achieves the optimal risk/reward return on any investment of people, time and resources.

The Executive Management Team of the Bank has responsibility for the management of the business as a whole including the origination of mortgages from EBS and those assets which comprise the Cover Pool. It has responsibility for devising and implementing the strategic business plan of the Bank and monitoring actual and projected performance including profitability, impairments, capital ratios and adherence to Cover Pool management policy.

Risk management in the Bank is supported by a clear risk management governance structure, a clear risk management framework and a significant investment of both senior management and Board time in reviewing the system of internal control. The Board oversees the effectiveness of the system of internal control through review of management information and is supported by the work of its sub committee, namely the Board Audit, Risk and Compliance Committee ("BARCC"). The BARCC supports the Board in monitoring the integrity of the financial statements, fulfilling its responsibilities in relation to the system of internal control, internal audit and compliance, by overseeing the relationship between the Bank and its external auditors, and discharging statutory duties in respect of relevant laws and regulations. It is also responsible for considering and recommending as appropriate to the Board, acceptance of the Bank's risk management and governance infrastructure, the Bank's material risk policies and risk appetite, risk disclosures in the Annual Report and Accounts and other Prospectus and capital adequacy including internal capital assessment and allocation.

There is a clear risk management framework, comprising of both the Bank and the EBS' risk committees. The Bank's risk appetite is aligned with the EBS' Risk Appetite. Risk policies and procedures are updated where appropriate to reflect the limits of risk appetite and are reviewed by the Board generally on an annual basis. These policies are closely managed on a day to day basis, and are monitored by the Bank's Executive management team supported by relevant EBS risk and compliance functions with oversight provided by the Bank's Asset & Liability Committee ("ALCO") and also by the relevant EBS risk management committees.

2. Risk Factors *

EBS' approach to identifying and monitoring the principal risks and uncertainties facing EBS is informed by risk factors. All of EBS' activities, and those of the Bank, involve, to varying degrees, the measurement, evaluation, acceptance and management of risks which are assessed on a company wide basis. Certain risks can be mitigated by the use of safeguards and appropriate systems and actions which form part of EBS' and the Bank's risk management framework, as described below. The principal risks and uncertainties facing the Bank are as follows:

2.1 The Bank's dependence on the EBS Group

The Bank is dependent on EBS in relation to the origination and servicing of Irish residential loans, administration and accounting services, treasury services, hedging arrangements, debt funding, equity and regulatory capital and services relating to the issuance of Mortgage Covered Securities. To meet its funding requirements, the Bank has dependency on EBS and AIB Group. EBS and the AIB Group has accessed a range of central bank liquidity facilities, including at times certain additional liquidity schemes introduced by central banks for market participants during periods of dislocation in the funding markets. In accessing central bank and other secured lending facilities, the EBS and AIB Group has relied significantly on its "Qualifying Liquid Assets" and "Contingent Funding" capacity. The curtailment or non-extension of the Central Bank liquidity facilities currently relied upon by the AIB Group, or the AIB Group's inability to access such facilities would require the AIB Group to seek alternative sources of funding.

The Bank is entirely dependent on EBS who in turn is dependent on the AIB Group to provide the necessary capital resources to meet minimum regulatory requirements. The AIB Group's target capital requirements as determined by the Central Bank under its Prudential Capital Assessment Review (PCAR) are currently core tier 1 ratio of 10.5% in the base scenario and 6% in a stress scenario, not including an allowance for an additional protective buffer. AIB Group has carried out extensive forward-looking stress tests on its capital adequacy position, including two European Banking Authority (EBA) stress tests carried out in the second half of 2011. The published results of both EBA stress tests confirmed that AIB did not require additional capital. However given the levels of uncertainty in the current economic climate there is the possibility that further losses over and above what is currently forecast could

* *Forms integral part of the audited financial statements*

materialise. In the event that such losses are significantly greater than forecasted, the AIB Group's capital position could be eroded to the extent that it may have insufficient capital resources to provide to EBS and in turn to the Bank to meet the Bank's regulatory requirements which is a total solvency ratio of 9%.

2.2 Exposure to the Irish Housing/Residential Loan Market

Since the beginning of 2007, the Irish residential property market has undergone a material negative correction as regards mortgage lending activity and residential property prices.

The Bank's exposure to credit risk is exacerbated when the collateral it holds cannot be realised or is liquidated at prices that are not sufficient to recover the full amount of the loan, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those currently being experienced.

Any such losses could have a material adverse effect on the Bank's future performance and results of operations. In addition, an increase in interest rates may lead to, amongst other things, further declines in collateral values, higher repayment costs and reduced recoverability which together with the aforementioned risks may adversely impact the Bank's earnings or require an increase in the expected cumulative impairment charge for the Bank.

2.3 The Bank's business activities must comply with increasing levels of regulatory requirements introduced as a result of failings in financial markets

In 2011 there was an unprecedented level of new regulation issued by both by the Central Bank of Ireland and the EU, through a number of new or revised Codes and Directives:

- The Corporate Governance Code for Credit Institutions and Insurance Undertakings was introduced on 1 January 2011 and it sets out the minimum requirements an institution must meet to promote effective governance.
- The Code of Conduct on Mortgage Arrears came into effect in June 2011, providing increased protection to the consumer particularly those in arrears situations.
- The new Fitness and Probity regime and the revised Minimum Competency Code became effective from 01 December 2011. They both seek to raise standards of competence of staff and require impacted persons to undergo an annual Fit and Proper assessment.
- The revised Consumer Protection Code came into effect on the 01 January 2012. EBS has until 30 June 2012 to be in full compliance with the provisions of the code.

Together with the high level of existing regulations, the challenge of managing regulatory compliance increased substantially in 2011. The changing regulatory standards has increased the demand on the Bank and it's service provider (EBS) in terms of the deployment of business and IT resources which is expected to continue in 2012. Delivering this level of change has and will continue to place added risk on the Bank and EBS, including the challenge to meet tight delivery timelines in the face of competing priorities and resource demands.

The AIB Group is subject to financial services laws, regulations and policies. Changes in supervision and regulation in Ireland has and will continue to have a material impact on the Bank's business, products offered and the value of its assets.

Future changes in government policy, central bank monetary authority policy, EU/Eurozone policies, legislation or regulation or their interpretation relevant to financial services may adversely affect the Bank's product range, funding sources, capital requirements and consequently reported results and financing requirements.

Any changes in the regulation of selling practices and solvency, funding and capital requirements could have a significant impact on the Bank's results of operations, financial condition and future prospects.

Furthermore, any new regulatory obligations regarding functional and operational arrangements within the EBS or AIB Group may also have an adverse impact on the Bank's results, financial conditions and prospects.

3. Risk management framework *

EBS has developed and implemented a risk management framework that is commensurate with the size, scale and complexity of the organisation. It is in line with industry practice and meets Central Bank specific requirements and EU supervisory standards.

The Bank, as a wholly owned subsidiary of EBS, has adopted a risk management structure and controls framework consistent with that of EBS. Risk management in the Bank is supported by a clear risk management governance structure and a significant investment of both senior management and Board time in reviewing the system of internal control.

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The key elements of the Bank's risk management framework are:

(i) The Bank operates a three lines of defence model for internal governance. Under the three lines of defence model, primary responsibility for risk management lies with line management. The EBS Group Risk Management function provides the second line of defence, providing independent oversight and challenge to business line managers. The EBS Risk and Compliance function, which forms the second line of defence report to the EBS Chief Risk Officer (who is also a member of the Bank's Executive Management team and Board). The third line of defence is the AIB Group Internal Audit function which provides independent assurance to the Audit Committee of the Board on the design and effectiveness of the system of internal controls.

(ii) There is a clearly defined risk governance structure which is regularly updated. The risk governance framework was updated in line with the published European Banking Authority Guidelines on Internal Governance (CP41) and Remuneration Practices (CP42) and the Central Bank of Ireland's (CBI) Corporate Governance Code for Credit Institutions and Insurance Undertakings. The risk governance framework, risk universe, roles, reporting lines and risk committees are documented in a risk manual which forms part of the induction of new Board members. The risk manual is updated at regular intervals throughout the year.

(iii) Strategies, goals, objectives, authority limits and reporting mechanisms are clearly defined and against which performance is monitored.

(iv) The Board has clearly defined its risk appetite in a risk appetite statement for all key aspects of the business of the Bank. The risk appetite statement is reviewed at least annually by the Board and more frequently if required. Risk policies and procedures are updated where appropriate to reflect the limits of risk appetite. These policies are closely managed on a day to day basis throughout the Bank, and are monitored by specific business units with oversight by the relevant risk management committees of both the Bank and EBS. Material changes to these policies are Board approved on an annual basis.

(v) The risk management framework is overseen by the Executive Management Team and supported by its underlying risk committee, namely the Asset & Liability Committee (ALCO). The ALCO in addition to the EBS Risk Committees (ALCO, Risk Rating Approval Committee, Credit Risk Committee, Operations Management Committee and Regulatory Compliance Committee) are responsible for identifying actions to support robust risk management in line with both the Bank's and the EBS's risk appetite. Progress is monitored and reported regularly to the Board.

(vi) The Bank is subject to monitoring of specific risks by the CAM as set out in the ACS act.
The risks involved are (a) Duration measurement (Duration of bonds must be less than duration of the covered pool) (b) Interest Rate coverage (interest income must exceed interest expense) and (c) Interest Sensitivity (sensitivity to market interest rate changes must be less than a certain % of own funds).

The risk management framework provides a firm-wide definition of risk and lays down the principles of how risk is to be identified, assessed, measured, monitored and controlled / mitigated and the associated allocation of capital against same. The Bank categorises risks under a number of headings namely, strategic, operational, compliance and financial (including credit, liquidity and market) risks. Together, these form the Bank's Risk Universe. This helps the Bank to assess and manage risk on an enterprise wide, holistic basis. The Risk Universe is continuously reviewed and updated reflecting the changing risk environment and was reviewed by the Board during 2011.

Strategic risk
Strategic risk management encompasses the management of the Bank's reputation and the implications for the Bank's covered bond programme of credit rating movements of either the Bank or the EBS. Strategic risk also encompasses external events which cannot be controlled but which could have a significant impact on the Bank's business such as the domestic macro economic environment, property values, banking sector and covered bond market conditions. Strategic risks are managed and monitored in the main by the Executive Management Team and the Board. Significant developments are reported to the Board directly and to its subcommittee on a regular basis.

Operational risk
Operational risk is the current or prospective risk of loss arising from inadequate or failed internal processes or systems, human error or external events.

Group Operational Risk is responsible for supporting the Bank in the management of Operational risk. EBS Mortgage Finance has adopted relevant Group Operational risk policies. The core focus of Operational risk management is the oversight of outsourced service activities related to the mortgage collateral of the Bank, management of the collateral pool in accordance with the requirements of the ACS Act, third party relationship management, business continuity management, fraud prevention, maintenance of efficient business process and operating practices, employee development and key person risk.

Regulatory compliance risk
Regulatory compliance risk is the risk that EBS Mortgage Finance fails to meet its legislative or regulatory requirements.

Group Regulatory Compliance is responsible for supporting the Bank in monitoring adherence to its regulatory compliance obligations. EBS Mortgage Finance has adopted the Group regulatory compliance policies. The core focus of regulatory compliance risk management is on supporting EBS Mortgage Finance's adherence with the requirements of the ACS Act, terms and conditions of its banking license, the Capital Requirements Directive and conditions of the government guarantee scheme.

Over Collateralisation Risk
A significant level of over collateralisation ('OC') is held in the covered asset pool in order to provide adequate protection to bondholders in the event of higher defaults and reducing asset values. The Bank has, as required, increased the nominal OC level during the period in response to the fall in asset values such that the prudent value of the collateral pool as measured in the regulatory OC value of the cover pool exceeds minimum regulatory, contractual and rating agency requirements. The Directors are satisfied that existence and level of over collateralisation provides the Bank with access to sufficient liquidity to enable repayments to be made when they fall due.

The Asset Covered Securities Act also provides protection to the Bondholders in preference to any other creditors in both the Bank and the Society. The Directors are also satisfied that the Bank is protected under the legislation such that it in the event of any parental insolvency that the liabilities due to the Bondholders as secured creditors can be met in priority to un-secured creditors.

Financial risk
EBS Mortgage Finance has exposure to the following financial risks - credit risk, interest rate risk, liquidity & funding risks.

EBS Treasury is responsible for supporting the Bank in the management of certain financial risks and adherence to legislative requirements specific to Designated Credit Management Institutions including to interest rate risk, foreign exchange risk, duration mismatch and interest coverage.

3.1 Risk Committees and Functions *
The Bank's ALCO was established to monitor the Bank's exposure to key market risks, i.e., liquidity risk, funding risk, interest rate risk, counterparty credit risk and foreign exchange risk. The Committee is responsible for asset & liability management, monitoring the adequacy of the liquidity framework and buffers, and for recommending the appropriate funding, liquidity, counterparty credit and market risk policies and plans to the Board for approval. The Committee monitors capital ratios, including projections and oversees the appropriate implementation of the capital policy.

The Bank is supported in its risk activities by the work of the EBS Risk Committees and risk functions. The Group Risk function supports the Bank and the EBS Group in developing and maintaining a robust risk management framework, and by providing independence in terms of risk identification, measurement, monitoring and reporting. The Risk function comprises (i) Risk Analytics, which develops and maintains risk models and risk rating systems and provides independent management information regarding loan book performance and adherence to credit policy, and independent credit review of adherence to procedures; (ii) Treasury Risk (middle office) which provides independent management information to both internal and external stakeholders such as the Central Bank, Department of Finance, NTMA etc regarding adherence to market risk policies and day to day treasury operations; (iii) Operational Risk, which monitors operational risk trends, losses and near misses and which incorporates Information Security which reports independently of Information Technology; (iv) Enterprise Risk, which supports the development and maintenance of a risk management framework to mitigate against unforeseen risk events materialising; and (v) Regulatory Compliance, which is responsible for advising and facilitating the business in identifying, managing and monitoring its conduct of business regulatory obligations and prudential regulatory requirements. Collectively, the Risk division monitor and report on key risk indicators, developments in risk management protocols, regulations and practices, and other risk developments to the relevant risk committees and to the Board.

3.2 The Bank has exposure to the following risks from its use of financial instruments:

(i) Liquidity risk
(ii) Market risks
(iii) Credit risk.

<u>**Liquidity risk**</u>
Liquidity risk relates to the ability of EBS to meet its on and off balance sheet obligations in a timely manner as they fall due, without incurring excessive cost, whilst continuing to fund its assets and growth therein. As part of the terms of its bank licence approval EBS Mortgage Finance elected to meet its solo prudential liquidity requirements at EBS Group level.

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As at the 1st July 2011 EBS was acquired by the AIB Group following instructions from the Minister for Finance on the 31st March 2011. As part of the AIB Group EBS' liquidity risk has been incorporated into the AIB centralised risk management model in line with AIB' common approach to Treasury Risk management. Under this centralised approach the management of Liquidity and related activities are overseen and controlled by AIB Treasury.

EBS Treasury, in conjunction with AIB Group Treasury, is responsible for the daily management of liquidity, i.e., to ensure that resources are available at all times to meet EBS' obligations arising from the daily business of the bank. EBS reports its liquidity positions to the Central Bank of Ireland as part of the AIB Consolidated Liquidity Reporting. The Asset and Liability Committee ('ALCO') monitors these risks and reports on key developments to EBS Board on a regular basis via the Chief Risk Officers report.

EBS conducts both regular and ad-hoc funding and liquidity risk stress testing to assess on an ongoing basis the ability of EBS to withstand various idiosyncratic and systemic stress scenarios. Liquidity contingency plans are developed and updated on a continual basis reflecting the results of the stress tests. These activities are conducted in conjunction with AIB Group Asset & Liability Management.

EBS applies the maturity mismatch approach to the management of liquidity following the adoption of this method by the Central Bank of Ireland in July 2007. The overall purpose of a maturity mismatch approach is to ensure that the EBS will have, at any given time, a pool of highly liquid assets capable of being converted into cash within four business days, sufficient to cover a certain percentage of foreseeable cash outflows for future periods of time ('time bands'). EBS has conducted stress tests in advance of these expected changes. Funding contingency plans are continually under review in light of unprecedented market and EBS specific events. Further information on liquidity risk is set out on page 29.

Key measures used by EBS for managing liquidity risk are the liquidity ratios, calculated and reported on a daily basis internally to the Treasury Front Office and to AIB Group, on a weekly basis for consolidation into the AIB Group Regulatory Liquidity Reports and on a monthly basis to ALCO and EBS Board

In October 2011 the Central Bank revoked the requirement for EBS to comply with the 'Requirements for the Management of Liquidity Risk' regulatory document under Section 9.2 of that document. Whereupon the EBS Liquidity Ratios would henceforth be reflected in the AIB Group Consolidated Liquidity Reports.

EBS continues to be one of the Irish covered institutions that are part of the Eligible Liability Guarantee (ELG) Scheme. This schemes continues to assist EBS in attracting and maintaining customer funding in times of great economic uncertainty. The cost of the ELG scheme for 2011 was €62.8m. The Bank is not a participant in the ELG scheme.

Market Risk

Market risk is the risk that changes in market prices, such as interest rate, and credit spreads (funding risk) will affect the Bank' income. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Bank is not allowed to engage in proprietary trading as per the conditions of the ACS Act and it's license. EBS Treasury manages non trading Interest Rate Risk using gap and sensitivity analysis with AIB Group Treasury. Derivatives such as interest rate and equity index options are used to hedge these market risks. The Asset and Liability Committee ('ALCO'), which meets monthly, monitors these risks and reports on key developments to the Board on a regular basis via the Chief Risk Officers report.

Interest rate risk is the risk that changes in interest rates will affect the Bank's income or the value of its holdings of financial instruments. The objective of interest rate risk management is to manage and control interest rate risk exposures in accordance with the requirements of the ACS act and internal parameters.

The Bank has outsourced the measurement and reporting management of its interest rate risk to the EBS Group. EBS Treasury Risk measures and manages these risks using gap and sensitivity analysis. Derivatives such as interest rate swaps are used by the Bank for hedging purposes (reducing risk) only. The Group Asset and Liability committee ('ALCO') monitors these risks at a Group level. The EBS Mortgage Finance ALCO is responsible for monitoring how interest rate risk is managed and ensuring that EBS Mortgage Finance policy is adhered to.

Credit Risk

Credit risk is the risk of financial loss to EBS Mortgage Finance if a customer or counterparty to a financial instrument fails to meet its contractual obligations.

The Bank's core focus in relation to credit risk management relates to the management of asset quality and counterparty credit risk. All mortgage credits purchased by the Bank and held as assets in its books and accounts must be originated by EBS in accordance with lending policies approved by the Board of directors of EBS as applicable at the time of origination of the loan as reflected in the Wholesale Mortgage Origination Agreement between EBS and the Bank.

Credit risk management at Group level is supported by an appropriate governance structure with separation of function between the sourcing and approval of business, the issuing of funds, loan management and independent review and monitoring. Given the deterioration in credit quality throughout 2011 in the retail market, both credit management and credit risk management have been a key area of focus at Group level over the past year. Resourcing, structures, policies and processes continue to be reviewed in order to ensure that the Group is best placed to manage asset quality in this severe downturn. The EBS Group credit risk management committee is responsible for reviewing and recommending appropriate credit risk management structures, forbearance strategies and policies in line with the credit risk appetite of the Group and for monitoring the performance of the book.

The Group Risk Analytics unit is responsible for the development and ongoing validation of credit risk rating models which are used to assess credit applications and to support a robust capital adequacy assessment process, and for independently monitoring the quality of EBS Mortgage Finance's loan assets. Credit impairment provisions are in line with International Financial Reporting Standards, the calculation and management of which are outsourced to EBS.

The Group conducts both regular and ad-hoc credit risk stress testing to assess on an ongoing basis the ability of the Group to withstand various idiosyncratic and systemic stress scenarios. Credit contingency plans are developed and updated on a continual basis reflecting the results of the stress tests.

The Group insures the Bank against risk in the Irish residential property market through mortgage indemnity insurance. This insurance is taken on a loan by loan basis, the amount of coverage being determined by the loan to value percentage at origination. In the event the Bank suffering a loss, a claim can be made via EBS up to the value of the insurance cover.

Claims against Banks and Credit Institutions are restricted to overnight deposits with counterparties that meet minimum legislative requirements.

Maximum exposure to credit risk *

The following table shows the Bank's credit exposure, which is the maximum potential exposure:

	2011 €'000	2010 €'000
Non-derivative financial assets		
Cash and balances with central banks	-	13,900
Loans and advances to customers	7,175,907	5,354,351
Loans and advances to credit institutions	130,160	68,726
Derivative financial instruments	56,096	58,173

Maximum exposure to credit risk – fair value of collateral

The following table presents the fair value of collateral held by the Bank for loans and advances to customers detailed in the maximum exposure to credit risk. The fair value is capped at the loan outstanding amount.

The following table shows the fair value of collateral held for loans and advances to customers at end 2011 and 2010.

Collateral Held: Loans and advances to customers *

	2011 €'000	2010 €'000
Impaired loans	756.8	310.0
Past due but not impaired	420.9	437.0
Non impaired/non past due	5,238.0	4,150.1
Total loans	**6,415.7**	**4,897.1**

Residential mortgages *

The Bank does not originate lending in its own right, but originates loans on a wholesale basis periodically from EBS. While EBS considers a borrower's repayment capacity to be paramount in granting any loan, EBS also takes collateral in support of lending transactions for the purchase of residential property. There are clear policies in place which set out the type of property which is acceptable as collateral and the loan to property value relationship. Collateral valuations are required at time of origination of each residential mortgage. The fair value at December 2011 of residential mortgages is based on the property values at origination and applying the CSO (Ireland) index to these values to take account of price movements in the interim. The collateral values above include all loans regardless of balance outstanding. Additional information in relation to LTV and Days Past Due profiles for residential mortgages is noted within the Risk Management Report.

Provisioning for impairment

The accounting policies of loans and advances to customers are outlined in Note 1. A loan or portfolio of loans is impaired and an impairment loss is incurred if there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of an asset or group of assets.

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Objective evidence can include both:

- Micro conditions – for example a breach in the repayment contract, i.e. arrears on the account, and
- Macro conditions – for example an adverse change in economic conditions.

An impairment loss event is an event which has an impact on the expected cash flows of the asset. Where the event has been incurred and has been identified, an individual provision is required. Where the loss has been incurred but has not yet been identified, a collective provision is required.

Provisions are calculated for assets which are deemed to be impaired where there is objective evidence of impairment. If the asset is deemed to be significant, then it is reviewed on an individual basis. Where the asset is impaired, but not significant, it is reviewed on a pooled or collective basis. Provisions are also calculated for individual assets where there is no objective evidence of individual impairment yet, but where impairment has been incurred. In this way, all assets are reviewed.
For Residential Loan Assets, the Bank assess loans for impairment where; loans which are €0.01 or more in arrears and where the arrears is not of a technical nature, or where there is other evidence of impairment, for example, where an issue may arise in relation to a loan or group of loans such as a legal claim etc. Categories of loans that will be classed as impaired regardless of arrears include: loans where the property is in possession of EBS and loans where fraudulent activity is suspected.

Significant assets in the Bank are defined as assets with an overall current value of more than €1.5m. This applies to non-retail loan and treasury assets: the threshold for Retail assets is set at €0.75m. Assets which are impaired and which are significant are reviewed on an individual case basis.

The loan value threshold is not applied to loans

- where the property is in possession of the Bank; or
- where fraudulent activity is suspected or proven.

All such loans are also assessed individually for provision.

All loans greater than 90 days past due are deemed impaired, regardless of significance.

Collective Provisions
All loans where the individual provision is zero, whether or not an individual assessment is completed, are part of the collective provision calculation.

The calculation has three key components reflecting the three stages in the movement of a loan to loss: probability of default (PD); probability of repossession given default (PRGD); and loss given repossession (LGR).

Default is defined to be 3 (monthly) payments or more in arrears, i.e., at least 90 days past due. If a loan is already in default then its PD is 1, otherwise it is a number between 0 and 1 measuring the likelihood of the loan moving into default in the coming 12 months. The rate of default is adjusted to take into account expected movements in external macroeconomic factors (such as unemployment and GDP).

The movement from default to repossession is assessed based on observed portfolio cure rates (which represents the repossession rate is one minus the cure rate). The rate varies according to the number of payments missed – the deeper in default a loan is, the more likely it is that loss will result. It also varies widely across the portfolios, being much higher for Commercial lending.

The calculation of incurred loss is driven largely by expectation of property values at disposal.

In this note, impaired assets are those for which an individual provision has been made.

Impairment Sensitivities
Altering the key assumptions for provisions has varying impacts on the overall provision numbers. The following table shows the relative impacts of standardised changes.

Factor	
1. Probability of Default: Interest Rate changes	- A 1% increase in Standard Variable Rate leads to a 2.5% increase in collective provisions for Homeloans.
2. Probability of Default: Macroeconomic factors	- A 2% fall in employment leads to a 4.3% increase in collective provisions for Retail assets (Homeloans and Buy-to-Lets) - The GDP and GNP numbers alone have little influence.
3. Roll rate from repossession to loss: Higher roll rates assumed (i.e. lower cure rates)	- Increasing the repossession rate from 50% to 55% results in an increase in provisions of 10.6%
4. Loss Given repossession: Higher reductions in house prices from peak	- An increased peak to trough assumption (changing to 58% from 55%) increases collective provisions by 6.4%.

4. Credit Profile *

The analysis below in relation to residential and commercial loans for the Bank is based on gross lending before unearned income and impairment provisions of €172.0m (2010: €42.2m).

Credit quality *
The following table includes the Bank's loans and advances to customers gross of impairment provisions split on a core/non-core basis. Core includes home loans and non core includes buy to let loans.

Loans and advances to customers		2011		2010
	Core	Non-core	Total	Total
	€m	€m	€m	€m
Residential mortgages	6,949.2	398.7	7,347.9	5,396.6

Asset quality has been affected by an increase in the level of arrears, with 86.9% of the combined loan book maintaining a satisfactory payment profile in 2011 compared with 93.4% for 2010. The change in loan quality is reflected in a higher level of provisions, detailed below.

Impairment provisions		2011		2010
	Core	Non-core	Total	Total
	€m	€m	€m	€m
Statement of financial position provisions	146.8	25.2	172.0	42.2
Statement of financial position provisions as a % of loans and advances	2.1%	6.3%	2.3%	0.8%
Specific provision as a % of impaired loans	16.3%	25.2%	17.2%	2.2%
Impairment charge as a % of total loans	1.6%	4.5%	1.8%	0.5%

The Bank's loans and advances to customers amounted to €7,347.9m at 31 December 2011 and have increased by €1,951.3m since December 2010. 24.3% or €1,786.5m (2010: 18.1% or €979.1m) of total Bank loans and advances to customers are criticised of which €959.5m or 13.1% (2010: €360.1 or 6.6%) is impaired.

Statement of financial position impairment provisions of €172.0m provide cover on impaired loans of 17.9% and on total loans of 2.3%.

The income statement provision charge (including the unearned interest provision of €0.4m (2010: €0.1m)) in 2011 was €129.8m or 1.8% of total loans. The charge is up from €27.3m or 0.5% of total loans in 2010.

Residential mortgages *
Residential mortgages amounted to €7,347.9m at 31 December 2011. This compares to €5,396.6m at 31 December 2010, the increase driven primarily by a transfer of €2,449m of assets from EBS to the Bank in November 2011 offset by repayments and redemptions during 2011.

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The split of the residential mortgage book is owner-occupier, €6,949.2m and buy-to-let, €398.7m. The income statement impairment provision charge for 2011 was €129.8m or 1.8% for Residential mortgages. The statement of financial position impairment provisions (including unearned income provision) of €172.0m is held at 31 December 2011, split €165.1m specific and €6.9m collective.

Residential mortgage – Total	2011			2010
	Owner-occupier (Core) €m	Buy-to-let (Non-Core) €m	Total €m	Total €m
Total residential mortgages	6,949.2	398.7	7,347.9	5,396.6
>30 days past due or impaired	975.6	101.2	1,076.8	570.3
>90 days past due or impaired	865.3	94.2	959.5	360.1
Of which impaired	865.3	94.2	959.5	360.1
Statement of financial position specific provisions	141.4	23.7	165.1	8.1
Statement of financial position collective provisions	5.4	1.5	6.9	34.1
Income statement specific provisions	15.1	2.2	17.3	6.4
Income statement collective provisions (note 1)	96.9	15.6	112.5	20.9
Specific provisions as % of impaired loans cover	16.3%	25.2%	17.2%	2.2%

The portfolio has experienced an increase in arrears reflecting the impact of a harsher economic climate on borrowers' repayment affordability. The level of loans >90 days in arrears or impaired was 13.1% at 31 December 2011 compared with 6.6% at 31 December 2010.

The level of loans >90 days in arrears or impaired in the owner occupier book has increased significantly since 31 December 2010 from €337.9m (6.8% of mortgages) to €865.3m or 12.5% at 31 December 2011. Unemployment, wage cuts and high levels of personal debt continued to be the principal drivers of increased arrears.

The level of loans >90 days in arrears or impaired in the Buy-to-Let ('BTL') portfolio has increased significantly from €22.2m or 5.3% at 31 December 2010 to €94.2m or 23.6% at 31 December 2011 and was influenced by falling rents.

Total owner occupier and BTL loans >90 days past due or impaired amounted to €959.5m at 31 December 2011. Total specific provisions of €165.1m provided cover of 17.2% of impaired loans and have been raised having assessed the peak to trough fall in house prices in Ireland (55%). Statement of financial position collective provisions of €6.9m are held for the performing book (86.9% of residential mortgage book) based on management's view of incurred loss in this book. The total income statement charge for 2011 was €129.8m (specific €17.3m and collective €112.5m).

EBS has received a number of requests for forbearance from customers who are experiencing cash flow difficulties. EBS considers these against the borrowers' current and likely future financial circumstances, their willingness to resolve these issues, as well as the legal and regulatory obligations. As part of that process loans are tested for impairment and where appropriate, the loans are downgraded to impaired status and provisions raised.

4.1 Asset Quality *

The following tables show criticised loans for the total loan book split into Core and Non-Core assets. Criticised loans include watch, vulnerable and impaired loans.

Asset quality – Residential Mortgages	2011				2010	
	Core	Non-core	Total		Total	
	€m	€m	€m	%	€m	%
Satisfactory	**5,314.7**	**246.7**	**5,561.4**	**75.7**	**4,417.5**	**81.9**
Watch	*624.1*	*47.8*	*671.9*	*9.1*	*532.5*	*9.9*
Vulnerable	*145.1*	*10.0*	*155.1*	*2.1*	*86.5*	*1.6*
Impaired	*865.3*	*94.2*	*959.5*	*13.1*	*360.1*	*6.6*
Criticised	**1,634.5**	**152.0**	**1,786.5**	**24.3**	**979.1**	**18.1**
Gross loans	**6,949.2**	**398.7**	**7,347.9**	**100.0**	**5,396.6**	**100.0**
Criticised as a % of total gross loans	23.5%	38.1%	24.3%		18.1%	
Impaired as % of total gross loans	12.5%	23.6%	13.1%		6.7%	

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The Bank's criticised loans and advances to customers amounted to €1,786.5m or 24.3% of total customer loans. The Bank's criticised loans have increased by €807.4m since 31 December 2010. The main drivers of the increases in criticised loans has been the impact of the continuing lack of activity in the property sector and consequent impact on the housing sector, together with increased unemployment and reduced earnings which negatively affected borrowers' ability to repay loans.

Total impaired loans	**2011**	**2011**	**2010**	**2010**
	€m	**%**	**€m**	**%**
Impaired loans – Core	865.3	11.8	337.9	6.3
Impaired loans – Non Core	94.2	1.3	22.2	0.4
Total	**959.5**	**13.1**	**360.1**	**6.7**

The Bank's impaired loans are up €599.4m in the year to €959.5m (or 13.1% of total loans) mainly in the residential mortgage portfolio. This is mainly due to the underlying deterioration in the book.

Past due but not impaired

Balances due on loans categorised as past due but not impaired increased by €8.7m in 2011 compared with 2010 as concerns regarding repayments became evident.

	2011				**2010**	
	Core	**Non-core**	**Total**	**%**	**Total**	**%**
	€m	**€m**	**€m**		**€m**	
Neither past due nor impaired	5,606.3	286.8	5,893.1	80.2	4,549.8	84.3
Past due but not impaired	477.6	17.7	495.3	6.7	486.6	9.0
Impaired – no provision	26.4	9.8	36.2	0.5	338.3	6.3
Impaired –provision held	838.9	84.4	923.3	12.6	21.9	0.4
Gross loans and advances	**6,949.2**	**398.7**	**7,347.9**	**100.0**	**5,396.6**	**100.0**
Provision for impairment	146.8	25.2	172.0		42.2	
Total loans and advances after provisions	**6,802.4**	**373.5**	**7,175.9**	**100.0**	**5,354.4**	**100.0**

Loans neither past due nor impaired have decreased from 84.3% of loan balances in 2010 to 80.2% as at December 2011. The value of loans past due has increased from 15.7% in 2010 to 19.8% in 2011.

Aged analysis of loans and advances which are past due but not impaired

Residential loans up to 90 days past due are not categorised as impaired. Non-core loans are assessed on a case by case basis.

	2011				**2010**	
	Core	**Non-core**	**Total**	**%**	**Total**	**%**
	€m	**€m**	**€m**		**€m**	
1 – 30 days	367.3	10.7	378.0	76.3	276.4	56.8
31 – 60 days	84.2	4.6	88.8	17.9	129.5	26.6
61 – 90 days	26.1	2.4	28.5	5.8	80.7	16.6
Total	**477.6**	**17.7**	**495.3**	**100.0**	**486.6**	**100.0**

Provisions are calculated for assets which are deemed to be impaired where there is objective evidence of impairment. If the asset is deemed to be significant, then it is reviewed on an individual basis. Where the asset is impaired, but not significant, it is reviewed on a collective basis.

2011	**Loans & Advances**	**Impaired Loans & Advances**	**Impaired % of Loans**	**Individually Assessed**	**Collectively Assessed**	**Total Impairment Provision**	**Provision as % of impaired loans**
Residential	7,347.9	959.5	13.1%	165.1	6.9	172	17.9%
Total	**7,347.9**	**959.5**	**13.1%**	**165.1**	**6.9**	**172**	**17.9%**

2010	**Loans & Advances**	**Impaired Loans & Advances**	**Impaired % of Loans**	**Individually Assessed**	**Collectively Assessed**	**Total Impairment Provision**	**Provision as % of impaired loans**
Residential	5,396.6	360.1	6.7%	8.1	34.1	42.2	11.7%
Total	**5,396.6**	**360.1**	**6.7%**	**8.1**	**34.1**	**42.2**	**11.7%**

** Forms integral part of the audited financial statements*

Global and domestic economic markets continued to experience difficulties throughout 2011 which impacted negatively on the Company's lending portfolios. The Bank's income statement provision charge for loans and advances to customers was €129.8m or 1.8% of loan balances and included a specific provision charge of €17.3m and a collective provision charge of €112.5m. 86.3% of the charge related to owner-occupier residential mortgages with the remainder 13.7% for borrowers in the buy-to-let sector.

4.2 Forbearance

The incidence of the main type of forbearance arrangements for residential mortgages is analysed below.

2011 Residential Mortgage (Core)	Total Number	Total Balances €m	Loans > 90 days in arrears and / or impaired Number	Loans > 90 days in arrears and / or impaired Balances €m	Performing (subject to revised terms) Number	Performing (subject to revised terms) Balances €m
Interest only	2,556	422.3	722	119.6	1,370	225.4
Arrears capitalised	318	49.0	105	15.4	127	22.3
Term extension	1,782	152.3	188	15.2	1,479	127.1
Hybrid (term extension and interest only)	120	14.1	44	4.6	50	5.5
Other	1	0.2	0	0.0	1	0.2
Total	**4,777**	**637.9**	**1,059**	**154.8**	**3,027**	**380.5**

2011 Buy-to-Let (Non-Core)	Total Number	Total Balances €m	Loans > 90 days in arrears and / or impaired Number	Loans > 90 days in arrears and / or impaired Balances €m	Performing (subject to revised terms) Number	Performing (subject to revised terms) Balances €m
Interest only	283	57.9	87	18.3	183	36.1
Arrears capitalised	-	-	-	-	-	-
Term extension	103	16.8	6	1.3	91	14.9
Hybrid (term extension and interest only)	4	0.8	2	0.4	1	0.2
Other	-	-	-	-	-	-
Total	**390**	**75.5**	**95**	**20.0**	**275**	**51.2**

2011 Total	Total Number	Total Balances €m	Loans > 90 days in arrears and / or impaired Number	Loans > 90 days in arrears and / or impaired Balances €m	Performing (subject to revised terms) Number	Performing (subject to revised terms) Balances €m
Interest only	2,839	480.3	809	138.0	1,553	261.5
Arrears capitalised	318	49.0	105	15.5	127	22.3
Term extension	1,885	169.1	194	16.4	1,570	142.0
Hybrid (term extension and interest only)	124	14.9	46	5.0	51	5.7
Other	1	0.2	0	0.0	1	0.2
Total	**5,167**	**713.5**	**1,154**	**174.9**	**3,302**	**431.7**

2010 Total	Total Number	Total Balances €m	Loans > 90 days in arrears and / or impaired Number	Loans > 90 days in arrears and / or impaired Balances €m	Performing (subject to revised terms) Number	Performing (subject to revised terms) Balances €m
Interest only	1,946	312.7	371	63.8	1,085	171.9
Arrears capitalised	142	21.2	3	0.1	90	13.2
Term extension	1,046	92.3	34	2.5	901	80.9
Hybrid (term extension and interest only)	40	4.8	10	0.5	21	3.2
Other	-	-	-	-	-	-
Total	**3,174**	**431.0**	**418**	**66.9**	**2,097**	**269.2**

The types of forbearance measures that are currently considered for mortgage customers are interest only, arrears capitalisation, term extension and deferred interest scheme. EBS has developed a Mortgage Arrears Resolution Strategy ("MARS") for dealing with customers in difficulty or likely to be in difficulty.

** Forms integral part of the audited financial statements*

Of the total residential mortgage book of €7,347.9m, 9.7% are subject to forbearance measures as at 31 December 2011, compared to 8.0% as at 31 December 2010. €174.9m (24.5%) of the loans under forbearance were >90 days past due or impaired as at 31 December 2011, compared to 15.5% as at 31 December 2010.

4.3 Residential Repossessions *

The Bank held 15 properties at year end, representing an increase of 9 compared with 2010. The Bank did not dispose of any repossessed properties in 2011.

Stock/Activity	Number of repossessions	Balance	Number of disposals	Balance outstanding at sale	Gross sales proceeds	Cost to sell	Loss on sale	Weighted Average LTV at sale
		€m		€m	€m	€m	€m	%
2011								
Owner Occupier	15	3.8	-	-	-	-	-	-
Buy-to-let	-	-	-	-	-	-	-	-
Total repossessions	**15**	**3.8**	**-**	**-**	**-**	**-**	**-**	**-**
2010								
Owner Occupier	6	1.6	-	-	-	-	-	-
Buy-to-let	-	-	-	-	-	-	-	-
Total repossessions	**6**	**1.6**	**-**	**-**	**-**	**-**	**-**	**-**

4.4 Residential mortgage lending - index linked LTV

Residential mortgage lending - Total

The property values used in the completion of the following loan to value ("LTV") tables are determined with reference to the most recent valuation indexed to the Central Statistics Office ("CSO") Residential Property Price Index.

2011	Owner Occupier	BTL	Total
	€m	€m	€m
Less than 50%	831.4	27.2	858.6
50% - 70%	782.9	22.6	805.5
71% - 80%	462.4	17.7	480.1
81% - 90%	509.9	17.9	527.8
91% - 100%	528.3	22.6	550.9
101% - 120%	1,297.3	89.7	1,387.0
121% - 150%	1,408.9	144.5	1,553.4
Greater than 150%	1,128.1	56.5	1,184.6
Total	**6,949.2**	**398.7**	**7,347.9**

2010	Owner Occupier	BTL	Total
	€m	€m	€m
Less than 50%	929.8	34.4	964.2
50% - 70%	670.8	39.7	710.5
71% - 80%	351.2	18.3	369.5
81% - 90%	356.5	29.0	385.5
91% - 100%	387.3	48.1	435.4
101% - 120%	876.0	140.2	1,016.2
121% - 150%	1,102.4	102.3	1,204.7
Greater than 150%	305.8	4.8	310.6
Total	**4,979.8**	**416.8**	**5,396.6**

44.8% of the owner-occupier and 27.1% of the buy-to-let mortgages were in positive equity at 31 December 2011. In terms of the total portfolio, 56.1% was in negative equity at 31 December 2011, reflecting the continuing decline in residential property prices in Ireland in 2011. The weighted average indexed loan to value ratio for the total book was 106.7% at 31 December 2011 whilst the indexed loan to value ratio for the impaired book was higher at 118.8%. The indexed loan to value ratio of new loans advanced during 2011 was 80.9%.

** Forms integral part of the audited financial statements*

Residential - Neither past due nor impaired
The following tables profile the residential mortgage portfolio that is neither past due nor impaired by the indexed loan to value ratio's at 31 December 2011 and 2010.

2011	Owner Occupier €m	BTL €m	Total €m
Less than 50%	745.5	23.3	768.8
50% - 70%	672.3	17.7	690.0
71% - 80%	398.7	13.8	412.5
81% - 90%	433.3	14.6	447.9
91% - 100%	435.4	17.4	452.8
101% - 120%	1,088.9	66.6	1,155.5
121% - 150%	1,074.0	97.0	1,171.0
Greater than 150%	758.2	36.4	794.6
Total	**5,606.3**	**286.8**	**5,893.1**

2010	Owner Occupier €m	BTL €m	Total €m
Less than 50%	843.7	32.0	875.7
50% - 70%	590.3	33.7	624.0
71% - 80%	298.5	15.6	314.1
81% - 90%	307.3	25.8	333.1
91% - 100%	323.6	39.9	363.5
101% - 120%	707.7	118.7	826.4
121% - 150%	882.0	87.7	969.7
Greater than 150%	239.0	4.3	243.3
Total	**4,192.1**	**357.7**	**4,549.8**

Among loans neither past due nor impaired, 47.9% of the owner-occupier and 30.3% of the buy-to-let mortgages were in positive equity at 31 December 2011. In terms of the total portfolio, 53.0% was in negative equity at 31 December 2011, reflecting the continuing decline in residential property prices in Ireland in 2011

90 days past due or impaired
LTV ratio of residential mortgage lending (index linked) which are 90 days past due.

The following tables profiles the residential mortgage portfolio that was > 90 days past due and /or impaired by the indexed loan to value ratios at 31 December 2011 and 2010

2011	Owner Occupier €m	BTL €m	Total €m
Less than 50%	44.4	2.6	47.0
50% - 70%	62.9	4.3	67.2
71% - 80%	36.5	3.4	39.9
81% - 90%	45.5	2.8	48.3
91% - 100%	53.5	4.2	57.7
101% - 120%	126.0	19.5	145.5
121% - 150%	219.3	39.7	259.0
Greater than 150%	277.2	17.7	294.9
Total	**865.3**	**94.2**	**959.5**

2010	Owner Occupier €m	BTL €m	Total €m
Less than 50%	28.9	0.6	29.5
50% - 70%	27.1	4.0	31.1
71% - 80%	18.2	0.7	18.9
81% - 90%	16.7	0.6	17.3
91% - 100%	25.3	1.9	27.2
101% - 120%	75.0	8.2	83.2
121% - 150%	111.3	6.2	117.5
Greater than 150%	35.4	0.0	35.4
Total	**337.9**	**22.2**	**360.1**

** Forms integral part of the audited financial statements*

28.1% of the owner-occupier and 18.3% of the buy-to-let mortgages were in positive equity at 31 December 2011. In terms of the total portfolio, 72.9% was in negative equity at 31 December 2011, reflecting the continuing decline in residential property prices in Ireland in 2011

Residential Mortgage lending with Fair Value Collateral

Residential mortgage lending - Total

The property values used in the completion of the following loan to value ("LTV") tables are determined with reference to the most recent valuation indexed to the Central Statistics Office ("CSO") Residential Property Price Index.

2011	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	831.4	27.2	858.6
50% - 70%	782.9	22.6	805.5
71% - 80%	462.4	17.7	480.1
81% - 90%	509.8	17.9	527.7
91% - 100%	528.3	22.6	550.9
Partially Collateralised			
Book Value	3,834.4	290.7	4,125.1
Value of Collateral	*2,969.4*	*223.6*	*3,193.0*
Total	**6,949.2**	**398.7**	**7,347.9**

2010	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	929.8	34.4	964.2
50% - 70%	670.8	39.7	710.5
71% - 80%	351.1	18.3	369.4
81% - 90%	356.5	29.1	385.6
91% - 100%	387.3	48.1	435.4
Partially Collateralised			
Book Value	2,284.3	247.2	2,531.5
Value of Collateral	*1,822.6*	*209.4*	*2,032.1*
Total	**4,979.8**	**416.8**	**5,396.6**

Residential - Neither Past Due nor Impaired

The following tables profile the residential mortgage portfolio that is neither past due nor impaired by the indexed loan to value ratio's at 31 December 2011 and 2010.

2011	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	745.5	23.3	768.8
50% - 70%	672.3	17.7	690.0
71% - 80%	398.7	13.8	412.5
81% - 90%	433.3	14.6	447.9
91% - 100%	435.4	17.4	452.8
Partially Collateralised			
Book Value	2,921.1	200.0	3,121.1
Value of Collateral	*2,311.2*	*154.9*	*2,466.1*
Total	**5,606.3**	**286.8**	**5,893.1**

** Forms integral part of the audited financial statements*

2010	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	843.6	32.0	875.6
50% - 70%	590.3	33.7	624.0
71% - 80%	298.5	15.6	314.1
81% - 90%	307.3	25.8	333.1
91% - 100%	323.7	39.9	363.6
Partially Collateralised			
Book Value	1,828.7	210.7	2,039.4
Value of Collateral	1,461.7	178.0	1,639.7
Total	**4,192.1**	**357.7**	**4,549.8**

Among loans neither past due nor impaired, 47.9% of the owner-occupier and 30.3% of the buy-to-let mortgages were in positive equity at 31 December 2011

Residential – Past due not impaired

The following tables profile the residential mortgage portfolio that is past due not impaired by the indexed loan to value ratio's at 31 December 2011 and 2010.

2011	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	41.5	1.2	42.7
50% - 70%	47.7	0.6	48.3
71% - 80%	27.2	0.5	27.7
81% - 90%	31.1	0.5	31.6
91% - 100%	39.3	1.1	40.4
Partially Collateralised			
Book Value	290.8	13.8	304.6
Value of Collateral	219.5	10.7	230.2
Total	**477.6**	**17.7**	**495.3**

Residential – Past due not impaired

2010	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	57.3	1.7	59.0
50% - 70%	53.5	2.0	55.5
71% - 80%	34.5	1.9	36.4
81% - 90%	32.5	2.6	35.1
91% - 100%	38.3	6.3	44.6
Partially Collateralised			
Book Value	233.8	22.1	255.9
Value of Collateral	187.2	19.2	206.4
Total	**449.9**	**36.6**	**486.5**

39.1% of the owner-occupier and 21.9% of the buy-to-let mortgages were in positive equity at 31 December 2011. In terms of the total portfolio, 61.5% was in negative equity at 31 December 2011, reflecting the continuing decline in residential property prices in Ireland in 2011

Residential – 90 Days past due and / or impaired
LTV ratio of residential mortgage lending (index linked) which are 90 days past due. The following tables profiles the residential mortgage portfolio that was > 90 days past due and /or impaired by the indexed loan to value ratios at 31 December 2011 and 2010

2011	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	44.4	2.6	47.0
50% - 70%	62.9	4.3	67.2
71% - 80%	36.5	3.4	39.9
81% - 90%	45.5	2.8	48.3
91% - 100%	53.5	4.2	57.7
Partially Collateralised			
Book Value	622.5	76.9	699.4
Value of Collateral	438.7	58.0	496.7
Total	**865.3**	**94.2**	**959.5**

2010	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	28.9	0.6	29.5
50% - 70%	27.1	4.0	31.1
71% - 80%	18.2	0.7	18.9
81% - 90%	16.7	0.6	17.3
91% - 100%	25.3	1.9	27.2
Partially Collateralised			
Book Value	221.7	14.4	236.1
Value of Collateral	173.7	12.3	186.0
Total	**337.9**	**22.2**	**360.1**

28.1% of the owner-occupier and 18.3% of the buy-to-let mortgages were in positive equity at 31 December 2011. In terms of the total portfolio, 72.9% was in negative equity at 31 December 2011, reflecting the continuing decline in residential property prices in Ireland in 2011

Residential – Impaired
LTV ratio of residential mortgage lending (index linked) which is impaired. The following tables profiles the residential mortgage portfolio that was impaired by the indexed loan to value ratios at 31 December 2011 and 2010.

2011	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	44.4	2.6	47.0
50% - 70%	62.9	4.3	67.2
71% - 80%	36.5	3.4	39.9
81% - 90%	45.5	2.8	48.3
91% - 100%	53.5	4.2	57.7
Partially Collateralised			
Book Value	622.5	76.9	699.4
Value of Collateral	438.7	58.0	496.7
Total	**865.3**	**94.2**	**959.5**

2010	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	28.9	0.6	29.5
50% - 70%	27.0	4.0	31.0
71% - 80%	18.2	0.7	18.9
81% - 90%	16.7	0.6	17.3
91% - 100%	25.4	1.9	27.3
Partially Collateralised			
Book Value	221.7	14.4	236.1
Value of Collateral	173.7	12.3	186.0
Total	**337.9**	**22.2**	**360.1**

** Forms integral part of the audited financial statements*

28.1% of the owner-occupier and 18.3% of the buy-to-let mortgages were in positive equity at 31 December 2011. In terms of the total portfolio, 72.9% was in negative equity at 31 December 2011, reflecting the continuing decline in residential property prices in Ireland in 2011.

Vintage analysis – Residential and Impaired
The following table profiles the Republic of Ireland residential mortgage book and impaired residential mortgage book at 31 December 2011 and 2010 by year of origination.

2011	Residential Mortgage Loan Book			Impaired Residential Mortgage Loan Book		
Total	Number of loans	Balance €m	Fair Value Collateral €m	Number of loans	Balance €m	Fair Value Collateral €m
1996 and before	5,094	140.2	136.8	291	14.2	13.3
1997	1,310	43.6	43.4	81	3.6	3.5
1998	1,396	53.0	52.6	88	4.5	4.3
1999	1,557	69.9	69.5	114	7.6	7.5
2000	1,687	106.5	105.3	113	9.3	9.1
2001	2,056	163.3	161.3	143	12.6	12.0
2002	3,109	281.9	277.7	211	22.1	21.2
2003	3,309	291.1	284.4	276	27.7	25.6
2004	3,793	384.6	367.8	336	41.8	37.4
2005	5,777	638.4	588.9	575	96.0	83.1
2006	8,945	1,363.2	1,135.1	1,031	205.9	160.0
2007	8,293	1,327.2	1,034.1	1,360	263.8	188.6
2008	7,748	1,157.8	905.2	1,184	203.2	149.3
2009	4,989	628.9	565.0	307	37.4	32.3
2010	4,773	642.5	632.1	73	9.8	9.6
2011	442	55.7	56.5	0	0.0	-
Total	**64,278**	**7,347.8**	**6,415.7**	**6,183**	**959.5**	**756.8**

2010	Residential Mortgage Loan Book			Impaired Residential Mortgage Loan Book		
Total	Number of loans	Balance €m	Fair Value Collateral €m	Number of loans	Balance €m	Fair Value Collateral €m
1996 and before	5,648	163.6	163.5	112	5.6	5.5
1997	1,137	45.1	45.1	31	1.6	1.5
1998	1,283	54.7	54.6	39	2.6	2.5
1999	1,435	71.2	71.0	49	4.0	4.0
2000	1,472	98.5	97.9	53	5.0	5.0
2001	1,637	126.6	125.8	55	4.3	4.2
2002	2,241	201.7	200.1	93	9.1	8.9
2003	2,722	235.8	232.8	115	12.0	11.4
2004	3,166	311.8	304.1	118	15.8	14.7
2005	4,751	499.6	474.4	200	31.9	29.4
2006	7,146	1,062.3	917.7	368	69.2	58.1
2007	6,767	1,077.9	906.3	562	107.5	85.4
2008	7,041	1,074.3	946.4	466	85.0	73.2
2009	3,274	367.3	351.4	61	6.4	6.1
2010	207	6.1	6.0	2	0.1	0.1
Total	**49,927**	**5,396.5**	**4,897.1**	**2,324**	**360.1**	**310.0**

** Forms integral part of the audited financial statements*

4.5 Analysis of loans and advances to customers by contractual residual maturity and interest rate sensitivity *

The following tables analyse gross loans to customers by maturity and interest rate sensitivity. Approximately 40% of Bank's mortgage portfolio is provided on a fixed rate basis. Fixed rate loans are defined as those loans for which the interest rate is fixed for the full term of the loan. The interest rate risk exposure is managed by Global Treasury at AIB Group level within agreed policy parameters.

Loans and advances to customers

	Fixed €'000	Variable €'000	Total €'000	Within 1 year €'000	After 1 year but within 5 years €'000	After 5 years €'000	Total €'000
2011	1,581,629	5,766,242	7,347,871	678,846	108,686	6,560,339	7,347,871
2010	1,040,572	4,355,999	5,396,571	353,003	96,997	4,946,571	5,396,571

4.6 Cross-border outstandings *

Cross-border outstandings are based on the country of domicile of the borrower and comprise placings with banks and money at call and short notice, loans to customers (including those held within discontinued operations), other monetary assets, including non-local currency claims of overseas offices on local residents. The Bank monitors geographic breakdown based on the country of the borrower and the guarantor of ultimate risk. There were no cross-border outstandings at 31 December 2011 (2010: Nil).

4.7 Large exposures

At 31 December 2011, the Bank's top 50 exposures amounted to €74.1m, and accounted for 1.0% (€73.8m and 1.4% at 31 December 2010) of the on-balance sheet total gross loans and advances to customers. No single customer exposure exceeds regulatory guidelines.

4.8 Treasury assets and derivatives *

Treasury assets consist of cash and balances with central banks, central government bills and other eligible bills, derivative financial instruments, available-for-sale, held-to-maturity financial assets and loans and advances to credit institutions excluding operating bank accounts.

The following tables present an analysis of Treasury asset counterparties based on the Bank's internal ratings mapped to an external rating agency scale. Where the counterparty is government guaranteed we have used the sovereign rating.

	Cash & Balances with Central Banks €'000	Derivatives €'000	Loans & Advances to Credit Institutions €'000
2011			
Balances at 31 December 2011	-	56,096	130,160
Aaa	-	-	-
Aa3 to Aa1	-	3%	-
A3 to A1	-	-	87%
Lower than A3	-	97%	13%
Unrated	-	-	-
2010			
Balances at 31 December 2010	13,900	58,173	68,726
Aaa	100%	-	-
Aa3 to Aa1	-	18%	81%
A3 to A1	-	-	-
Lower than A3	-	82%	19%
Unrated	-	-	-

The Bank has established and enforces operating limits and other practices that maintain exposures within levels consistent with their internal policies. The Bank adheres to the principles of sound practices for managing interest rate risk and complies with any regulatory requirements as a minimum.

The Bank transacts derivatives for the purpose of reducing or eliminating Interest Rate Risk in the Banking Book (IRRBB). The Bank only uses interest rate swaps for this purpose.

** Forms integral part of the audited financial statements*

Liquidity risk *

Liquidity risk relates to the ability of the Bank to meet its obligations in a timely manner as they fall due, without incurring excessive cost, whilst continuing to fund its assets and growth therein.

The Bank applies the maturity mismatch approach to the management of liquidity following the adoption of this method by the Central Bank in July 2007. The overall purpose of a maturity mismatch approach is to ensure that the Bank will have, at any given time, a pool of highly liquid assets capable of being converted into cash within four business days, sufficient to cover a certain percentage of foreseeable cash outflows for future periods of time ('time bands'). The Bank has conducted stress tests in advance of these expected changes. Funding contingency plans are continually under review in light of unprecedented market and the Bank specific events.

The Group conducts both regular and ad-hoc funding and liquidity risk stress testing to assess on an ongoing basis the ability of the Bank to withstand various idiosyncratic and systemic stress scenarios. Liquidity contingency plans are developed and updated on a continual basis reflecting the results of the stress tests. These activities are conducted in conjunction with AIB Group Asset & Liability Management.

Key measures used for managing liquidity risk are the liquidity ratios, calculated and reported on a daily basis internally to the Treasury Front Office and to AIB Group, on a weekly basis for consolidation into the AIB Group Regulatory Liquidity Reports and on a monthly basis to ALCO and the Bank's Board. Any breaches of limits are escalated immediately in line with the escalation procedure.

The Bank is a covered institution within the meaning of the Government Guarantee Scheme ('the Scheme') and stood specified under the Credit Institutions (Financial Support) (Specification of Institutions) Order 2008 (Statutory Instrument No. 416 of 2008) ('CIFS') for the period 30 September 2008 to 29 September 2010. The Bank is not a participating institution under the new Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 which came into effect on 9 December 2009.

Exposure to liquidity risk *

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

	Up to 1 month €'000	Over 1 month to 3 months €'000	Over 3 months to 6 months €'000	Over 6 months to 1 year €'000	1 to 2 years €'000	Over 3 years €'000	Total €'000
31 December 2011							
Financial Liabilities							
Deposits by credit institutions	3,613,508	-	-	-	-	-	3,613,508
Derivative financial instruments	-	-	-	-	-	54,439	54,439
Debt securities in issue	4,674	335	-	1,038,856	650,000	1,950,000	3,643,865
	3,618,182	**335**	**-**	**1,038,856**	**650,000**	**2,004,439**	**7,311,812**

	Up to 1 month €'000	Over 1 month to 3 months €'000	Over 3 months to 6 months €'000	Over 6 months to 1 year €'000	1 to 2 years €'000	Over 3 years €'000	Total €'000
31 December 2010							
Financial Liabilities							
Deposits by credit institutions	2,874,009	-	-	-	-	-	2,874,009
Derivative financial instruments	-	-	-	-	50,774	-	50,774
Debt securities in issue	1,503	-	997	38,750	1,000,000	1,350,000	2,391,250
	2,875,512	**-**	**997**	**38,750**	**1,050,774**	**1,350,000**	**5,316,033**

The previous tables show the undiscounted cash flows (other than for derivatives) on the Bank's financial liabilities on the basis of contractual maturity. Liabilities are included according to the earliest possible date of obligation. The disclosure for derivatives shows a net amount as the derivatives are all net settled. The Bank's expected cash flows on these instruments (other than derivatives) may vary significantly from this analysis. Liquidity is managed on a behavioural basis based on back tested historical performance and stress tested on an ongoing basis. For example, deposits by credit institutions are expected to maintain a stable or increasing balance.

** Forms integral part of the audited financial statements*

Market risk*

Interest rate sensitivity gap analysis 2011

Interest rate risk is the risk that changes in interest rates will affect the Bank's income or the value of its holdings of financial instruments. The objective of interest rate risk management is to manage and control interest rate risk exposures within acceptable parameters, while optimising the return on risk.

The Bank has outsourced the measurement and reporting management of its interest rate risk to EBS. EBS Treasury measures and manages these risks using gap and sensitivity analysis. Derivatives such as interest rate swaps are used by the Bank for hedging purposes (reducing risk) only. The Group Asset and Liability committee ('ALCO') monitors these risks at a Group level. The Bank's ALCO is responsible for monitoring how interest rate risk is managed and ensuring that the Bank's policy is adhered to.

Interest rate sensitivity gap analysis 2011 *

The tables below give an indication of the interest rate re-pricing mismatch in the Bank's statement of financial position. A cumulative net liability position in a time band indicates an exposure to a rise in interest rates.

	Not more than 3 months €'000	Over 3 months but not more than 6 months €'000	Over 6 months but not more than 12 months €'000	Over 1 year but not more than 5 years €'000	Over 5 years €'000	Non Interest Bearing €'000	Total €'000
2011							
Non-trading book							
Assets							
Cash and balances with central banks	-	-	-	-	-	-	-
Loans and advances to credit institutions	130,160	-	-	-	-	-	130,160
Loans and advances to customers	5,830,886	159,156	277,674	1,026,661	53,000	(171,470)	7,175,907
Other assets	26,296	-	4,130	2,217	23,453	12,816	68,912
Total assets	**5,987,342**	**159,156**	**281,804**	**1,028,878**	**76,453**	**(158,654)**	**7,374,979**
Liabilities							
Debt securities in issue	2,269,647	-	998,850	-	-	-	3,268,497
Deposits by credit institutions	3,613,508	-	-	-	-	-	3,613,508
Other liabilities	29,819	-	-	24,620	-	7,672	62,111
Total liabilities	**5,912,974**	**-**	**998,850**	**24,620**	**-**	**7,672**	**6,944,116**
Derivatives	(1,000,000)	-	-	1,000,000	-	-	-
Interest rate sensitivity gap	**(925,632)**	**159,156**	**(717,046)**	**2,004,258**	**76,453**	**(166,326)**	**430,863**
Cumulative gap	**(925,632)**	**(766,476)**	**(1,483,522)**	**520,736**	**597,189**	**430,863**	**430,863**

** Forms integral part of the audited financial statements*

Interest rate sensitivity gap analysis 2010 *

	Not more than 3 months €'000	Over 3 months but not more than 6 months €'000	Over 6 months but not more than 12 months €'000	Over 1 year but not more than 5 years €'000	Over 5 years €'000	Non Interest Bearing €'000	Total €'000
2010							
Non-trading book							
Assets							
Cash and balances with central banks	13,900	-	-	-	-	-	13,900
Loans and advances to credit institutions	68,726	-	-	-	-	-	68,726
Loans and advances to customers	4,414,043	69,926	136,084	727,295	49,223	(42,220)	5,354,351
Other assets	15,832	-	4,140	7,383	30,818	3,038	61,211
Total assets	**4,512,501**	**69,926**	**140,224**	**734,678**	**80,041**	**(39,182)**	**5,498,188**
Liabilities							
Debt securities in issue	1,300,000	-	-	918,977	-	-	2,218,977
Deposits by credit institutions	2,874,009	-	-	-	-	-	2,874,009
Other liabilities	19,772	-	-	31,002	-	13,984	64,758
Total liabilities	**4,193,781**	**-**	**-**	**949,979**	**-**	**13,984**	**5,157,744**
Derivatives	(1,050,000)	-	-	1,050,000	-	-	-
Interest rate sensitivity gap	**(731,280)**	**69,926**	**140,224**	**834,699**	**80,041**	**(53,166)**	**340,444**
Cumulative gap	**(731,280)**	**(661,354)**	**(521,130)**	**313,569**	**393,610**	**340,444**	**340,444**

In the tables above the assets and liabilities are allocated to time buckets based on the next re-pricing date of the individual assets and liabilities underlying the categories above.

The financial assets exposed to fair value interest rate risk are €1,546.3m (2010: €1,024.9m), exposed to cash flow interest rate risk are €5,987.3m (2010: €4,512.5m) and not exposed to interest rate risk are (€158.6m) (2010: (€39.2m)).

The financial liabilities exposed to fair value interest rate risk are €1,023.5m (2010: €949.9.0m), exposed to cash flow interest rate risk are €5,913.0m (2010: €4,193.8m) and not exposed to interest rate risk are €7.6m (2010: €14.0m).

There are some limitations associated with the above analysis, mainly due to market effects, over aggregation and run-offs. However, measures have been taken to minimise the effect of these limitations in line with industry practice and we are satisfied that the sensitivity analysis is an appropriate tool for measuring interest rate risk.

Interest rate stress testing *
The tables below provide an analysis of the Bank's sensitivity to an increase or decrease in market rates:

		100 bps parallel shift (increase/decrease) 2011 €'000		2010 €'000
Banking book portfolio				
Average for the period	- / +	841	- / +	819
Maximum for the period	- / +	2,883	- / +	2,695
Minimum for the period	- / +	166	- / +	71

The above table shows the present value effect that would be realised in the Income Statement on an accruals basis on the banking book and reserve investment book over the life of the assets and liabilities contained therein.

Overall interest rate risk positions are managed by EBS Group Treasury in conjunction with AIB Group Treasury.

** Forms integral part of the audited financial statements*

Exposure to other market risks

Fair value risk *

The following table represents the fair value of financial instruments, including those not reflected in the financial statements at fair value. It is accompanied by a discussion of the methods used to determine fair value for financial instruments. In addition we have also set out the accounting classifications of each of the assets and liabilities. Where assets or liabilities are in a fair value hedge relationship the underlying asset or liability is also marked to market.

		2011			2010		
Assets	**Accounting classifications**	**Carrying value €'000**	**Fair value €'000**	**Unrecognised gain / (loss) €'000**	**Carrying value €'000**	**Fair value €'000**	**Unrecognised gain / (loss) €'000**
Cash and balances with central banks	Amortised cost	-	-	-	13,900	13,900	-
Derivative financial instruments	Fair value	56,096	56,096	-	58,173	58,173	-
Loans and advances to credit institutions	Loans and advances	130,160	130,160	-	68,726	68,726	-
Loans and advances to customers	Loans and advances	7,175,907	6,314,907	(861,000)	5,354,351	4,978,608	(375,743)
Liabilities							
Deposits by credit institutions	Amortised cost	3,613,508	3,613,508	-	2,874,009	2,874,009	-
Derivative financial instruments	Fair value	54,439	54,439	-	50,774	50,774	-
Debt securities in issue	Amortised cost	3,268,497	2,911,889	(356,608)	2,218,978	2,226,215	7,237

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. For financial instruments carried at fair value, market prices or rates are used to determine fair value where an active market exists (for example a recognised stock exchange), which is the best evidence of the fair value of the financial instrument. For all financial assets held at fair value the Bank has applied Fair Value based upon quoted market prices where available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar instruments and adjusted for differences between the quoted instrument and the instrument being valued. In certain cases, including some loans and advances to customers, where there are no ready markets, various techniques have been used to estimate the fair value of the instruments.

Market prices are not available for all financial assets and liabilities held or issued by the Bank. Where no market price is available, fair values are estimated using valuation techniques. These are generally applied to over-the-counter (OTC) derivatives, unlisted trading assets and unlisted financial investments. The most frequently applied pricing models and valuation techniques include present value of future cash flows and option models. The valuations arrived at by applying these techniques are significantly affected by the choice of valuation model used and the underlying assumptions made concerning factors such as the amounts and timing of future cash flows, discount rates and volatility.

The following methods and significant assumptions have been applied in determining the fair value of financial instruments presented in the previous table, both for financial instruments carried at fair value, and those carried at cost (for which fair values are provided as a comparison):

i. The carrying value of liquid assets and other assets maturing within 12 months is assumed to be their fair value.
ii. The Bank has used a discounted cashflow methodology to arrive at the fair value for loans and advances to customers. The model used at 31 December 2011 has discounted the expected cashflows on the mortgage book based on the current market rate adjusted for various loan to value bands. An additional credit spread was included for the portion of the loans that are greater than 90% loan to value and an additional credit spread was included for buy to let and commercial loans.
iii. Derivative financial instruments used for hedging are carried on the statement of financial position at fair values, those with a positive replacement value are classified as assets and those with a negative value are classified as liabilities.
iv. Debt securities in issue are fair valued using a quoted market valuation.

While the Bank believes that its estimate of fair value is appropriate, the use of different measurements or assumptions could lead to different fair values.

** Forms integral part of the audited financial statements*

Fair value measurements *

Derivative financial instruments	2011	2010
Level 1	-	-
Level 2	100%	100%
Level 3	-	-

The fair value hierarchy set out above reflects the significance of the inputs used in making the fair value measurements. Level 1 relates to quoted prices in active markets. Level 2 relates to inputs other than quoted prices that are observable either directly or indirectly. Level 3 relates to inputs which use unobservable market data. As required, the level in the fair value hierarchy within which the fair value measurement is categorised in its entirety is determined based on the lowest level of input. There are no transfers between levels 1, 2 or 3 in the Bank in respect to assets held at 31 December 2011.

** Forms integral part of the audited financial statements*

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF

EBS MORTGAGE FINANCE UNLIMITED

We have audited the financial statements of EBS Mortgage Finance ('the Bank') for the year ended 31 December 2011, which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows, the Statemenf of Changes in Shareholders' Equity and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Bank's shareholder, as a body, in accordance with section 193 of the Companies Act 1990. Our audit work has been undertaken so that we might state to the Bank's shareholder 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 Bank and the Bank's shareholder as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors
The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 10.

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

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with IFRSs as adopted by the EU, and have been properly prepared in accordance with the Companies Acts 1963 to 2009. We also report to you, in our opinion whether proper books of account have been kept by the Bank; whether at the balance sheet date, there exists a financial situation requiring the convening of an extraordinary general meeting of the Bank; and whether the information given in the Directors' Report is consistent with the financial statements. In addition, we state whether we have obtained all the information and explanations necessary for the purposes of our audit, and whether the Bank's statement of financial position is in agreement with the books of account.

We also report to you if, in our opinion, any information specified by law regarding directors' remuneration and directors' transactions is not disclosed and, where practicable, include such information in our report.
We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises the Directors' Report and the Risk Management Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

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

Opinion
In our opinion:
• the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Bank's affairs as at 31 December 2011 and of its loss for the year ended; and
• the financial statements have been properly prepared in accordance with the Companies Acts 1963 to 2009.

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

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

The net assets of the Bank, as stated in the statement of financial position are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 December 2011 a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the Bank.

Killian Croke
For and on behalf of
KPMG
Chartered Accountants, Statutory Audit Firm
1 Harbourmaster Place
International Financial Services Centre
Dublin 1

14 May 2012

EBS MORTGAGE FINANCE UNLIMITED

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2011

	Note	2011 €'000	2010 €'000
Interest income	3	235,960	184,394
Interest expense	3	(183,194)	(128,411)
Net Interest Income		**52,766**	**55,983**
Net trading income	4	2,045	(9,892)
Operating expenses	5	(5,945)	(6,853)
Income before impairment provisions		**48,866**	**39,238**
Provision for impairment losses of loans and advances to customers	10	(128,382)	(26,674)
(Loss)/Profit before taxation		**(79,516)**	**12,564**
Taxation on ordinary activities	6	9,935	(1,561)
(Loss)/Profit for the year		**(69,581)**	**11,003**

Approved by the Board:

Date:

14 May 2012

EBS MORTGAGE FINANCE UNLIMITED

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2011

	2011 €'000	2010 €'000
(Loss)/Profit for the year	(69,581)	11,003
Total comprehensive (loss)/profit for the year	**(69,581)**	**11,003**

There are no other items in other comprehensive income other than the (loss)profit for the year.

Approved by the Board:

Date:

14 May 2012

EBS MORTGAGE FINANCE UNLIMITED

STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER 2011

	Note	2011 €'000	2010 €'000
ASSETS			
Cash and balances with central banks	7	-	13,900
Derivative financial instruments	21	56,096	58,173
Loans and advances to credit institutions	9	130,160	68,726
Loans and advances to customers	10	7,175,907	5,354,351
Deferred taxation	12	9,939	-
Prepayments and accrued income	13	453	266
Intangible assets	11	2,424	2,772
Total assets		**7,374,979**	**5,498,188**
LIABILITIES			
Deposits by credit institutions	14	3,613,508	2,874,009
Derivative financial instruments	21	54,439	50,774
Current taxation	16	13	25
Provisions for liabilities and commitments	17	32	20
Accruals and deferred income	18	6,121	6,210
Other liabilities	19	1,506	7,729
Debt securities in issue	15	3,268,497	2,218,977
Total liabilities		**6,944,116**	**5,157,744**
SHAREHOLDER'S EQUITY			
Ordinary share capital	24	476,540	316,540
General Reserves		(45,677)	23,904
Total shareholder's equity		**430,863**	**340,444**
Total liabilities and shareholder's equity		**7,374,979**	**5,498,188**

Approved by the Board:

Date: 14 May 2012

EBS MORTGAGE FINANCE UNLIMITED

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2011

	Note	2011 €'000	2010 €'000
Cash flows from operating activities			
Loss/Profit for the period before taxation		(79,516)	12,564
Adjustments for:			
Amortisation of intangibles	11	348	348
Amortisation of premium/discount		39,104	2,136
Provision for impairment of loans and advances	10	129,744	27,340
Fair value movement on hedging derivatives	4	6,146	(17,613)
Fair value movement on hedged item	4	(6,221)	15,635
Operating income before changes in working capital and provisions		**89,605**	**40,410**
Net increase in loans and advances to customers	10	(1,951,300)	(505,167)
Net increase in prepayments and accrued income	13	(187)	(917)
Net (increase)/decrease in derivative interest accrued		(404)	815
Increase in other liabilities	14	739,499	220,591
Increase/(decrease) in accrual and deferred income		327	(425)
Increase/(decrease) in provision for liability and commitments	17	12	(4)
Decrease in taxation liability	16	(12)	(14)
Other non cash adjustments		(7)	
Cash used in operations		**(1,122,467)**	**(244,711)**
Income taxes refunded		-	120
Net cash used in operating activities		**(1,122,467)**	**(244,591)**
Net cash outflow from investing activities			
Cash flows from financing activities			
Issue of debt securities	15	1,010,000	1,170,000
Redemption of debt securities	15	-	(1,000,000)
Issue of share capital	24	160,000	50,000
Net cash inflow from financing activities		**1,170,000**	**220,000**
Net increase in cash and cash equivalents		**47,533**	**(24,591)**
Cash and cash equivalents at beginning of period		82,575	107,166
Cash and cash equivalents at 31 December	7	**130,108**	**82,575**

EBS MORTGAGE FINANCE UNLIMITED

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2011

	Note	Ordinary Share Capital €'000	General Reserves €'000	Total €'000
At 1 January 2010		**266,540**	**12,901**	**279,441**
Ordinary share capital issued	24	50,000	-	50,000
Total comprehensive income for the year		**316,540**	**12,901**	**329,441**
Profit for the period		-	11,003	11,003
At 31 December 2010		**316,540**	**23,904**	**340,444**

	Note	Share Reserves €'000	General Reserves €'000	Total €'000
At 1 January 2011		**316,540**	**23,904**	**340,444**
Ordinary share capital issued	24	160,000	-	160,000
Total comprehensive income for the year		**476,540**	**23,904**	**500,444**
Loss for the year		-	(69,581)	(69,581)
At 31 December 2011		**476,540**	**(45,677)**	**430,863**

1. ACCOUNTING POLICIES

1.1 Reporting Entity

EBS Mortgage Finance (the 'Bank') was incorporated in the Republic of Ireland on 30 October 2008 as an unlimited company and commenced trading on 1 December 2008 operating under the Irish Central Bank Act, 1971 (as amended) and as a designated mortgage credit institution under the Asset Covered Securities Acts. The Bank is a wholly owned subsidiary of EBS Limited (formally EBS Building Society), is part of the EBS and AIB Group (the 'Group') and is regulated by the Central Bank of Ireland. The principal activities of the Bank are described in note 2.

On 1 July 2011 EBS Building Society was demutualised pursuant to the Building Societies Act 1989 (amended) and converted to EBS Limited, a private limited company pursuant to the Companies Act 1963 (as amended) under the terms of an Acquisition Conversion Scheme (the 'Scheme) completed on 1 July 2011. Under the terms of the Scheme the special investment shares issued by the Society were converted to ordinary shares in EBS Limited. 100% of the issued ordinary shares in EBS Limited held by the Minister for Finance were acquired by Allied Irish Banks, p.l.c. ('AIB') on 1 July 2011.

The Bank is a covered institution within the meaning of the Government Guarantee Scheme ('the Scheme') and stood specified under the Credit Institutions (Financial Support) (Specification of Institutions) Order 2008 (Statutory Instrument No. 416 of 2008) ('CIFS') for the period 30 September 2008 to 29 September 2010. The Bank is not a participating institution under the new Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 which came into effect on 9 December 2009.

The Bank is currently a participating institution under the National Asset Management Agency Act 2009. However, there were no mortgage loans transferred under the Act.

1.2 Statement of compliance

The financial statements have been prepared in accordance with International Accounting Standards and International Financial Reporting Standards (collectively 'IFRS') both as issued by the International Accounting Standards Board ('IASB') and subsequently adopted by the European Union ('EU') and applicable for the year ended 31 December 2011. The accounting policies have been consistently applied by Group entities and are consistent with the previous year, unless otherwise described. The financial statements also comply with the requirements of Irish Statute comprising the Companies Acts 1963 to 2009 and the European Communities (Credit Institutions: Accounts) Regulations, 1992 (as amended) and the Asset Covered Securities Acts 2001 and 2007.

1.3 Basis of preparation

The financial statements are presented in euro (€), which is the functional currency of the Bank, rounded to the nearest one thousand.

The financial statements have been prepared on an historical cost basis, except for derivative contracts all of which are measured at fair value. The carrying value of recognised assets and liabilities that are hedged are adjusted to record changes in the fair value attributable to the risks that are being hedged.

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.

1.4 Critical Accounting Judgements and Estimates

The preparation of financial statements requires management to make judgments, 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's judgement involves making estimates concerning the likelihood of future events, the actual results could differ from those estimates. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future period affected.

Full details of the significant accounting policies are set out below.

The bank believes that of its significant accounting policies and estimation techniques, the following may involve a higher degree of judgement and complexity.

(i) Impairment losses on loans and advances

The Bank has purchased mortgage loans from EBS, which are secured on residential property. Where there is a risk that the Bank will not receive full repayment of the amount advanced, provisions are made in the financial statements to reduce the carrying value of loans and advances to the amount expected to be recovered.

Management reviews the Bank's loan portfolios to assess impairment at least quarterly and the Board reviews it on a semi-annual basis. Impairment loss calculations involve the estimation of future cash flows of loans and advances based on observable data at the reporting date and historical loss experience for assets with similar credit risk characteristics. These calculations are undertaken on either a portfolio basis or separately for individually significant exposures. In applying the portfolio basis the Bank makes use of various modelling techniques which are specific to different portfolio types.

The estimation of credit losses is inherently uncertain and depends on many factors such as employment rate, GNP, house price movements, collateral values, cash flows, structural changes within industries and other external factors. These assessments are made using a combination of specific reviews, statistical techniques based on previous loan loss experience and management's judgement. Certain aspects of this process may require estimation, such as the amounts and timing of future cash flows and the assessment of the realisable value of collateral held.

The Bank considers that the provisions for loan impairments at 31 December 2011 were adequate based on information available at that time. However, actual losses may differ as a result of changes in collateral values, the timing and amounts of cash flows or other economic events.

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

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. This critical accounting policy is assessed on an annual basis and any charges are charged/ credited to the income statement.

(iii) Derivatives financial instruments
The Bank uses derivative financial instruments to hedge its exposure to interest rate risks. In accordance with treasury policy, the Bank does not hold or issue derivative financial instruments for trading purposes.

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on re-measurement to fair value is recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the hedge relationship.

The fair value of derivative financial instruments is the estimated amount that the Bank would receive or pay to terminate the instrument at the reporting date. Interest rate swaps are valued by calculating the net present value of the cash flows over the life of the swap. All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

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

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

- the absence of any expiry dates for Irish tax losses;
- the non-enduring nature of the dominant sources of losses in recent years;
- the continued generation of operating profits before provisions in recent years;
- the return to profitability within the Bank's financial plans.

Taking account of all relevant factors the Bank believes that it is more likely than not that it will return to profitability within the timescale of its Financial Plans. In the absence of any expiry date for tax losses in Ireland, the Bank therefore believes that it is more likely than not that there will be future taxable profits against which to use the tax losses.

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

Going Concern

The Bank's activities are subject to risk factors as set out in the Risk Management Report. The continued financial crisis has increased these risk factors.

The financial statements have been prepared on a going concern basis.

In making its going concern assessment, the Bank's Directors have considered the economic, political and market risks and uncertainties currently impacting Irish financial institutions, including EBS Group (the 'Group'). In particular these relate to challenges in terms of liquidity, funding and capital. The Bank is dependent on the financial support from its parent, EBS Limited, who in turn is dependent on the ultimate parent, AIB p.l.c, to meet its capital requirements and ultimately its funding requirements. Since 1 July 2011 EBS Group has received the full support of AIB p.l.c. in meeting the necessary capital and funding requirements and for the full year 2011 the Bank has received the full support of EBS in meeting its necessary capital and funding requirements.

The financial statements have been prepared on a going concern basis on the basis of the assessment of the above mentioned risks and the commitment from AIB p.l.c. to support the funding and capital needs of the EBS Group and similarly the commitment from EBS to support the funding and capital needs of the Bank. In making this assessment the Directors have considered the basis on which EBS concluded that it is appropriate to prepare its own financial statements for the year ended 31 December 2011 on a going concern basis.

Extract from the EBS Group Annual report and financial statements for the year ended 31 December 2011
In making their assessment, the Directors' have considered the economic, political and market risks and uncertainties currently impacting Irish financial institutions, including EBS Group. In particular these relate to challenges in terms of liquidity, funding and capital. The Group is dependent on the financial support from its parent, AIB p.l.c., to meet its capital requirements and ultimately it's funding requirements. Since 1 July 2011 the Group has received the full support of its parent in meeting the necessary capital and funding requirements.

The financial statements have been prepared on a going concern basis on the basis of the Board's assessment of the above mentioned risks and the commitment from the parent to support the funding and capital needs of the Group going forward. In making this assessment the Directors' have considered the basis on which the parent itself concluded that it is appropriate to prepare it's own financial statements for the year ended 31 December 2011 on a going concern basis.

Extract from the AIB p.l.c. Annual report and financial statements for the year ended 31 December 2011 (on this extract the Group refers to AIB Group)

The financial statements have been prepared on a going concern basis as the Directors are satisfied, having considered the risks and uncertainties impacting the Group, that it has the ability to continue in business for the foreseeable future.

In making their assessment, the Directors have considered a wide range of information relating to present and future conditions. These have included financial plans, cash flow and funding forecasts, capital resources projections, all of which have been prepared under base and stress scenarios. In addition, the Directors have considered the commitment of support provided to AIB p.l.c. by the Irish Government through the programme for restructuring the Irish banking system with AIB designated as one of the two 'Pillar Banks'. Furthermore, the Directors have considered the outlook for the Irish economy, taking into account such factors as progress on improving the fiscal situation and the support provided by the EU/IMF to Ireland. The Directors' also considered the Eurozone sovereign debt crisis in its assessment of the going concern basis.

Background
The deterioration in the Irish economy culminated in the EU/IMF Programme of Financial Support for Ireland. This deterioration, which persisted throughout 2010 and 2011, presents significant risks and challenges for the Group in the years ahead:

The funding position of the Group has been impacted by:
- *The downgrading of the Group and sovereign credit ratings;*
- *The withdrawal of the Irish Government from the funding markets; and*
- *The EU/IMF Programme of Financial Support and the consequent withdrawal of funds from Irish banks.*

The EU/IMF Programme provided for the restructuring and reorganisation of the Irish banks. The subsequent Financial Measures Programme published by the Central Bank in March 2011 set a PCAR requirement for AIB (including EBS) to raise capital amounting to €14.8bn. This requirement was met by the end July 2011 through liability management exercises and Government capital injections (€5bn by way of an equity placing; a capital contribution of €6.1bn; and €1.6bn by way of a Contingent Capital Notes issuance).

Since 2010 and through 2011, AIB p.l.c. has had limited access to wholesale funding and has been dependant on secured funding from the European Central Bank ('ECB') and has utilised non standard facilities from the Central Bank for a limited period. The Bank ceased using non-standard facilities in April 2011. Breaches of liquidity ratios up to July 2011 were remedied as new capital was injected by the Government. However, Allied Irish Bank p.l.c. and AIB Mortgage Bank deposits from the Central Bank have continued, since October 2010, to exceed a regulatory limit of 25%.

Market volatility remained elevated and liquidity depressed during 2011 driven by the deterioration in global credit markets as sovereign difficulties in the Eurozone grew and the overall global macroeconomic environment remained uncertain. Credit spreads widened sharply, especially in the second half of the year, for certain countries within the Eurozone. This negative sentiment impacted on access to wholesale funding for certain sovereigns and credit institutions across Europe.

At different stages since the beginning of 2011, European leaders reaffirmed their commitment to the euro.

- *On 21 July 2011, a statement by the Heads of State or Government of the euro area and EU institutions reaffirmed their commitment to the euro and to do whatever was needed to ensure the financial stability of the euro area as a whole and its Member States;*
- *ECB decided to actively implement its Securities Markets Programme i.e. to intervene in the euro area public and private debt securities markets (to ensure depth and liquidity in those market segments which are dysfunctional);*
- *On 9 December 2011, the Heads of State or Government of the euro area and European Council agreed a package of measures to restore confidence in the financial markets which included:*
  - *a new fiscal compact and the strengthening of stabilisation tools for the euro area including a more effective European Financial Stability Facility (EFSF);*
  - *the bringing forward of the implementation of the European Stability Mechanism(ESM); and*
  - *a solution for the unique challenges faced by Greece.*
- *On 21 February 2012, European leaders agreed a second bail-out package for Greece in order to secure Greece's future in the euro area.*

These various measures, adopted since the beginning of 2011, are indicative of the commitment of all euro area Member States to save the euro and to support euro area members.

Capital

Under the EU/IMF Programme and the subsequent Financial Measures Programme published by the Central Bank in March 2011, which detailed the outcome of its review of capital (PCAR) and funding (PLAR), AIB was set a minimum capital target of 10.5% core tier 1 in the base scenario, and a 6% core tier 1 in the stress scenario, plus an additional protective buffer which could be in the form of contingent capital. The total PCAR requirement for AIB (including EBS) was €14.8bn. This requirement was met by the end July 2011 as outlined above. The Group's core tier 1 ratio at 31 December 2011 is 17.9% (2010: 4%). The Group's total capital ratio at 31 December 2011 is 20.5% (2010: 9.2%).

AIB has passed the European Banking Authority ('EBA') stress test in July 2011 and the EBA capital exercise in December 2011(which incorporated a capital buffer for sovereign exposures) without any further capital being required.

The Directors have reviewed the capital and financial plans for period of assessment and believe that the capital resources are sufficient to ensure that the Group is adequately capitalised both in a base and stress scenario.

Liquidity and funding

The Group's balance sheet saw significant change in 2011 arising from: the disposal of BZWBK; the acquisition of NAMA senior bonds and the deposit business from Anglo Irish Bankcorp ('Anglo'); the acquisition of EBS; the recapitalisation in July and asset deleveraging in the Non-Core segment. These changes reduced the funding requirement of AIB p.l.c. by €10bn in 2011. The cash proceeds from the sale of BZWBK, the State deposit in advance of the Government capital injection and the issuance of Own Use Bank Bonds (i.e. self issued MTN under the Government guarantee) enabled AIB exit non standard facilities in April 2011. Nonetheless, the Group remains heavily dependent on Central Bank/ECB support, which amounted to €31bn (including EBS) at 31 December 2011 down from €37bn (AIB only) at 31 December 2010.

AIB's access to wholesale funding markets continued to be restricted in 2011. This is a result of the continued negative sentiment towards the IMF/ECB bail out in the first half of 2011, the Europe-wide uncertainty in the second half of 2011 and the Group's credit rating. This increases the requirement for AIB to maintain/increase its deposit franchise, deleverage its balance sheet enabling reduction in wholesale funding dependency

Customer deposits remain the largest source of funding for the Group. Excluding the Anglo and EBS deposits, plus the impact of the NTMA deposits at June 2011, the Group's deposits were broadly stable in the second half of 2011, notwithstanding the uncertainty Europe-wide in the latter months of the year.
While the Irish Sovereign's credit rating was downgraded in 2011 and contagion has spread to the broader euro area, the Irish Sovereign has been able to distinguish itself from the other peripheral countries. In particular, the Irish Government has met the fiscal requirements and the recapitalisation of its banks as part of its EU/IMF Programme which has resulted in bond yields significantly tightening since July 2011.

Notwithstanding the 2011 improvements, it is expected that the Group will continue to be reliant on the monetary authorities for funding during the assessment period. However, AIB.'s access to Central Bank funding support as required is considered to be assured due to its position as one of the two 'Pillar Banks' and in particular by the announcements by the ECB, the Minister for Finance and the Head of the Banking Policy Division at the Department of Finance on 31 March 2011 to the effect that the required Central Bank funding would be made available. Furthermore, the ECB confirmed that the Eurosystem would continue to provide liquidity to banks in Ireland, including AIB .

Furthermore, the Group have had discussions with the Central Bank and it sought assurance of the continued availability of the required liquidity from the Eurosystem during the period of assessment for the going concern statement. The Directors' are satisfied based on the clarity of confirmations received from the Central Bank and public announcements by ECB, EU, IMF and the Minister of Finance, that in all reasonable circumstances, the required liquidity and funding from the Central Bank/ECB will be available to the Group during the period of assessment.

The Directors', therefore consider that the funding and liquidity position of AIB. is assured during the assessment period.

Conclusion

On the basis of the above, the Directors' believe that it is appropriate to prepare the financial statements on a going concern basis having concluded that there are no material uncertainties related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern over the period of assessment.

The Directors of the Bank recognise that given the significant Irish and European economic, political and market risks and uncertainties that currently impact Irish Financial institutions, including the EBS and AIB Group, and the Bank's dependence on its parent for capital and funding, there is material uncertainty that may cast significant doubt on the Bank's ability to continue as a going concern. In considering the position of the Bank the most relevant mitigants considered by the Board of Directors are:

- The injection of capital by the Irish Government into AIB Group of €14.8bn in July 2011 as required under the Financial measures programme published by the Central bank in March 2011.
- The injection of €300m of capital from AIB p.l.c. into EBS in December 2011 and subsequently the injection of €160m of capital from EBS in to the Bank in December 2011.
- The position of AIB p.l.c. as one of the two pillar banks in Ireland and the continued support of the Irish government and ECB to continue to provide liquidity to banks in Ireland, including AIB Group.
- The assurance obtained by AIB p.l.c. from the Central Bank regarding the continued availability of the required liquidity from the Eurosystem during the period of assessment for the going concern statement.
- The fact that AIB p.l.c. has formally committed to support the funding and capital needs of the EBS Group and the fact that EBS has committed to support the funding and capital needs of the Bank for a period of at least 12 months from the date these financial statements are approved by the Board.

On the basis of the above, the Bank's Directors believe that it is appropriate to prepare the financial statements on a going concern basis having concluded that there are mitigants in place to the aforementioned risks and uncertainties related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern over the period of assessment.

Adoption of new accounting standards

The following amendments to standards have been adopted by the Bank during the year ended 31 December 2011.

<u>Amendment to IAS 24 – Related Party Disclosures</u>

This amendment simplifies the definition of a related party, clarifying its intended meaning and eliminating inconsistencies from the definition. It also provides a partial exemption from the disclosure requirements for Government-related entities which, as permitted by the amendment, was early adopted by the Bank in 2010.The remainder of the amendment impacts upon the disclosure of certain related party relationships, transactions and outstanding balances including commitments in the financial statements of the Bank.

<u>Amendment to IAS 32 – Financial Instruments: Presentation-Classification of rights issues</u>

The amendment which is effective for annual periods beginning on or after 1 February 2010, states that if rights are issued by an entity pro rata to all existing shareholders in the same class for a fixed amount of currency, they should be classified as equity regardless of the currency in which the exercise price is denominated. This amendment did not have any impact on the Bank's financial statements but may do so in the future.

<u>FRIC 19 Extinguishing Financial Liabilities with Equity Instruments</u>

This IFRIC which is effective for annual periods beginning on or after 1 July 2010, clarifies the requirements of International Financial Reporting Standards ('IFRSs') when an entity renegotiates the terms of a financial liability with its creditor and the creditor agrees to accept the entity's shares or other equity instruments to settle the financial liability fully or partially. The impact on the Bank will be dependent on the nature of any future liability management actions undertaken by the Bank.

Improvement to IFRSs May 2010

In May 2010, the IASB issued its third edition of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording.

The adoption of the following amendments resulted in changes to accounting policies, but did not have any impact on the financial position or performance of the Bank.

- IFRS 3 Business Combinations: The measurement options available for non-controlling interest ('NCI') have been amended. Only components of NCI that constitute a present ownership interest that entitles their holder to a proportionate share of the entity's net assets in the event of liquidation shall be measured at either fair value or at the present ownership interests' proportionate share of the acquiree's identifiable net assets. All other components are to be measured at their acquisition date fair value.

- IFRS 7 Financial Instruments - Disclosures: The amendment to IFRS 7 clarifies the required level of disclosure about credit risk and collateral held and provides relief from disclosures previously required regarding renegotiated loans.

- IAS 1 Presentation of Financial Statements: The amendment clarifies that an option to present an analysis of each component of other comprehensive income may be included either in the statement of changes in equity or in the notes to the financial statements. The Bank has adopted the option of disclosing this analysis in the notes to the financial statements.

- IAS 34 Interim Financial Reporting: These amendments, which are effective for annual periods beginning on or after 1 January 2011, emphasise the principle in IAS 34 that disclosures about significant events and transactions in interim periods should update the relevant information presented in the most recent annual financial report. Additional disclosure requirements included in the amendment require the Bank to disclose:
  - transfers between levels of the 'fair value hierarchy' used in measuring the fair value of financial instruments;
  - changes in the classification of financial assets as a result of a change in the purpose or use of those assets;
  - changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities, whether those assets or liabilities are recognised at fair value or amortised cost; and;
  - changes in contingent liabilities or contingent assets.

Other amendments resulting from improvements to IFRS which the Bank adopted in 2011 did not have any impact on the accounting policies, financial position or performance of the Bank.

The significant accounting policies that the Bank applied in the preparation of the financial statements are set out in this section. The significant accounting policies below have been applied consistently to all periods presented in these Financial Statements. Certain comparative amounts have been amended in the Income Statement and Statement of Financial position to comply with current year's presentation. See note 27 for full details.

1.5 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 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 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.

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

1.7 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 financial income. The present value of provisions is included in other liabilities.

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

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

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

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

Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle the current tax assets and liabilities on a net basis or to realise the asset and settle the liability simultaneously. The principal temporary differences arise from revaluation of certain financial assets and financial liabilities including derivative contracts.

1.9 Impairment of Financial Assets
It is 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 are impaired. A financial asset or portfolio of financial assets are 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 and 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 are 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;
   ii. national or local economic conditions that correlate with defaults on the assets in the portfolio.

Incurred but not reported
The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and 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 under the collective incurred but not reported ('IBNR') assessment. A collective impairment provision represents an interim step pending the identification of impairment losses on an individual asset in a group of financial assets. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

Collective evaluation of impairment
For the purpose of collective evaluation of impairment (individually insignificant impaired assets and collective), 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 repayment behaviour for a group of financial assets that are collectively evaluated for impairment is assessed on the basis of the historical loss experience for assets with credit risk characteristics similar to those in the 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 assumptions used for estimating repayment behaviour and loss are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Impairment loss
For loans and advances and assets held to maturity, 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.

Assets acquired in exchange for loans and advances in order to achieve an orderly realisation are accounted for as a disposal of the loan and an acquisition of an asset. Any further impairment of the assets or business acquired is treated as an impairment of the relevant asset and not as an impairment of the original instrument.

Collateralised financial assets
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.

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 a term used to describe the equivalent cumulative numbers of days that a missed payment is overdue. For loans paying interest in advance, past due days commence from the close of business on the last day of the month in which a payment is due but not received. For loans paying interest in arrears, past due days commence from the close of business on the day on which a payment is due but not received. When a borrower is past due, the entire exposure is reported as past due, rather than the amount of any excess or arrears.

Loans and advances renegotiated
Loans and advances renegotiated are those facilities outstanding at the reporting date that, during the financial year have had their terms renegotiated, resulting in an upgrade from 90+ days past due or impaired status to performing status.

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

1.10 Determination of Fair Value of Financial Instruments
The fair value of a financial instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial assets are initially recognised at fair value, and with the exception of financial assets at fair value through profit or loss, the initial fair value includes direct and incremental transaction costs.

Financial liabilities are initially recognised at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. 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 on an arm's length basis. Where quoted prices are not available or are unreliable because of market inactivity, fair values are determined using valuation techniques. These valuation techniques which use, to the extent possible, observable market data, include the use of recent arm's length transactions, reference to other similar instruments, option pricing models and discounted cash flow analysis and other valuation techniques commonly used by market participants.

Quoted prices in active markets
Quoted market prices are used where those prices are considered to represent actual and regularly occurring market transactions on an arm's length basis, 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 Group'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, or 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, equities and commodities prices, credit spreads, option volatilities and currency rates. In addition, the Bank considers the impact of own credit risk when valuing its derivative liabilities.

The methodology is to calculate the expected cash flows under the terms of each specific contract and then discount these values back to a present value. 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.

Certain financial instruments 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 level at which an arm's length transaction would occur under normal business 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.
The Bank tests the outputs of the 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, the liquidity of the market, and hedging costs 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.

1.11 Financial Assets

The Bank classifies its financial assets into the following categories: - financial assets at fair value through profit or loss and loans and advances.

Purchases and sales of financial assets are recognised on trade date, being the date on which the Bank commits to purchase or sell the assets. Loans are recognised when cash is advanced to the borrowers.

Interest is calculated using the effective interest method and credited to the income statement. Dividends on available-for-sale equity securities are recognised in the income statement when the entity's right to receive payment is established. Impairment losses and translation differences on monetary items are recognised in the income statement.

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

Financial assets at fair value through profit or loss
This category can have two sub categories: - Financial assets held for trading; and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if it is acquired principally for the purpose of selling in the near term; part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking; or if it is so designated at initial recognition by management, subject to certain criteria.

The assets are recognised initially at fair value and transaction costs are taken directly to the income statement. Interest and dividends on assets within this category are reported in interest income, and dividend income, respectively. Gains and losses arising from changes in fair value are included directly in the income statement within net trading income.

Derivatives are also classified in this category unless they have been designated as hedges or are financial guarantee contracts.

Loans and advances
Loans and advances 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 advances are initially recognised at fair value including direct and incremental transaction costs and are subsequently carried on an amortised cost basis.

1.12 Financial Liabilities

Issued financial instruments or 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, 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 their 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 recognised in the income statement using the effective interest method.

Where financial liabilities are classified as trading they are also initially recognised at fair value and the related transaction costs are taken directly to the income statement. Gains and losses arising from changes in fair value are recognised directly in the income statement within net trading income.

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

1.13 Intangible Assets

Intangible assets are costs associated with the set up of the Bank. They are amortised using the straight-line method over their useful life not exceeding 10 years. The amortisation expense is recognised in the Income Statement in operating expenses.

1.14 Derivatives and Hedge Accounting

Derivatives, such as interest rate swaps, are used for hedging purposes as part of the Bank's risk management strategy against assets, liabilities, positions and cash flows.

Derivatives

Derivatives are measured initially at fair value on the date on which the derivative contract is entered into and subsequently re-measured 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 either:

i. hedges of the fair value of recognised assets or liabilities or firm commitments ('fair value hedge'); or
ii. hedges of the exposure to variability of cash flows attributable to a recognised asset or liability, or a highly probable forecasted transaction ('cash flow hedge').

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

The Bank discontinues hedge accounting when:

a) it is determined that a derivative is not, or has ceased to be, highly effective as a hedge;
b) the derivative expires, or is sold, terminated, or exercised;
c) the hedged item matures or is sold or repaid; or
d) a forecast transaction is no longer deemed highly probable.

To the extent that the changes in the fair value of the hedging derivative differ from changes in the 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. For available-for-sale items the fair value hedging adjustment remains in equity, until the hedged item affects the income statement and is recognised in the income statement using the effective interest method. If the hedged item is sold or repaid, the unamortised fair value adjustment is recognised immediately in the income statement.

Cash flow hedge accounting
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is initially recognised directly in other comprehensive income and included in the cash flow hedging reserve in the statement of changes in equity. The amount recognised in other comprehensive income is re-classed to profit or loss as a reclassification adjustment in the same period as the hedged cash flows affect profit or loss, and in the same line item in the statement of comprehensive income. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the income statement immediately.
When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised in other comprehensive income from the time when the hedge was effective remains in equity and is reclassified to the income statement as a reclassification adjustment as the forecast transaction affects profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in other comprehensive income from the period when the hedge was effective is reclassified from equity to the income statement.

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 derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

1.15 Collateral and Netting
The Bank enters into master netting agreements with counterparties, to ensure that if an event of default occurs, all amounts outstanding with those counterparties will be settled on a net basis.

Collateral
The Bank obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Bank a claim on these assets for both existing and future liabilities. The collateral is, in general, not recorded on the statement of financial position.

The Bank also receives collateral in the form of cash or securities in respect of other credit instruments, such as stock borrowing contracts and derivative contracts in order to reduce credit risk. Collateral received in the form of securities is not recorded on the statement of financial position. Collateral received in the form of cash is recorded on the statement of financial position with a corresponding liability. These items are assigned to deposits received from banks or other counterparties in the case of cash collateral received. Any interest payable or receivable arising is recorded as interest expense or interest income respectively.

In certain circumstances, the Bank will pledge collateral in respect of liabilities or borrowings. Collateral pledged in the form of securities or loans and advances continues to be recorded on the statement of financial position. Collateral paid away in the form of cash is recorded in loans and advances to banks or customers. Any interest payable or receivable arising is recorded as interest expense or interest income respectively.

Netting
Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements where the related assets and liabilities are presented gross on the statement of financial position.

1.16 Share Capital
Issued financial instruments, or their components, are classified as equity where they meet the definition of equity and confer on the holder a residual interest in the assets of the Bank. Incremental costs directly attributable to the issue, if any, of an equity instrument are deducted from the initial measurement of the equity instrument.

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

1.18 Prospective Accounting Changes

The following new accounting standards and amendments to existing standards approved by the IASB in 2010 and 2011, but not early adopted by the Bank, will impact the Bank's financial reporting in future periods.

The following will be applied in 2012

Amendments to IFRS 7, Disclosures – Transfers of Financial Assets

In October 2010, the IASB issued amendments to IFRS 7 Financial Instruments: "Disclosures – Transfers of Financial Assets". These amendments, which are effective for annual period beginning on or after 1 July 2011, with earlier application permitted, comprise additional disclosures on transfer transactions of financial assets (for example, securitisations), including the possible effects of any risks that may remain with the transferor of the assets. The impact of these amendments is currently being assessed by the Bank.

The following will be applied in 2013 unless otherwise noted:

Amendments to IAS 1 - Presentation of Items in Other Comprehensive Income

The amendments to IAS 1 were issued in June 2011 and are applicable to annual periods beginning on or after 1 July 2012. These amendments require companies preparing financial statements in accordance with IFRSs to group together items within other comprehensive income that may be reclassified to the profit or loss section of the income statement. The amendments also reaffirm existing requirements that items in other comprehensive income and profit or loss should be presented as either a single statement or two consecutive statements.

IFRS 13 Fair Value Measurement

This standard, which applies prospectively for annual periods beginning on or after 1 January 2013, establishes a single source of guidance for fair value measurements under IFRSs. IFRS 13 defines fair value, provides guidance on its determination and introduces consistent requirements for disclosures on fair value measurements. IFRS 13 requires entities to disclose information about the valuation techniques and inputs used to measure fair value, as well as information about the uncertainty inherent in fair value measurements. This information will be required for both financial and non-financial assets and liabilities.

Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32, and Disclosures – Offsetting Financial Assets and Financial Liabilities – Amendments to IFRS 7

In December 2011, the IASB issued amendments to IAS 32 and IFRS 7 which clarify the accounting requirements for offsetting financial instruments and introduce new disclosure requirements that aim to improve the comparability of financial statements prepared in accordance with IFRS and US GAAP.

The amendments to IFRS 7 will require more extensive disclosures than are currently required. The disclosures focus on quantitative information about recognised financial instruments that are offset in the statement of financial position, as well as those recognised financial instruments that are subject to master netting or similar arrangements, irrespective of whether they are offset. The amended offsetting disclosures are to be retrospectively applied, with an effective date of annual periods beginning on or after 1 January 2013.

The amendments to IAS 32 clarify that the right of set-off must be currently available and legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy. The IAS 32 changes are effective for annual periods beginning on or after 1 January 2014 and apply retrospectively.

The following will be applied in 2015:

IFRS 9 Financial instruments

In 2009, the IASB commenced the implementation of its project plan for the replacement of IAS 39. This consists of three main phases:

Phase 1: Classification and measurement

In November 2009, the IASB issued IFRS 9 Financial Instruments, covering classification and measurement of financial assets, as the first part of its project to replace IAS 39 and simplify the accounting for financial instruments. The new standard endeavours to enhance the ability of investors and other users of financial information to understand the accounting for financial assets and to reduce complexity. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortised cost or fair value, replacing the many different rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments (its business model) and the contractual cash flow characteristics of the financial assets.

In October 2010, the IASB reissued IFRS 9 incorporating new requirements on accounting for financial liabilities, and carrying over from IAS 39 the requirements for de-recognition of financial assets and financial liabilities. IFRS 9 does not change the basic accounting model for financial liabilities under IAS 39.Two measurement categories continue to exist: fair value through profit or loss ('FVTPL') and amortised cost. Financial liabilities held for trading are measured at FVTPL, and all other financial liabilities are measured at amortised cost unless the fair value option is applied.

IFRS 9 requires gains and losses on financial liabilities designated as at fair value through profit or loss to be split into the amount of change in the fair value that is attributable to changes in the credit risk of the liability, which should be presented in other comprehensive income, and the remaining amount of change in the fair value of the liability which should be presented in profit or loss in the income statement.

The basic premise for the de-recognition model in IFRS 9 (carried over from IAS 39) is to determine whether the asset under consideration for de-recognition is:

- an asset in its entirety; or
- specifically identified cash flows from an asset (or a group of similar financial assets); or
- a fully proportionate (pro rata) share of the cash flows from an asset (or a group of similar financial assets); or
- a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets).
- A financial liability should be removed from the statement of financial position when, and only when, it is extinguished, that is, when the obligation specified in the contract is either discharged or cancelled or expires.
- All derivatives, including those linked to unquoted equity investments, are measured at fair value. Value changes are recognised in profit or loss unless the entity has elected to treat the derivative as a hedging instrument in accordance with IAS 39, in which case the requirements of IAS 39 apply.

Phase 2: Impairment methodology
An exposure draft issued by the IASB in November 2009 proposes an "expected loss model" for impairment. Under this model, expected losses are recognised throughout the life of a loan or other financial asset measured at amortised cost, not just after a loss event has been identified. The expected loss model avoids what many see as a mismatch under the incurred loss model – front-loading of interest revenue (which includes an amount to cover the lender's expected loan loss) while the impairment loss is recognised only after a loss event occurs. The impairment phase of IFRS 9 is subject to on-going deliberations and has not yet been finalised.

Phase 3: Hedge accounting
In December 2010, the IASB issued an exposure draft on hedge accounting which will ultimately be incorporated into IFRS 9. The exposure draft proposes a model for hedge accounting that aims to align accounting with risk management activities. It is proposed that the financial statements will reflect the effect of an entity's risk management activities that uses financial instruments to manage exposures arising from particular risks that could affect profit or loss. This aims to convey the context of hedge instruments to allow insight into their purpose and effect. This phase of IFRS 9 is not yet finalised.

The effective date for implementation of IFRS 9 is annual periods beginning on or after 1 January 2015, which was extended from 1 January 2013 due to delays in completing phases 2 and 3 of the project as well as the delay in the insurance project.

Since significant aspects of the standard have yet to be finalised, it is impracticable for the Bank to quantify the impact of IFRS 9 at this stage.

1.19 Comparatives

The 2010 comparatives incorporate reclassifications made to the financial statements and notes to the accounts following an alignment of presentation with that adopted by the Bank's ultimate Parent, AIB p.l.c. The changes in presentation are shown in note 27.

2. REPORTING BY BUSINESS SEGMENTS AND GEOGRAPHICAL LOCATION

The Bank's activities are carried out exclusively in the financial services sector in the Republic of Ireland. The Bank does not sell mortgage loans directly to the public. It has an origination agreement with EBS whereby EBS continues to sell mortgage loans directly to the public and subsequently sell pools of loans to the Bank for an appropriate consideration.

For management and reporting purposes the Bank's activities are organised in one reportable segment based on the information provided internally to the chief operating decision maker. The chief operating decision maker is considered to be the Bank's Board of Directors.

3. NET INTEREST INCOME

	2011 €'000	2010 €'000
Interest income and similar income		
Loans and advances to customers	224,061	177,171
Amortisation of fair value discount on loans and advances to customers	11,064	5,617
Loans and advances to credit institutions	720	1,456
Cash with central banks	115	150
Total interest income	**235,960**	**184,394**
Interest expense and similar charges		
Deposits by credit institutions	(72,735)	(73,778)
Debt securities in issue	(67,056)	(51,887)
Amortisation of fair value discount on debt securities in issue	(39,520)	(2,746)
Acceleration of fair value premium on loans and advances to customers	(3,883)	-
Total interest expense	**(183,194)**	**(128,411)**
Net interest income	**52,766**	**55,983**

Included within various captions under interest income for the year ended 31 December 2011 is a total of €5.9m (2010: €0.5m) accrued on impaired financial assets.

The acceleration of the fair value premium of €3,883k is in respect of a premium on mortgage assets purchased from EBS in 2009. The premium was being amortised on an effective interest rate basis, however in 2011 it was deemed appropriate to accelerate the amortisation of the premium and recognise it in full in 2011.

4. NET TRADING INCOME

	2011 €'000	2010 €'000
Gain (loss) on hedge ineffectiveness:		
Derivatives held for hedging	125	494
Derivatives held at fair value through Income Statement	(50)	1,484
	75	**1,978**
Interest income (expense) on derivatives held at fair value through Income Statement:		
Interest income	4,379	12,174
Interest expense	(2,409)	(24,044)
	1,970	**(11,870)**
	2,045	**(9,892)**

Interest rate swaps are held for managing interest rate risk in the Bank and while these are effective in hedging the risk, the derivatives hedging the mortgage assets are not in a hedge relationship under the accounting standards. As a result, the derivatives are fair valued through the Income Statement and the mortgages are held at amortised cost. This treatment can give rise to volatility in the Income Statement. The gain on these derivatives for the year is €1,263k (2010: gain of €279k).

The derivative held for managing the interest rate risk on the €50m fixed rate private placement bond is not in a hedge relationship under the international financial reporting standards. As a result, the derivative is also fair valued through the Income Statement giving rise to a loss on this derivative for the year of €1,313k (2010: gain of €1,205k).

The derivatives hedging the €1bn fixed rate bond in issue are in a fair value hedge relationship minimising the volatility in the Income Statement. The net gain on the derivative in a fair value hedge relationship is €125k (2010: €494k) arising from the decrease in the fair value of the derivative of €6,096k (2010: increase of €16,129k) and the increase in fair value of the underlying hedged item of €6,222k (2010: decrease of €15,635k). Details on derivative financial instruments are also disclosed in note 21.

Interest income (expense) on derivatives held at fair value through the Income Statement previously reported as part of net interest income was reclassified to net trading income in 2011.

5. OPERATING EXPENSES

	2011 €'000	2010 €'000
Personnel expenses	271	344
Government Guarantee scheme fees	-	1,068
Other administrative expenses	5,326	5,093
Amortisation of intangibles (note 11)	348	348
	5,945	**6,853**

	2011 €'000	2010 €'000
Personnel expenses comprise:		
Wages and salaries	216	302
Social welfare costs and health insurance	26	33
Pension costs (note 20)	29	9
	271	**344**

Other administrative expenses includes service fee expense of €4,945k (2010: €4,723k) payable to EBS for the period. This fee is in respect of servicing tasks performed by EBS in relation to the portfolio of mortgages sold to the Bank and is determined with reference to the value of the outstanding loans in the Bank.

In accordance with the Credit Institutions (Financial Support) (Specification of Institutions) Order 2008 (Statutory Instrument No. 416 of 2008) ('CIFS'), no Government Guarantee scheme fees were incurred in 2011 (2010: €1,068k).

Directors' remuneration in 2011 is €30k (2010: €30k).

An analysis of the auditor's fees is set out below.

	2011 €'000	2010 €'000
Fees and expenses paid to our statutory auditors are analysed as follows:		
Audit of the individual financial statements	12	12
Other assurance services	-	-
Other non-audit services	-	-
	12	**12**

Auditor's remuneration of €12k (2010: €12k) is in relation to the audit of the individual financial statements. No other fees have been paid to the auditors.

The average number of full time persons employed by the Bank in the reporting period was 3.1 (2010: 4.8). All employees are permanent staff members.

6. TAXATION

	2011 €'000	2010 €'000
Corporation tax charge	4	1,561
Deferred tax credit	(9,939)	-
	(9,935)	**1,561**

The reconciliation of total tax on income at the standard Irish corporation tax rate to the Bank's actual tax charge is analysed as follows:

	2011 €'000	2010 €'000
(Loss)Income before tax @ 12.5%	(9,939)	1,571
Effects of:		
Addbacks and income not taxable at standard rates	-	-
Other temporary differences	-	(4)
Under/(Over) provision in prior years	4	(6)
Corporation Tax	(9,935)	1,561

There was no purchase of group relief from EBS or other subsidiaries of the Group (2010: €1,567k).

7. CASH AND BALANCES WITH CENTRAL BANKS

	2011 €'000	2010* €'000
Balances with Central Banks other than mandatory reserve deposits	-	13,900
	-	13,900

Mandatory reserve deposits are not available for use in the Bank's day-to-day operations.

* The 2010 comparatives have been reclassified to adjust for the change in reporting approach to exclude mandatory reserve deposits as part of cash and balances with central banks and to include them in loans and advances to credit institutions.

8. CASH AND CASH EQUIVALENTS

For the purpose of cash flows the cash and cash equivalents comprise the following:	2011 €'000	2010 €'000
Balances with Central Banks other than mandatory reserve deposits	-	13,900
Loans and advances to credit institutions	130,108	68,675
Total cash and cash equivalents	**130,108**	**82,575**

Cash and cash equivalents include balances with original maturities of less than 3 months and balances with Central Banks and exclude the mandatory reserve deposits.

9. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	2011 €'000	2010* €'000
Repayable in less than three months	130,108	68,675
Mandatory reserve deposits with Central Bank	52	51
	130,160	68,726

Mandatory reserve deposits are not available for use in the Bank's day-to-day operations.

* The 2010 comparatives have been reclassified to adjust for the change in reporting approach to include mandatory reserve deposits as part of loans and advances to credit institutions.

10. LOANS AND ADVANCES TO CUSTOMERS

	2011 €'000	2010 €'000
Repayable on demand	672,578	348,015
Repayable in less than three months	814	1,190
Repayable in more than three months but less than one year	5,454	3,798
Repayable in more than one but less than five years	108,686	96,997
Repayable in more than five years	6,560,339	4,946,571
Total customer loans	**7,347,871**	**5,396,571**
Less provision for loan impairments	(171,470)	(42,140)
Less unearned income provision	(494)	(80)
Total loans and advances to customers after provisions	**7,175,907**	**5,354,351**

Loans and advances to customers – Analysis by sector

	2011 €'000	2010 €'000
Home loans	6,949,217	4,979,824
Retail Buy to let loans	398,654	416,747
Total loans and advances to customers before provisions	7,347,871	5,396,571
Less provision for loan impairments	(171,470)	(42,140)
Less unearned income provision	(494)	(80)
Total loans and advances to customers after provisions	**7,175,907**	**5,354,351**

Fair value of the collateral held for residential mortgages is €6,416k at 31 December 2011 (2010: €4,897k) based on the CSO House Price Index.

PROVISION FOR LOAN IMPAIRMENTS

	2011 €'000	2010 €'000
Individual provision for loan impairments		
At beginning of the period	8,090	1,772
Charge of impairment loss	16,866	6,318
Transfer from collective impairment provision	139,664	-
At end of period	**164,620**	8,090
Collective provision for loan impairments		
At beginning of the period	34,050	13,108
Charge of impairment loss	112,464	20,942
Transfer to individual impairment provision	(139,664)	-
At end of period	**6,850**	**34,050**
Total provision for loan impairments at 31 December	**171,470**	**42,140**
Unearned income provision	494	80
Total provision for loan impairments (including unearned income provision)	**171,964**	**42,220**

The impairment charge recognised in the Income Statement of €128,382k (2010: €26,754k) is net of an amount received from EBS of €948k (2010: €586k) as part of an early settlement received by them from Genworth in respect of mortgage indemnity insurance relating to a pool of loans in the Bank.

During 2011, the criteria for determining the individual, and therefore collective provisions were amended. This resulted in €139.7m of collective provisions being transferred to Individual provisions.

11. INTANGIBLE ASSETS

	2011 €'000	2010 €'000
Development costs		
At 1 January	3,480	3,480
Additions – Internal development	-	-
Additions – Purchased	-	-
At 31 December	**3,480**	**3,480**
Amortisation		
At 1 January	708	360
Charge for the period	348	348
At 31 December	**1,056**	**708**
Net book amounts at 31 December	**2,424**	**2,772**

Computer software costs are amortised on a straight line basis over a period not exceeding ten years and all are in use at 31 December 2011

12. DEFERRED TAXATION

	2011 €'000	2010 €'000
At 1 January	-	-
Current tax losses	9,939	-
At 31 December	**9,939**	-

Comments on the basis of recognition of deferred tax assets on unused tax losses are included in the critical accounting policies.

At 31 December 2011 recognised deferred tax assets on tax losses and other temporary differences totalled €9,939k (2010: nil). These are expected to be recovered after more than 12 months. The tax losses arise in the Irish tax jurisdiction and their utilisation is dependent on the generation of future taxable profits.

13. PREPAYMENTS AND ACCRUED INCOME

	2011 €'000	2010* €'000
Sundry prepayments	453	266
	453	**266**

Sundry prepayments mainly comprises up front deferred costs of in respect of the bond issuances which are being amortised over the life of the bonds.

14. DEPOSITS BY CREDIT INSTITUTIONS

Deposits by credit institutions – Analysis by contractual maturity	**2011 €'000**	**2010 €'000**
Repayable in less than three months	3,613,508	2,874,009

Deposits by Credit Institutions consist of a borrowing facility from the EBS.

The facility limit with EBS is €5bn and the balance at 31 December 2011 amounted to €3.6bn (2010: €2.9bn). The interest rate is equal to the aggregate of Euribor and an applicable margin as agreed from time to time between the Bank and EBS. The facility can be terminated by either the Bank or EBS in accordance with the terms of the loan agreement. The Bank makes repayments under the facility from time to time without any premium, penalty or break costs.

15. DEBT SECURITIES IN ISSUE AND ASSET COVERED SECURITIES ACT INFORMATION

	2011 €'000	**2010 €'000**
Mortgage covered securities in issue:		
Opening balance	**2,218,977**	**2,046,231**
Issued during the period	1,010,000	1,170,000
Redemptions and repayments	-	(1,000,000)
Amortisation of premium / discount	39,520	2,746
Closing balance at 31 December	**3,268,497**	**2,218,977**
Mortgage covered securities in issue by remaining maturity:		
Repayable in more than one year	998,850	
Repayable in more than one year but less than five years	2,269,647	1,633,295
Repayable in grater than 5 years		585,682
	3,268,497	**2,218,977**

Mortgage covered securities in issue to external and internal issuances at nominal value:	**2011 €'000**	**2010 €'000**
External investors	1,050,000	1,050,000
EBS	2,550,000	1,300,000
Nominal value of mortgage covered securities in issue	**3,600,000**	**2,350,000**

During the year ended 31 December 2011 the Bank issued three retained bonds with a total nominal value of €1.25bn and these bonds were subscribed in full by EBS. The retained bonds were recognised on the Statement of Financial Position at a value of €1.01bn representing the Day 1 fair value of the bonds as required under the International Financial Reporting Standards. The discount is being amortised through the Income Statement over the life of the bonds.

During the year ended 31 December 2011 there were no redemptions or repayments of mortgage covered securities in issue.

As at 31 December 2011, the total amount of principal outstanding in respect of mortgage covered securities was €3,600m (2010: €2,350m) of which €1,050m (2010: €1,050m) was held by third parties and €2,550m (2010: €1,300m) by EBS.

The 2010 comparatives have been reclassified to align the accounting treatment of hedging fair value adjustments with EBS Group. As a result, hedging fair value adjustments of €7,729k in 2010 were re-classified from debt securities in issue to other liabilities.

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.

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.

The external bond issued in November 2009 was covered under the CIFS scheme up to 29 September 2010 and a charge of €1,068k was paid under the scheme in 2010.

15 (a) Mortgage properties and principal loan balances outstanding in the cover assets pool

		As at 31 December 2011		As at 31 December 2010	
From €	To €	Total principal balances	Number of loans	Total principal balances	Number of loans
0	100,000	1,105,455	31,536	559,060	17,997
100,000	200,000	2,260,112	15,143	1,276,034	13,674
200,000	500,000	3,055,257	11,450	1,736,738	9,667
Over 500,000		247,338	344	235,027	552
Total		**6,668,162**	**58,473**	**3,806,859**	**41,890**

15(b) Geographical location of related property assets (mortgaged properties) in the cover assets pool

	As at 31 December 2011		As at 31 December 2010	
	Number of mortgaged properties	%	Number of mortgaged properties	%
Geographical area:				
Dublin	15,792	36	11,058	39
Outside Dublin	27,825	64	17,217	61
Total	**43,617**	**100**	**28,275**	**100**

15(c) Non-performing mortgage loans in the cover assets pool
As at 31st December 2011 there were 1,138 (2010: 639) accounts in default (the term default is defined as any single loan account where the total amount in arrears is greater than or equal to 3 monthly payments). The total arrears amount for these 1,138 (2010: 639) accounts was €4,272,827 (2009: €2,051,796).

15(d) Non-performing mortgage loans in the cover assets pool with arrears greater than €1,000
During the year ended 31 December 2011, 4,002 (2010: 1,405) mortgage loans in the cover assets pool were non performing with arrears greater than €1,000. As at 31 December 2011, 972 (2010: 516) mortgage loans were non-performing with arrears greater than €1,000 in the cover assets pool.

15(e) Replacement of non-performing mortgage loan accounts from the cover assets pool
During the period ended 31 December 2011, 1,069 (2010: 1,027) mortgage loan accounts were removed from the Cover Asset Pool. (For this purpose, non-performing is defined as in arrears by six monthly repayments or more). These loan accounts were not replaced with other assets as the Cover Assets Pool continued to meet all regulatory requirements.

15(f) Amount of interest in arrears on mortgage loan accounts in the cover assets pool not written off
Total interest in arrears on mortgage loans in the Cover Asset Pool as at 31 December 2011 was €5,466,289 (2010: €1,869,132). None of the accounts in question were written off as at 31 December 2011.

15(g) Total principal and interest payments on mortgage loan accounts
The total amount of repayments (principal and interest) made by borrowers on mortgage loan accounts in the Cover Assets Pool during the period ended 31 December 2011 was €443.9m (2010: €388.2), of which €281.4m (2010: €268.3m) represented repayment of principal and €162.5m (€2010: €119.9m) represented payment of interest.

15(h) Number and amount of mortgage loans in the cover assets pool secured on commercial property
As at 31 December 2010 and 2011 there were no loan accounts in the Cover Asset Pool that were secured on commercial properties.

16. CURRENT TAXATION	**2011 €'000**	**2010 €'000**
Value added tax	-	7
Other taxes	13	18
	13	25

17. PROVISIONS FOR LIABILITIES AND COMMITMENTS	**2011 €'000**	**2010 €'000**
At 1 January	20	24
Provisions utilised	(3)	(9)
Other provisions	15	5
At 31 December	32	20

18. ACCRUALS AND DEFERRED INCOME	2011 €'000	2010 €'000
Interest payable on mortgage covered securities	5,515	5,069
Other accruals	606	1,141
At 31 December	6,121	6,210

19. OTHER LIABILITIES	**2011 €'000**	**2010 €'000**
Funding liabilities fair value hedge	1,506	7,729

Other liabilities consist of the fair value adjustment to the carrying value of €1bn debt securities in a fair value hedge relationship of €1,506k (2010: €7,729k).

20. EMPLOYEE BENEFITS

The Bank is a participating employer in the EBS pension plan. The Bank participates in a defined benefit and a defined contribution pension scheme. The defined benefit scheme is based on final pensionable pay and operated for eligible employees of EBS and the Bank. Whilst the scheme is a defined benefit scheme, the Bank is unable to identify its share of the underlying assets and liabilities of the scheme on a consistent and reasonable basis, hence it is treated as a defined contribution scheme in the accounts of the Bank.

The cost of the defined contribution pension scheme is charged to the income statement in the accounting period in which it is incurred. Any contributions unpaid at the reporting date are included as a liability. The Bank has no further obligation under this scheme once these contributions have been paid.

Contributions on behalf of the Bank employees amounted to €29k (2010: €9k).

21. DERIVATIVE FINANCIAL INSTRUMENTS

EBS Mortgage Finance

Group operations are exposed to the risk of interest rate fluctuations to the extent that assets and liabilities re-price at different times or in differing amounts. Derivatives allow the Bank to modify the re-pricing characteristics of assets and liabilities in a cost efficient manner. This flexibility helps the Bank to achieve liquidity and risk management objectives.

Derivatives fluctuate in value as interest rates rise or fall just as all other assets and liabilities fluctuate in value. If the derivatives are purchased or sold as hedges of balance sheet items, the appreciation or depreciation of the derivatives, as interest or exchange rates change, will generally be offset by the unrealised appreciation or depreciation of the hedged items.

To achieve its risk management objectives, the Bank uses interest rate swaps. The Bank only engages in derivative activity for hedging purposes, although all swaps are considered to be effective hedges in economic terms, due to the nature of some it is not possible to establish a "Fair Value" hedging relationships under IAS 39, such swaps are classified as "Fair Value through the Income Statement".

Derivative instruments are contractual agreements whose value is derived from the price movements in underlying assets, interest rates or indices. Derivatives are an efficient and cost effective means of managing market risk and limiting counterparty exposure.

The Bank hedges part of its existing interest rate risk resulting from any potential movement in the fair value of fixed rate assets or liabilities using interest rate swaps. The net fair value of these swaps at 31st December 2011 was €1,052k (2010: €7,198k).

	2011			*2010*		
	Contract/ notional amount €'000	***Fair Values €'000***	***Accrued Interest €'000***	***Contract/ notional amount €'000***	***Fair Values €'000***	***Accrued Interest €'000***
Derivatives held at fair value through income statement						
Derivative assets						
Interest rate swaps	2,880,938	24,927	26,296	2,659,420	31,360	15,832
Derivative liabilities						
Interest rate swaps	4,845,449	(24,619)	(26,153)	2,860,982	(31,002)	(16,568)
Total derivatives held at fair value through income statement	**7,726,387**	**308**	**143**	**5,520,402**	**358**	**(736)**
Derivatives designated as fair value hedges						
Derivative assets						
Interest rate swaps (note 1)	1,000,000	744	462	1,000,000	6,840	937
Total derivative asset designated as fair value hedges	**1,000,000**	**744**	**462**	**1,000,000**	**6,840**	**937**
Total derivatives	**8,726,387**	**1,052**	**605**	**6,520,402**	**7,198**	**201**
Derivative assets	3,880,938	25,671	30,425	3,659,420	38,200	19,973
Derivative liabilities	4,845,449	(24,619)	(29,820)	2,860,982	(31,002)	(19,772)
Total derivatives	**8,726,387**	**1,052**	**605**	**6,520,402**	**7,198**	**201**

Accrued interest of €462k (2010: €937k) includes accrued interest payable of €3,667k (2010: €3,204k) and accrued interest receivable of €4,129k (2010: €4,141k) on €1.0bn derivative asset designated as fair value hedge.

Derivative assets of €56,096k (2010: €58,173k) and derivative liabilities of €54,439k (2010: €50,774k) represent fair value of the derivative and accrued interest on them. Accrued interest receivable on all derivatives is included in derivative assets.

Similarly, accrued interest payable in respect of all derivatives is included in derivative liabilities.

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

The derivative maturity table below analyses the asset, liability and embedded derivatives notional amounts by maturity bucket.

Derivative Maturity Table – at 31 December 2011

	Not more than 3 months	Over 3 months but not more than 6 months	Over 6 months but not more than 12 months	Over 1 year but not more than 5 years	Over 5 years	Total
	€'000	€'000	€'000	€'000	€'000	€'000
Interest Rate Swaps	-	-	1,000,000	1,456,285	1,424,653	3,880,938
Total Assets	**-**	**-**	**1,000,000**	**1,456,285**	**1,424,653**	**3,880,938**
Interest Rate Swaps	-	-	-	4,845,449	-	4,845,449
Total Liabilities	**-**	**-**	**-**	**4,845,449**	**-**	**4,845,449**

The methods and assumptions used in determining fair value are described in the Risk Management Report.

Derivative Maturity Table – at 31 December 2010

	Not more than 3 months	Over 3 months but not more than 6 months	Over 6 months but not more than 12 months	Over 1 year but not more than 5 years	Over 5 years	Total
	€'000	€'000	€'000	€'000	€'000	€'000
Interest Rate Swaps	-	-	-	1,050,000	2,609,420	3,659,420
Total Assets	**-**	**-**	**-**	**1,050,000**	**2,609,420**	**3,659,420**
Interest Rate Swaps	-	-	-	2,860,982	-	2,860,982
Total Liabilities	**-**	**-**	**-**	**2,860,982**	**-**	**2,860,982**

The derivative maturity table below represents the undiscounted projected cash flows on asset and liability derivatives based on yield curves as at 31 December 2011:

Derivative Cashflow table – at 31 December 2011

	Not more than 3 months	Over 3 months but not more than 6 months	Over 6 months but not more than 12 months	Over 1 year but not more than 5 years	Over 5 years	Total
	€'000	€'000	€'000	€'000	€'000	€'000
Interest Rate Swaps	(8,684)	(8,051)	24,368	29,708	19,088	56,429
Total Assets	**(8,684)**	**(8,051)**	**24,368**	**29,708**	**19,088**	**56,428**
Interest Rate Swaps	(2,944)	(3,043)	(8,705)	(29,734)	(6,580)	(51,006)
Total Liabilities	**(2,944)**	**(3,043)**	**(8,705)**	**(29,734)**	**(6,580)**	**(51,006)**

Derivative Cashflow table – at 31 December 2010

	Not more than 3 months	Over 3 months but not more than 6 months	Over 6 months but not more than 12 months	Over 1 year but not more than 5 years	Over 5 years	Total
	€'000	€'000	€'000	€'000	€'000	€'000
Interest Rate Swaps	(6,890)	(7,810)	20,352	34,677	27,610	67,939
Total Assets	**(6,890)**	**(7,810)**	**20,352**	**34,677**	**27,610**	**67,939**
Interest Rate Swaps	(2,011)	(2,287)	(4,550)	(32,565)	(10,492)	(51,905)
Total Liabilities	**(2,011)**	**(2,287)**	**(4,550)**	**(32,565)**	**(10,492)**	**(51,905)**

22. RELATED PARTY TRANSACTIONS

The immediate holding company and controlling party is EBS Limited, with a registered office at 2 Burlington Road, Dublin 4. The ultimate holding entity and controlling party is AIB p.l.c., with a registered office at Bankcentre, Ballsbridge, Dublin 4. Copies of both EBS Group and AIB Group financial statements are available from the registered office. The only related party transactions are normal banking transfers to and from EBS.

The Irish Government and Government related entities
The Irish Government has taken a range of measures to stabilise the Irish banking system since the commencement of the financial crisis in 2008. These measures have included the injection of equity and preference share capital into AIB p.l.c. As a result of these capital injections, the Irish Government, through the NPRFC, now holds 99.8% of the ordinary shares of AIB p.l.c. and €3.5bn in 2009 Preference Shares. In addition, the Minister for Finance holds €1.6bn of contingent capital notes.

As a result of the various measures taken by the Irish Government (specifically the guarantee schemes, the Direction Order, and the capital injections) the Irish Government is a related party to AIB p.l.c. and therefore EBS Mortgage Finance. Details regarding these measures, as well as others taken in the context of the Irish banking crisis, are set out below.
The Minister for Finance (the 'Minister') and/or the Central Bank of Ireland has considerable rights and powers over the operations of the AIB Group (and other financial institutions) arising from the various stabilisation measures.

These rights and powers include, inter alia:

- The acquisition of shares in other institutions;
- Maintenance of solvency ratios and compliance with any liquidity and capital ratios that the Central Bank, following consultation with the Minister, may direct;
- The appointment of non-executive directors and board changes;
- The appointment of persons to attend meetings of various committees;
- Restructuring of executive management responsibilities, strengthening of management capacity and improvement of governance;
- Declaration of payment dividends;
- Restrictions on various types of remuneration;
- Buy-backs or redemption of its shares;
- The manner in which EBS extends credit to certain customer groups; and
- Conditions regulating the commercial conduct of AIB p.l.c., having regard to capital ratios, market share and the EBS' balance sheet growth.

(a) Irish Government Guarantee Schemes:
The Bank is a covered institution under the Government's Credit Institutions (Finance Support) Scheme 2008 (the 'CIFS Scheme') which guaranteed covered liabilities raised by covered institutions up to 29 September 2010. Covered liabilities that were covered by the CIFS Scheme were those liabilities in respect of retail and corporate deposits (to the extent not covered by existing deposit protection scheme in Ireland or any other jurisdiction), inter-bank deposits and senior unsecured debt excluding any intra group borrowing and any debt due to the European Central Bank arising from Eurosystem monetary operations. Under the terms of the CIFS Scheme the Central Bank in consultation with the Minister regulated the commercial conduct of covered institutions strictly in order to achieve the objectives of this scheme.

(b) National Asset Management Agency (NAMA)
The Irish Government set up an asset relief scheme in 2009 under the auspices of the National Asset Management Agency in Ireland. The Bank is a participating institution in NAMA. However, no loans were transferred from the Bank to NAMA.

(c) Credit Institutions (Stabilisation) Act 2010
On 31 March 2011, under the Credit Institutions (Stabilisation) Act 2010, the Minister for Finance (in consultation with the Governor of the Central Bank of Ireland) exercised his powers to announce the combination of EBS with AIB p.l.c. The Credit Institutions (Stabilisation) Act 2010 was passed into Irish law on 21 December 2010. The Act provides the legislative basis for the re-organisation and restructuring of the Irish banking system agreed in the joint EU/IMF programme for Ireland. The act applies to all institutions that have received financial support from the State and as such applies to EBS. The Act provides powers to the Minister for Finance (in consultation with the Governor of the Central Bank of Ireland) to act on financial stability grounds to effect the restructuring and recapitalisation measures envisaged in the programme. This allows the Minister to take the actions required to bring about a domestic retail bank system that is proportionate to and focussed on the Irish economy.

(d) Central Bank and Credit Institutions (Resolution) Act 2011
The Central Bank and Credit Institutions (Resolution) Act 2011 was signed into law on 20 October 2011 and became effective on 28 October 2011.

This legislation provides the Central Bank with additional powers to achieve an effective and efficient resolution regime for credit institutions that are failing or likely to fail and that is effective in protecting the Exchequer and the stability of the financial system and the economy.

The Act give the Central Bank power to take control of banks, appoint managers to run them and remove directors, staff and consultants and to move their deposits and loans to other banks. It provides for the establishment of a Credit Institution Resolution Fund which would provide a source of funding for the resolution of financial instability or in the event of an imminent serious threat to the financial stability of an authorised credit institution. Authorised credit institutions will be obliged to contribute to the resolution fund.

The Act provides for the establishment of "Bridge-Banks" for the purpose of holding assets or liabilities which have been transferred under a transfer order. Bridge-Banks are only intended to hold such assets or liabilities on a temporary basis pending onward transfer as soon as possible.

The Central Bank will also be empowered to make special management orders in relation to an authorised credit institution or in relation to a subsidiary or holding company of the authorised credit institution in certain circumstances. The Act also provides powers to the Central Bank regarding the liquidation of authorised credit institutions. Authorised credit institutions may also be directed to prepare a recovery plan setting out actions that could be taken to facilitate the continuation or secure the business or part of the business of that institution.

The legislation is expected to, in due course, replace the provisions of the Credit Institutions (Stabilisation) Act 2010 outlined above which ceases to have effect on 31 December 2012 or at a later date substituted by resolution of both Houses of the Oireachtas.

(e) Government related entities
As a result of the capital received from Government in 2010 and the participation in the Government guarantee scheme, the Government is recognised as a related party, as defined under the accounting standards.
In the normal course of business the Group has transactions with the Government, state departments and semi-state bodies and state owned financial institutions including the holding of securities issued by the Government and semi-state bodies.

(f) Transactions with immediate parent
The following amounts represent the transactions and outstanding balances with the EBS:

- Loans from related parties at 31 December 2011 are €3,613,508k (2010: €2,874,009k).
- Deposits with related parties at 31 December 2011 are €16,778k (2010:€13,403k).
- The nominal value of debt securities in issue to related parties at 31 December 2011 are €2,550,000k (2010:€1,300,000k).

At 31 December 2011 there were no transactions between the Bank and the ultimate Parent, AIB p.l.c.

	2011 €'000	2010 €'000
Income and expense included in the Income Statement from related parties:		
Service fee	(4,945)	(4,723)
Interest expense on loans	(72,735)	(73,778)
Interest income from deposits	720	1,456
Interest expense on debt securities	(64,272)	(52,933)

The above transactions arose in the ordinary course of business. The interest charged and interest earned involving related parties is at normal commercial rates appropriate to the transaction.

There have been no contracts or arrangements with the Bank in which a director of the Bank was materially interested and which were significant in relation to the Bank's business.

Transactions with key management personnel

For the purpose of IAS 24: Related Party Transactions, 'key management personnel' comprises executive and non executive directors.

Loans to key management personnel are made in the ordinary course of business and on normal commercial terms. Loans are made (i) by the parent company on terms applicable to other employees of the parent company, in accordance with established policy, within limits set on a case by case basis, and/or (ii) otherwise, on normal commercial terms.

	2011 €'000	2010 €'000
At 31 December : Loans outstanding	1,151	2,721

The loans outstanding were to 2 directors (2010: 3 Directors).

Non executive directors are compensated by way of fees. Details of the compensation of non executive directors are set out in note 5 'Operating Expenses'. Executive directors' emoluments for the period were nil (2010: nil).

23. CAPITAL MANAGEMENT

From 1 January 2008 the minimum regulatory capital requirement of the Bank's operations has been calculated in accordance with the provisions of Basel II as implemented by the European Capital Requirements Directive and the Irish Central Bank. The objective of Basel II is to more closely align bank regulatory capital with the economic capital required to support the risks being undertaken. The capital required to cover credit, operational and market risks is required to be explicitly measured under the Basel II methodology. In implementing Basel II, the Bank has adopted the standardised approach to credit risk.

The Bank sets and monitors capital policy in line with regulatory and legislative requirements. Capital adequacy is monitored by the Executive Management Team.

The Bank is required under the terms of its banking license to maintain a solvency ratio of at least 9%. EBS Mortgage Finance maintained at least this ratio throughout 2011. No increase in the minimum capital requirement has been requested by the Central Bank for the Bank.

The Bank's regulatory capital comprises:

Tier 1 capital, which includes ordinary share capital, general reserve capital, deductions for intangible assets.
Tier 2 capital is comprised of collective impairment provision add back.
Within these tiers, limits are set for different components of capital. Qualifying Tier 2 capital cannot exceed Tier 1 capital. There also are restrictions on the amount of collective impairment allowances that may be included as part of Tier 2 capital.

Banking operations are categorised as either banking book or reserve investments, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

The Bank's policy is to ensure that sufficient capital is in place to meet regulatory requirements.

The Bank's regulatory capital position at 31 December was as follows:

	2011 €'000	2010 €'000
Tier 1 capital		
Ordinary Share Capital	476,540	316,540
Profit and loss account	(45,677)	23,904
Intangible assets	(2,424)	(2,772)
Total	**428,439**	**337,672**
Tier 2 capital		
Collective allowances for impairment	8,501	34,050
Total regulatory capital	**436,940**	**371,722**

24. SHARE CAPITAL

	2011 €'000	2010 €'000
Authorised:		
1,000,000,000 ordinary shares of €1.00 each	1,000,000	1,000,000
Issued and fully paid:		
416,540,000 ordinary shares of €1.00 each (2010: 316,540 ordinary shares of €1.00 each)	476,540	316,540

On 28 April 2010, the Bank issued 50,000,000 €1 ordinary shares to EBS and on 21 December 2011, the Bank issued another 160,000,000 €1 ordinary shares to EBS.

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.

25. REGULATORY COMPLIANCE

During December 2011, EBS Mortgage Finance breached the large exposures limit. This arose due to the acquisition of loans from EBS in November 2011. The issue was resolved and the exposures were brought back within limits in January 2012.

26. EVENTS SINCE THE REPORTING DATE

In the directors' view, there have been no events since the year end that have had a material effect on the financial position of the Bank.

27. RECLASSIFICATIONS

	2010	Reclassifications			2010
	As previously reported	Derivatives/ Interest income/ Interest Expense	Derivatives held for risk management	Unearned income provision	After reclassifications
	€'000	€'000	€'000	€'000	€'000
Interest income	196,649	(12,175)	-	(80)	184,394
Interest expense	(152,456)	24,045	-		(128,411)
Net interest income	**44,193**	**11,870**	**-**	**(80)**	**55,983**
Net trading income (expense)	-	(11,870)	1,978	-	(9,892)
Loss on derivatives held for risk management	1,978	-	(1,978)	-	-
Operating expenses	(6,853)	-	-	-	(6,853)
Income before impairment provisions	**39,318**	**-**	**-**	**(80)**	**39,238**
Provision for impairment losses on loans and advances to customers	(26,754)	-	-	80	(26,674)
Profit before taxation	**12,564**	**-**	**-**	**-**	**12,564**
Taxation	(1,561)	-	-	-	(1,561)
(Loss) Profit for the year	**11,003**	**-**	**-**	**-**	**11,003**

During the year ended 31 December the Bank modified the Income Statement classification for certain line items listed below to reflect the results of the Bank with its ultimate parent; AIB p.l.c. Comparative amounts in the Income Statement were reclassified for consistency which resulted in the following changes:

Interest income and net trading income
Gain / loss on derivatives held for risk management purposes previously reported as part of net interest income were reclassified to net trading income, a separate line item on the Income Statement for 2011.

Interest income / expense on derivatives held at fair value through the Income Statement previously reported as part of net interest income was reclassified to net trading income, a separate line item on the Income Statement for 2011.

Interest income and Provision for impairment losses
Interest earned on loans and advances to customers has been reduced following the adoption of the AIB Group policy to recognise interest income on the carrying value of the impaired loan assets. This change has no overall impact on the Income Statement as there is an offsetting adjustment to the provisions for impairment of loans and advances to customers.

NOTES TO THE FINANCIAL STATEMENTS (continued) – 31 December 2011

	2010								2010
	As previously reported	Mandatory Deposits with Central Bank	Accrued Interest on derivatives	Hedging fair value adjustments	Accrued interest on loans and advances to customers	Pre-payments & accrued Income	Provisions	Accruals and deferred income	Reclassified
	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000
ASSETS									
Cash and balances with central banks	13,951	(51)	-	-	-	-	-	-	13,900
Loans and advances to credit institutions	68,675	51	-	-	-	-	-	-	68,726
Loans and advances to customers	5,354,395	-	-	-	(44)	-	-	-	5,354,351
Derivative financial instruments	38,200	-	19,973	-	-	-	-	-	58,173
Prepayments and accrued income	-	-	-	-	44	222	-	-	266
Intangible assets	2,772	-	-	-	-	-	-	-	2,772
Other Assets	423	-	(201)	-	-	(222)	-	-	-
Total Assets	**5,478,416**	-	**19,772**	-	-	-	-	-	**5,498,188**
LIABILITIES									
Deposits by credit institutions	2,874,009	-	-	-	-	-	-	-	2,874,009
Debt securities in issue	2,226,706	-	-	(7,729)	-	-	-	-	2,218,977
Derivative financial instruments	31,002	-	19,772	-	-	-	-	-	50,774
Accruals and deferred income	-	-	-	-	-	-	-	6,210	6,210
Current taxation	25	-	-	-	-	-	-	-	25
Provisions & contingent liabilities	-	-	-	-	-	-	20	-	20
Other liabilities	6,230		(5,069)	7,729	-	-	(20)	(1,141)	7,729
Total liabilities	**5,137,972**	-	**(14,703)**	-	-	-	-	**(5,069)**	**5,157,744**
SHAREHOLDER'S EQUITY									
Issued share capital	316,540	-	-	-	-	-	-	-	316,540
Profit and loss account	23,904	-	-	-	-	-	-	-	23,904
Total shareholder's equity	**340,444**	-	-	-	-	-	-	-	**340,444**
Total liabilities and shareholder's equity	**5,478,416**	-	-	-	-	-	-	-	**5,498,188**

As a result of aligning the reporting structure with the ultimate parent, AIB p.l.c, the Bank's statement of financial position, amounts reported for the prior year 2010 have been reclassified as follows:

The key changes as a result of reclassifications are as follows:

Mandatory deposits with Central Bank:
Mandatory reserve deposits with Central Bank have been reclassified out of cash and balances with central banks into loans and advances to credit institutions.

Accrued interest on derivatives:
Both asset and liability derivative financial instruments now include the accrued interest which was previously classified in the other liabilities.

Hedging fair value adjustments:
The fair value adjustments to the carrying value of loans, debt securities and subordinated liabilities in a fair value hedge relationship is reclassified into other assets or other liabilities.

Accrued interest - Loans and advances to customers:
Current month's accrued interest on loan assets, which was previously reported as part of loans and advances to customers has been reclassified into prepayments and accrued income.

Prepayments & accrued income:
Prepayments and accrued income previously reported in Other Assets are now reported as a separate line item in the statement of financial position.

Provisions:
Provisions and contingent liabilities are now reported as a separate line item on the statement of financial position. These were previously included in the other liabilities.

Accruals and deferred income:
Accruals and deferred income is now reported as a separate line item on the statement of financial position. This was previously included in the other liabilities.

28. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were authorised for issue by the Board of Directors on 14 May 2012.